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What Happened to the American Dream - An Analysis of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Its Effect on Home Ownership.

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WHAT HAPPENED TO THE AMERICAN DREAM? AN ANALYSIS OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT AND ITS EFFECT ON HOME OWNERSHIP

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I. Introduction

The "American Dream," a term coined in James Truslow Adams's 1931 book, *The Epic of America*,[1] is a collection of social ideals rooted in the very fabric of the United States of America.[2] While the definition and interpretation of the American Dream has varied through its long history, at its core, the American Dream has always stressed "egalitarianism [and] material prosperity."[3] One of the central features rooted in the modern

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1. James Truslow Adams, The Epic of America 404 (1931).

2. *See generally* Jim Cullen, The American Dream: A Short History of an Idea that Shaped a Nation (2003) (giving a history of how the American Dream evolved over the course of time and how it influences and affects the United States of America).

3. *American dream*, Merriam-Webster, http://www.merriam-webster.com/dictionary/american%20dream (last visited Oct. 24, 2014) (defining the American Dream as "an

American Dream ethos is the ability of a citizen to own and control real property.[4] This idea of homeownership has become so entrenched in the American psyche that it has effectively become a "presumed right and privilege" and has "embedded [itself] in the American consciousness."[5] However, the question that remains for the government to answer is, "If ownership of real property is vital to American wealth and prosperity, how should we govern and protect the ability to acquire it?"

The purpose of this article is to analyze whether the large piece of legislation passed on July 21, 2010, Public Law 111–203, known as The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), and the massive regulations it has spawned, will actually provide consumer protection in the realm of real estate and homeownership, or whether the legislation will prevent a large portion of the American population from attaining the American Dream as a result of a system that makes it nearly impossible to qualify for mortgage loans.[6]

Although its stated purpose is to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American Taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes"[7] it is clear that Dodd-Frank, while addressing some of the excesses in the last housing boom and bust, will likely cause many more problems than it has solved, particularly for minorities and the lower and middle class populations of the United States.[8]

American social ideal that stresses egalitarianism[,] especially material prosperity"). *See generally* CULLEN, *supra* note 2 (highlighting ability for Americans to climb out of obscurity and climb social and economic ladders).

4. *See* JULIE B. ISAACS, ISABEL V. SAWHILL, & RON HASKINS, GETTING AHEAD OR LOSING GROUND: ECONOMIC MOBILITY IN AMERICA 50 (2008) *available at* http://www.brookings.edu/~/media/Research/Files/Reports/2008/2/economic%20mobility%20sawhill/02_economic_mobility_sawhill.pdf (stating that housing is central to the wealth of most Americans); *see also* Edward N. Wolff, *Recent Trends in Wealth Ownership, from 1983 to 1998* (2000), *reprinted in* ASSETS FOR THE POOR: THE BENEFITS OF SPREADING ASSET OWNERSHIP 34, 47 (Thomas M. Shapiro & Edward N. Wolff eds., 2001) (claiming sixty percent of the total assets of middle-class Americans are held in owner-occupied homes); CULLEN, *supra* note 2, at 136 (describing the American Dream of homeownership as one with the widest appeal and application while being extraordinarily resilient and versatile).

5. Michael A. Stegman et al., *Home ownership and family wealth in the United States, in* HOUSING AND FAMILY WEALTH: COMPARATIVE INTERNATIONAL PERSPECTIVES 86, 86 (Ray Forrest & Alan Murie eds., 1995).

6. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010) [hereinafter Dodd-Frank] (stating that one of the purposes of the act is to "protect consumers from abusive financial services practices").

7. *Id.*

8. *See* U.S. DEP'T OF HOUS. & URBAN DEV., AN ANALYSIS OF MORTGAGE REFINANCING, 2001–2003, at 2 (2004) *available at* www.huduser.org/Publications/pdf/Mortgage

Part I of this article will provide a brief history of the events that gave rise to the enactment of Dodd-Frank.[9] Part II will provide an analysis of the salient parts of the Ability-to-Repay Standard and Qualified Mortgage Standard. Part III will examine the disparate impact the Ability-to-Repay Standard creates for minority and lower income consumers. Part IV will examine some of the major legal implications of Dodd-Frank. Finally, Part V will include a modest set of proposed solutions and revisions to improve the regulations.[10] The effects of other parts of Dodd-Frank that relate to the housing market, such as the appraisal regulations, the loan servicing regulations, modification of RESPA procedures, etc., will be left for others to explore.

II. Historical Events and Causes for The Dodd-Frank Wall Street Reform and Consumer Protection Act

A. *The Housing Bubble and its Burst*

Between the years 1997 and 2009, the housing market went through an unparalleled cycle of expansion and contraction. National nominal home prices rose approximately one hundred eighty-eight percent before proceeding to fall roughly thirty-three percent from that peak by 2009.[11] Many of the significant players in the U.S. financial system, all of whom were trying to benefit from the historic boom in the housing sector, had been drawn into various mortgage related activities. Consequently, when the housing market began its collapse, according to Thomas F. Siems, senior economist and policy advisor at the Federal Reserve Bank of Dallas, it sparked the "longest and deepest economic contraction . . . since the Great Depression."[12]

The cause of the housing bubble is hotly contested among experts.[13] Various reasons for the housing bubble range from:

Refinance03.pdf (noting that although Americans have taken advantage of refinancing for lower interest rates, minorities have "continue[d] to rely disproportionately on higher-cost subprime loans").

9. Provisions and regulations with respect to other aspects of Dodd-Frank—such as wall street reform, credit for purposes other than consumer housing, or banking and "too big to fail" provisions—exceed the scope of this article and will not be examined.

10. The solutions and revisions are by no means an exhaustive list and are included to give the reader some "food for thought."

11. Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 Geo. L.J. 1177, 1179 (2012).

12. Thomas F. Siems, *Branding the Great Recession*, Fin. Insights, May 31, 2012, at 1, 3, *available at* http://www.dallasfed.org/assets/documents/banking/firm/fi/fi1201.pdf.

13. *See generally* Levitin & Wachter, *supra* note 11 (giving an in-depth explanation of various theories for the bubble and providing the authors' own theory to add to the multitude).

> [A] lack of regulation to too much regulation; from political pressure on banks to extend mortgages to unqualified buyers; to the greed of extravagantly compensated and arrogant Wall Street financiers who created exotic financial instruments designed to avoid capital requirements and attain extreme leverage; from conflicts of interest on the part of appraisers, auditors, and rating agencies, to incompetent regulators; and from the greed of homeowners to the greed of lenders.[14]

While experts will argue for years to come over the finer points of what caused the most recent housing bubble, an expansion in the housing segment of an economy is ordinarily attributable to both particular economic conditions and changes within the industry itself.[15] The particular economic conditions usually needed to create an expansion of a housing market include a significant drop in interest rates,[16] an increase in home prices,[17] and an increase in the volume of refinancing of home mortgage loans.[18] Thus, when the deterioration of credit standards and lending practices took place in the mortgage industry from 1996 to 2007, it created a perfect storm of low interest rates, increases in housing prices, and frequent refinancing transactions that created the overheated American housing market bubble.[19]

With the advent of "easy credit" and no required documentation or verification, some joked the only test to qualify for a loan at this time was the ability to fog a mirror, the 2003–2008 housing boom created a significant market of loans for less-than-average borrowers, referred to as the subprime market.[20] The American subprime market generally consisted

14. Robert Hardaway, *The Great American Housing Bubble: Re-Examining Cause and Effect*, 35 U. DAYTON L. REV. 33, 34–35 (2009).

15. Ability-to-Repay on Qualified Mortgage Standards under the Truth in Lending Act, 78 Fed. Reg. 6408, 6410 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

16. *See* U.S. DEP'T OF HOUS. & URBAN DEV., *supra* note 8, at 2 (stating interest rates dropped more than twenty percent from 2001–2003).

17. *See* U.S. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 156, 156 (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf (asserting home prices increased about one hundred fifty-two percent between 1997 and 2006).

18. *See* U.S. DEP'T OF HOUS. & URBAN DEV., *supra* note 8, at 1 (declaring the volume of refinanced loans went from 2.5 million in 2000 to more than 15 million by 2003).

19. *See* KATALINA M. BIANCO, THE SUBPRIME LENDING CRISIS: CAUSES AND EFFECTS OF THE MORTGAGE MELTDOWN 6–8 (2008), *available at* http://business.cch.com/bankingfinance/focus/news/subprime_wp_rev.pdf (explaining the rise of the subprime credit market).

20. *See* Ability-to-Repay on Qualified Mortgage Standards under the Truth in Lending Act, 78 Fed. Reg. at 6410 (noting the growth of subprime lending products and the "steady deterioration of credit standards in mortgage lending" during the mid-2000s).

of what was known as Subprime and Alternative A Paper (Alt-A) products. These products were particularly attractive to both creditors and consumers who faced problems getting loans. Because consumers could qualify with poor or no credit history, they required little or no documentation of income or capability to repay, they were usually more expensive in the long term than prime mortgages, and they often had very low introductory rates that increased significantly above prime within a short period of time.[21] These products were so attractive to financial institutions that in 2003, subprime and Alt-A origination volume was $395 billion and by 2006 the origination volume reached $1 trillion—a 153.2% increase.[22]

Subprime and Alt-A mortgage products, however, are just that: below prime and alternatives to other less-risky lending products.[23] These types of loans are usually given out to high-risk borrowers and include suspect features such as higher than average cost deferral, higher than prime interest rates, significant fees, and interest rate fluctuation, resets, and adjustments.[24] Before the market crash, Subprime and Alt-A mortgage product interest rate resets and adjustments were not viewed as presenting a significant risk to the housing market as long as the housing prices continued to increase; it was believed that consumers could always refinance their existing loans with relative ease if they began to face problems making a payment.[25] However, as any grade-schooler can tell you, what goes up, must eventually come down, and when housing prices began to decline in 2005, refinancing became more difficult, and delinquency and foreclosure rates on the subprime mortgages began to rise.[26] The decline in home prices continued, and during 2007 and 2008, the United States experienced the worst decline in home sales in twenty years.[27] By 2009, America's average home prices dropped twenty-eight percent from their 2006 peak.[28] Some cities saw as high as a fifty-five

21. *Id.*

22. Inside Mortg. Fin., *Mortgage Originations by Product: 1990–2010*, *in* 1 THE 2011 MORTGAGE MARKET STATISTICAL ANNUAL 20, at 4 (2011).

23. *See* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073 (2009) (describing the Alt-A market as "covering 'medium risk' loans between subprime and prime").

24. *See generally id.* (discussing the "suspect features" subprime mortgages generally have and stating Alt-A products have similar features).

25. Ability-to-Repay on Qualified Mortgage Standards under the Truth in Lending Act, 78 Fed. Reg. at 6410.

26. *See* U.S. FIN. CRISIS INQUIRY COMM'N, *supra* note 17, at 215–17 (describing how the decline in housing prices reported by the National Association of Realtors impacted the rate of defaults and foreclosures).

27. *Id.* at 215.

28. *Id.*

percent drop in home prices.[29] This sharp decline had disastrous effects on those consumers with subprime or Alt-A loans who were unable to refinance their mortgages, which forced many people into delinquency.[30] Between 2007 and 2009, the peak of the housing crisis, an estimated 2.5 million foreclosures had been instituted.[31] Policymakers became concerned that the losses on subprime mortgages would destabilize the entire mortgage market.[32]

The consequences of delinquencies on individual homeowners and their neighbors are severe.[33] These economic consequences become even more troubling when foreclosures are concentrated in one geographical location.[34] Communities with high foreclosure rates experience a reduction in home prices for *all* properties located within that area, whether the loans were in good standing, default, or foreclosure.[35] With a drop in housing values, less tax revenues were collectable from property taxes, further pinching government programs.[36] Crime in areas with a significant number of foreclosures increased, and homeowners who otherwise could afford to make their mortgage payments determined it was in their best economic interest to default (i.e. a "strategic default"), rather than

29. *Id.*

30. *See* Ability-to-Repay on Qualified Mortgage Standards under the Truth in Lending Act, 78 Fed. Reg. at 6410 (giving statistical data to show that due to the fall in home pricing, subprime and Alt-A borrowers showed significant delinquency rates both at the early default stage and serious delinquency stage).

31. Debbie Gruenstein Bocian et al., Foreclosures by Race and Ethnicity: The Demographics of a Crisis 2 (2010), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf.

32. *See* Cong. Budget Office, Options For Responding to Short-Term Economic Weakness 23 (2008), *available at* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/89xx/doc8916/01-15-econ_stimulus.pdf (discussing the role policymakers could play in helping the housing market "cope with the aftereffects of the end of the housing boom" in light of the fact that "[p]olicymakers cannot undo all those losses, and attempting to do so would reward the excessive risk taking, which could encourage excessive risk taking in the future, and shift the losses from borrowers and lenders to taxpayers").

33. Truth in Lending, 73 Fed. Reg. 44522, 44524 (July 30, 2008) (to be codified at 12 C.F.R. pt. 226) (stating homeowners in default face the possibility of foreclosure, loss of accumulated home equity, higher credit rates, and reduced access to credit); *see* Michael G. Bradley et al., *Strategic Mortgage Default: The Effect of Neighborhood Factors*, Real Estate Econ. (forthcoming Nov. 2013) (manuscript at 18), *available at* http://www.urban.org/events/upload/Bradley-Cutts-Liu_Strategic-Default_11-3-13_final.pdf (asserting when a borrower enters into foreclosure, it further "affects the well-being of surrounding homeowners").

34. *See generally* Bradley et al., *supra* note 34, at 18 (discussing the extent of the affects of foreclosure on the encompassing neighborhood).

35. Truth in Lending, 73 Fed. Reg. at 44524 (explaining the clustering of foreclosures hurts entire communities by reducing the property values).

36. Bradley et al., *supra* note 34, at 18

pay on a loan for a property that was worth less than the loan.[37] The inability to access vanishing equity in their homes to start businesses and pay other debt, finance educations, refinance houses, and the lack of buying power for durable goods all became evident.[38] An estimated $7 trillion of household wealth was lost between 2007 and 2009,[39] a period that became known as the "Great Recession."[40]

Another factor in the increased levels of default, delinquency, and foreclosure were the increased securitization of mortgages and their movement prior to and during the housing bubble that lowered the cost of money for loans and for which the loan originator retained no "skin in the game."[41] Originally pioneered by the government-sponsored enterprises (GSEs), Fannie Mae[42] and Freddie Mac,[43] "securitization of mortgages" refers to the pooling of various mortgages with credit risks ranging from excellent to high risk.[44] The originator, the person or entity that owns the assets, makes the loan and then places the assets into a special-purpose corporation, pool, trust, or other appropriate legal entity.[45] Shares or ownership interest in these newly created legal entities are then sold on the capital markets.[46]

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37. *Id.*

38. Cristian deRitis, *Lasting Consequences of the Home-Equity Bust*, MOODY'S ANALYTICS (Oct. 12, 2011), https://www.economy.com/dismal/article_free.asp?cid=225309&src=ma.

39. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS 3 (2012), *available at* http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf.

40. *See generally* Robert Rich, *The Great Recession of 2007-2009*, FEDERALRESERVEHISTORY.ORG (Nov. 22, 2013), http://www.federalreservehistory.org/Events/DetailView/58. (defining the "Great Recession" as the period between 2007–2009; a time when the real gross domestic product showed the largest decline since World War II and unemployment peaked at ten percent).

41. *See* BIANCO, *supra* note 19, at 8–9 (explaining securitization of mortgages and citing that there was an increase of twenty one percent in movement of securitized subprime loans to third parties from 2001 to 2006); *see also* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 6408, 6416 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026) (stating creditors increasingly relied on the fees generated from such loans, and less from the interest rate income received later by the holder of the loan).

42. Fannie Mae is the Federal National Mortgage Association.

43. Freddie Mac is the Federal Home Loan Mortgage Corporation.

44. Bruce D. Fisher, *A Simple Explanation of Some Legal and Economic Aspects of the Financial Meltdowns of Banks*, MICH. B. J., Mar. 2010, at 38, 39.

45. *See* Joseph. C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues, and New Frontiers*, 69 TEX. L. REV. 1369, 1377–78 (1991) (explaining how a basic securitized transaction works).

46. *See* Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 134 (1994) (illustrating what needs to be done to sell securitized vehicles on the capital markets).

It should be noted, while securitization is cited as one of the many reasons the United States stumbled into the predicament that produced the "Great Recession," securitization is not inherently evil; in fact, securitization is one of the most efficient ways to allocate risk and create capital.[47] This is because the risks (and rewards) of such investments can be spread to other investors in the capital markets, instead of concentrating the risks of default in only the originating lender and its shareholders.[48]

While a diverse allocation of risk may appear to be sound economic practice, the subprime mortgages may be a flawed asset type that should not be securitized.[49] Even though securitization allowed many people to realize the American dream of owning their own home, in practice the result from the actual sale of these products in the early 2000s amounted to a proverbial game of hot potato. The securitized vehicle, acting as the potato, was passed around as quickly as it could be, with each institutional lender or private investor moving it as fast as they could, collecting fees in the process, and trying to pass it on to another investor. The unlucky final investor would then deal with the risky investment when the merry-go-round stopped and there was a default by the consumer, usually in a foreclosure situation where there was a high likelihood of monetary losses.[50] Unfortunately, in the end, it wasn't just the investors who participated in the reckless buying and selling of subprime and Alt-A mortgages who lost. An estimated $7 trillion loss of everyday household wealth can be attributed to this reckless investing,[51] and while distressed homeownership and foreclosure rates are improving, they still remain at extraordinary levels.[52]

B. *Initial Government Response to the Financial Crisis Caused by the Housing Bubble Burst*

Congress responded to the deteriorating home and mortgage markets by enacting The Housing and Economic Recovery Act of 2008 (HERA), which was signed into law by President George W. Bush on July 30,

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47. *See* Steven L. Schwarcz, *Securitization Post-Enron*, 25 CARDOZO L. REV. 1539, 1553–70 (2009) (explaining in depth why securitization is efficient).

48. *Id.* at 1566 n.142.

49. *See* Steven L. Schwarcz, *The Future of Securitization*, 41 CONN. L. REV. 1313, 1317–18 (2009) (explaining in-depth why subprime mortgages are a flawed asset type).

50. *See* Levitin & Wachter, *supra* note 11, at 1183–84 (explaining how financial institutions were incentivized to securitize as many mortgages as possible, which led to lowering lending standards, causing a collapse similar to pyramid schemes collapses).

51. BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 40, at 3.

52. *See generally* CORELOGIC, NATIONAL FORECLOSURE REPORT (2013), *available at* http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-april-2013.pdf (stating that although foreclosures are down twenty-four percent, over 4.4 million foreclosures took place since the beginning of the financial crisis in 2008).

2008.[53] The Act was intended to provide new precautions and increased regulations on government sponsored entities, such as Fannie Mae and Freddie Mac,[54] provide relief for borrowers and lenders dealing with the effects of the housing crisis, and assist troubled borrowers in the hardest hit communities by remedying the social consequences of foreclosure.[55] While HERA did provide some relief to families across the country, it was plagued with party politics and compromises, and its provisions were not effective to reduce the housing crisis for most American families.[56]

Congress continued to respond to the deteriorating home and mortgage markets with a second act, The Troubled Asset Relief Program ("TARP"),[57] embedded in the Emergency Economic Stabilization Act of 2008.[58] TARP's main tool in combating the Great Recession included programs to help struggling homeowners avoid foreclosure by lowering monthly payments, working out situations with the homeowner where they can leave their home without being foreclosed on, assisting the homeowner with the refinancing process, helping the homeowner get mortgage relief while looking for employment, and providing support when the homeowner owes more than the home is worth, etc.[59] TARP's

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53. *See generally* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008) (stating that the intended purpose of the Act is "[t]o provide needed housing reform").

54. *See* FED. HOUS. FIN. AGENCY, THE 2013 STRATEGIC PLAN FOR THE CONSERVATORSHIP OF FANNIE MAE AND FREDDIE MAC 3 (2014), *available at* http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf (pointing out that HERA grants discretionary authority to the Director of the new Federal Housing Finance Agency (FHFA) in appointing the FHFA as conservator or receiver of Fannie Mae and Freddie Mac—which the Director exercised on September 6, 2008—placing Freddie Mae and Freddie Mac in conservatorship).

55. *See generally* Bruce Arthur, *Housing and Economic Recovery Act of 2008*, 46 HARV. J. ON LEGIS. 585, pincite (2009) (giving in-depth explanations of the various provisions in the House and Economic Recovery Act of 2008).

56. *See* John H. Vogel, Jr., *Share the Pain: How to Deal with the Housing Crisis*, HUFFINGTON POST (Oct. 22, 2008, 03:45 PM), http://www.huffingtonpost.com/john-h-vogel-jr/share-the-pain-how-to-dea_b_136937.html (criticizing the Housing and Economic Recovery Act of 2008 for having a "brilliant framework" but too many "compromises and contortions" to be workable for most American families).

57. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §§ 101–36, 122 Stat. 3765, 3767–800 (2008).

58. *See generally id.* at 3765 (describing the Act's purpose as giving the Federal Government the authority "[t]o purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers").

59. *See* Brent Horton & Jack Vrablik, *The Troubled Asset Relief Program (TARP): Uses and Abuses*, 29 BANKING & FIN. SERVICES POL'Y REP. 24, 29 (2010) (discussing how the Troubled Asset Relief Program uses the Making Home Affordable Program to aid struggling homeowners); *see also About MHA*, MAKINGHOMEAFFORDABLE.GOV, http://www.makinghomeaffordable.gov/about-mha/Pages/default.aspx (last visited Oct. 25, 2014)

success is hotly debated and largely depends on broad interpretation of the goals of the program; however, its unpopularity in most circles remains unquestioned.[60]

The Board of Governors of the Federal Reserve System also responded to the crisis by revising and adopting new rules under the 1994 legislation, The Home Ownership and Equity Protection Act (HOEPA).[61] The Board's 2008 action extended consumer protections regarding a consumer's ability to repay and prepayment penalties by establishing a new category of "higher-priced mortgage loans" with lower annual percentage rates (APRs) and made such provisions enforceable by consumers through civil actions.[62] Certain creditors have been required to follow these regulations since October 2009.[63]

Since 2008, the increased market presence of the Federal Housing Administration has resulted in mortgage credit remaining available to at least some consumers, and stricter regulations have resulted in a marked decrease in foreclosures.[64] However, it has also resulted in a precipitous drop in mortgages written. Such over-regulation may continue to impact the economy as investors and lenders continue to rack up losses on their portfolios of defaulted properties and lose income and assets that could have been otherwise deployed.

The rise in government involvement in the housing market has also increased exponentially—to the point where almost all of the loans created today are made with some sort of government assistance.[65] Today,

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(explaining how the Making Home Affordable Program can help homeowners get mortgage relief and avoid foreclosures).

60. *See* Annie Lowery, *Final Arguments: Was TARP a Success or Failure? It Depends on Who You Think it was Supposed to Help, Moneybox*, SLATE (Apr. 1, 2011, 3:38 PM), http://www.slate.com/articles/business/moneybox/2011/04/final_arguments.html (citing a Bloomberg poll showing twenty-four percent of respondents said TARP was helpful).

61. *See* Truth in Lending, 73 Fed. Reg. 44522, 44522 (July 30, 2008) (to be codified at 12 C.F.R. pt. 226) (amending Regulation Z, which implements the Truth in Lending Act and Home Ownership and Equity Protection Act, and establishing new regulatory protections for consumers in the residential mortgage market).

62. Ability-to-Repay on Qualified Mortgage Standards under the Truth in Lending Act, 78 Fed. Reg. 6408, 6414 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

63. Truth in Lending, 73 Fed. Reg. 44522 (stating the final rule became effective October 1, 2009 "except for § 226.35(b)(3) which [became] effective on April 1, 2010").

64. Ability-to-Repay on Qualified Mortgage Standards under the Truth in Lending Act, 78 Fed. Reg. at 6411; *see also* CoreLogic, *supra* note 53, at 3 (stating that foreclosures were down twenty-four percent in 2013 compared to 2014).

65. *See* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6412 (reporting that approximately three out of every four loans are either bought or guaranteed by government assistance).

even this government assistance is being attacked from all sides.[66] Mortgage brokers predicted in late 2013 that the drop in year over year mortgages could experience a thirty-two percent decrease in the amount of money used to write mortgages in 2014.[67] The home and mortgage markets remain extremely fragile and people with lower credit scores and less money to use as a down payment continue to have an extremely difficult time getting a mortgage, even with the government sponsored programs.[68]

III. Dodd-Frank and the Dismantling and Rebuilding of the Lending Industry

A. *"Cracking Down on Abusive Practices":[69] The Dodd-Frank Wall Street Reform and Consumer Protection Act*

As previously mentioned, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) defines its purpose as "[a]n Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[70] In the words of President Barack Obama, Dodd-Frank's purpose is to "crack down on abusive practices."[71] The passage of the 2,300 page piece of legislation fell almost exclusively on party lines[72] and initiated the largest expansion of government power since the Great De-

66. *See* Barack Obama, U.S. President, Remarks on Responsible Homeownership (Aug. 6, 2013), *available at* http://blogs.wsj.com/washwire/2013/08/06/text-of-obama-speech-on-homeownership (calling for the winding down of Freddie Mac and Fannie Mae and supporting bipartisan efforts in the Senate to end both programs).

67. Scott Reckard, *Mortgage refinancing projected to plunge in 2014 as rates rise*, L.A. Times (Oct. 29, 2013, 12:32 PM), http://www.latimes.com/business/money/la-fi-mo-mortgage-forecast-20131029,0,5248739.story#axzz2obSSNzUq.

68. *See* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6412 ("The Federal Reserve Board calculates that the share of mortgage borrowers with credit scores below 620 has fallen from about 17 percent of consumers at the end of 2006 to about 5 percent more recently.").

69. Barack Obama, U.S. President, Remarks at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act.

70. *Compare* Dodd-Frank, *supra* note 6, *with* Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (showing very similar purposes and a need for comprehensive protection for credit based transactions).

71. Obama, *supra* note 70.

72. *See H.R. 4173 (111th): Dodd-Frank Wall Street Reform and Consumer Protection Act*, GovTrack.us, www.govtrack.us/congress/bills/111/hr4173 (last visited Oct. 25, 2014) (reporting that the bill passed in the House with the affirmative votes of 234 Democrats

pression, touching everything in the finance industry from ATM cards and fees to Wall Street to home financing.[73] While every part of this behemoth piece of legislation deserves and requires comprehensive and meticulous review,[74] the scope of this article is limited to the analysis of two very specific parts and their effects on home ownership:[75] The Ability-to-Repay Standard and the Qualified Mortgage Standard.[76] These two parts of the Dodd-Frank regulations constitute the bulk of the regulatory scheme with respect to residential lending, generate the most commentary, and, as shown below, have the greatest effect on the lending industry and minority and lower income consumers.

The Dodd-Frank Act and the regulations provide two options or standards with which lenders must comply when writing residential loans to determine if a borrower has a reasonable ability to repay their loan. First, the regulations provide for at least eight factors the lender must consider before writing a loan to make a reasonable and good faith determination that a borrower has a reasonable ability to repay the loan.[77] Second, the lender could alternatively write what has been termed a "Qualified Mortgage" and obtain either a presumption of compliance or a "safe harbor" from actions by borrowers against it alleging the lender did not have a

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and only 3Republicans; while in the Senate, 55 Democrats voted in favor of the bill alongside only 3 Republicans and 2 Independents).

73. *See* Damian Paletta & Aaron Lucchetti, *Law Remakes U.S. Financial Landscape, Politics & Policy*, WALL ST. J. (July 16, 2010, 12:01 AM), http://online.wsj.com/news/articles/SB10001424052748704682604575369030061839958; *see also* Obama, *supra* note 70 (stating the Dodd-Frank Act will "crack down on abusive practices in the mortgage industry . . . mak[ing] sure that contracts are simpler—putting an end to many hidden penalties and fees in complex mortgages—so folks know what they're signing").

74. *See* Paletta & Lucchetti, *supra* note 74 (claiming that the Commodity Futures Trading Commission asked for $45 million to help it begin to understand and implement its new regulatory powers and J.P Morgan assembled more than 100 teams to examine the legislation).

75. The Ability-to-Repay and Qualified Mortgage regulations apply to virtually all closed-end consumer credit transactions secured by a dwelling including any real property attached to the dwelling. *See* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 6408, 6446–47 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026) (outlining the minimum standards for transactions secured by a dwelling). It includes residential structures containing one to four residential units and includes co-ops and condominiums. *Id.* at 6446. It is not limited solely to a first lien on a dwelling, but also to any second or additional lien on the property. *Id.* However, it does not apply to open-end credit plans (i.e. home equity lines of credit) time share plans, bridge loans and construction loans for less than 12 months, mortgages on vacant land or reverse mortgages. *Id.* at 6447. Loan modifications are covered only if they are considered a refinancing of the debt under Regulation Z at section 1026.20(a). *Id.*

76. Dodd-Frank, *supra* note 6, §§ 1411–12, 2142–48.

77. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6408.

reasonable belief the borrower had the ability to repay the loan.[78] Thus, the Dodd-Frank Act establishes two sets of prerequisites for writing a residential mortgage: underwriting prerequisites in the Ability-to-Repay Standard and product prerequisites in the Qualified Mortgage Standard.

B. *The Ability-to-Repay Standard*

The first means by which a lender can comply with Dodd-Frank is by examining certain underwriting characteristics explained in the Ability-to-Repay Standard. These characteristics illuminate personal circumstances of the borrower that signal a likelihood of a future default on the proposed residential mortgage, as opposed to the terms of the mortgage or the collateral for the loan.[79] Section 1411 of the Dodd-Frank Act broadly establishes the Ability-to-Repay Standard by stating:

> *In accordance with regulations prescribed by the Board,* no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.[80]

While this is a laudable goal, with which no prudent businessperson would find issue, (except true libertarians who deny government any role in regulating commerce), the "devil" truly is "in the details." The minimum requirements in the Ability-to-Repay regulations adopted by the Consumer Finance Protection Bureau (CFPB) require creditors to make an ability to repay determination on every consumer loan secured by a dwelling on real property.[81] To make this determination, the regulations require lenders to consider at least eight factors as judged against an objective underwriting model.[82] The rule does not dictate *how* these factors must be considered,[83] but the underwriting model used by lenders must be "based on empirically derived, demonstrably and statistically sound

78. *Id.* at 6408–09.

79. *See* Dodd-Frank, *supra* note 6, § 1411, 2145–46 (establishing the basis for determining the consumer's ability to repay the residential mortgage loan).

80. *Id.* (emphasis added).

81. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6603.

82. Dodd-Frank, *supra* note 6, §§ 1411–12, 2142–48.

83. *See* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6410 (explaining that the rules do not dictate that underwriters must follow a particular model for underwriting residential loans but that, at a minimum, creditors must generally consider the factors listed).

models."[84] These eight factors include: (1) the potential borrower's credit history;[85] (2) the potential borrower's employment status for the last two years;[86] (3) the monthly payment for the loan;[87] (4) the monthly payments on any simultaneous loan;[88] (5) the potential borrower's monthly payment for property taxes, insurance, and homeowner's association dues;[89] (6) the potential borrower's current income or reasonably expected income or assets (if the consumer will rely on them to repay the loan);[90] (7) the potential borrower's current debt obligations including alimony and child support;[91] and (8) the potential borrower's debt-to-income ratio or residual income the consumer will have after non-mortgage debt and mortgage-related obligations.[92]

Creditors will have to use reasonably reliable third party records to verify this information[93] and a lender cannot merely rely on a borrower's application or statements,[94] even if they are signed and subject to penalties for making false statements.[95] Lenders must retain the evidence of

84. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6603. The lender is instructed to look at the issue of the Ability-to-Repay Standards in the context of the facts and circumstances relevant to the lender's market. *Id.* While the government does not dictate the model to be used, certain factors are listed that may show a lender acted in good faith, including that the underwriting standards have historically resulted in low rates of delinquency and default during adverse economic conditions and the payment history of the borrower-that is, the borrower was able to repay the loan for a significant period of time. *Id.* The converse would likely demonstrate a lack of good faith or reasonableness in a lender's determination. *See id.* at 6603–04 (discussing the agencies responsibility in ensuring fair lending practices); *see also* CONSUMER FIN. PROT. BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE (2013), *available at* http://files.consumerfinance.gov/f/201401_cfpb_atr-qm_small-entity-compliance-guide.pdf (discussing the agencies responsibility in ensuring fair lending practices).

85. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6607.

86. *Id.* at 6605.

87. *Id.* at 6605–6608 (using the introductory rate or fully indexed rate, whichever is higher, and monthly, fully amortizing payments that are substantially equal).

88. *Id.* at 6607.

89. *Id.*

90. *Id.*at 6605.

91. *Id.* at 6606–07.

92. *Id.* at 6607–08; Truth in Lending (Regulation Z), 12 C.F.R. § 1026.43(c)(2)(vii) (2014).

93. *Id.* at 6607–08 (explaining that examples of a reasonably reliable third-party records include governmental records, HOA and co-op provided records, written lease agreements, credit reports, court orders, tax returns, W-2 and other payroll statements, bank statements, check cashing receipts, and remittance transfer receipts).

94. *Id.* at 6603.

95. *See Uniform Residential Loan Application*, FANNIE MAE, https://www.fanniemae.com/content/guide_form/1003rev.pdf (last visited Oct. 6, 2014) (stating in Section IX that

their compliance with the Ability-to-Repay Standard for three years after the date of consummation of a covered transaction.[96] The failure to comply with any of the Ability-to-Repay requirements subjects the lender to certain penalties discussed infra and a lender will be required to demonstrate its compliance in any suit brought by a consumer.[97] In other words, the burden rests on the lender to show they are in compliance with the regulations, not on the consumer to show that the lender failed to comply.[98]

C. *The Qualified Mortgage Standard*

In contrast to facing the risks of suit regarding compliance with the Ability-to-Repay Standard, a lender could write a Qualified Mortgage.[99] A Qualified Mortgage relates to the prerequisites of the terms of the loan and only tangentially touches on the borrower's Ability-to-Repay underwriting characteristics.[100] A Qualified Mortgage provides certain protections from litigation, discussed infra, by establishing either a rebuttable presumption or a conclusive safe harbor, depending on the terms of the loan and other lender factors.[101] This appears to create an overwhelming incentive for lenders to write only Qualified Mortgages, since there are no presumptions or safe harbors for compliance with the Ability-to-Repay Standard.[102]

Section 1412 of the Dodd-Frank Act defines "Qualified Mortgage" by establishing various product-feature prerequisites and affordability un-

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the undersigned (borrower) acknowledges that everything in the document is correct under punishment of fine or imprisonment).

96. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6409.

97. *See id.* at 6416 (stating Dodd-Frank creates special remedies for violations of the ability-to-repay requirements including special statutory damages unless the creditor can demonstrate their failure to comply was not material).

98. *Id.* at 6416.

99. Technically a lender is deemed to be in compliance with the Ability-to-Repay requirements if they write a Qualified Mortgage, but since the Qualified Mortgage Standard has very little to do with the characteristics of a borrower, it is actually a second alternative standard for lenders to meet to comply with the requirements of Dodd-Frank. *See id.* at 6418 (reflecting changes made by the Dodd-Frank Act and how the Act consolidated the rulemaking authority for consumer financial laws).

100. *Id.* at 6409.

101. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6409.

102. *Id.* at 6408; *see also id.* at 6505 (noting the CFPB considered that depending on the definition of a Qualified Mortgage, the regulation could curtail access to credit and create a "straightjacket setting the outer boundary of credit availability").

derwriting requirements.[103] The regulations provide for additional requirements and provide for certain exceptions of the requirements based upon the location of the lender, its size, and the number of loans it writes annually.[104] Generally, a Qualified Mortgage cannot be a loan with negative amortization, have interest-only payments, have a balloon feature, or exceed thirty years, and must provide for substantially equal regular periodic payments.[105] Additionally, a Qualified Mortgage is limited in its interest rate and prepayment penalties, and requires a lender to verify assets and income of the borrower and meet certain income to debt ratios.[106]

i. No Negative Amortization

A loan with negative amortization—a loan in which periodic payments are not sufficient to pay at least the accrued interest and thus the principal is ever increasing—has obvious ramifications and risk that at some point the principal amount due may prove to exceed the value of the collateral.[107] This would have the effect of providing homeowners with an incentive to merely walk away from their property. While the use of these loans have never been very prevalent in the market, they were written with the intention of having them paid off within a short time of their origination, into a more traditional loan.[108] When housing prices were rising significantly, or interest rates dropping significantly, there was usually little problem in refinancing these loans. However, once the values stopped rising or interest rates increased, the homeowner would not be able to refinance and would need to take steps to convert the negative amortizing loan into one that would amortize (that is pay off), usually by adding to their interest payment some amount to cover all of the accrued interest and a portion of the principal. For most consumers, this calcula-

103. Dodd-Frank, *supra* note 6, § 1412, 2145–46; *see also* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6409 (discussing the presumption for Qualified Mortgages provided by the Dodd-Frank Act).

104. *See generally* CONSUMER FIN. PROT. BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE, *supra* note 84 (discussing the requirements used by the creditor in determining whether the consumer has the ability to repay the loan and the factors that are exempt from the ability-to-repay requirement).

105. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6409.

106. *Id.*

107. *See* CONSUMER FIN. PROT. BUREAU, WHAT IS NEGATIVE AMORTIZATION? http://www.consumerfinance.gov/askcfpb/103/what-is-negative-amortization.html (last visited Sept. 1, 2014) (defining "negative amortization" and highlighting risks).

108. Jessica Bosari, *The State of Negatively Amortizing Loans*, FORBES (Sept. 20, 2012, 5:36 PM), http://www.forbes.com/sites/moneywisewomen/2012/09/20/the-state-of-negatively-amortizing-loans.

tion was out of their reach, and the neighborhoods where these loans were concentrated faced consistently higher foreclosure rates.[109]

ii. No Balloon Features

A relatively common lender practice is to use balloon payment mortgage. This lending vehicle requires the borrower to 'refinance' or otherwise come up with funds to pay off the loan at the conclusion of time period, usually five to ten years.[110] The practice was implemented by lenders to mitigate the long-term interest rate risk, by providing that lenders would not be stuck with loans written at a significantly lower interest rate than the market at less predictable future times. Without a balloon and significant interest rate fluctuations, lenders could find themselves locked into a book of loans written at interest rates that were half or even less than the interest rates on newer loans.

A Qualified Mortgage cannot contain a balloon payment, unless the interest rate is fixed, the term is longer than five years, and scheduled payments (without the balloon feature) would fully amortize the loan over thirty years or less.[111] The loan must be kept in the lender's portfolio for at least three years or is otherwise sold according to certain limited exceptions.[112] Obviously, this is an attempt to end the cycle of refinancing "hot potato" experienced during the crisis, when homeowners relied on the appreciation to refinance into ever-higher loans.

iii. Thirty Years or Less Amortization

A Qualified Mortgage must be amortizing over thirty years or less and cannot result in an increase of the principal balance.[113] This may actually have the effect of restricting the lending market for those borrowers on the edges, by removing the ability of a lender to extend the payment term over a longer period of time, thus reducing the monthly payments of a borrower.

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109. *See generally* BOCIAN ET AL., *supra* note 31 (addressing three key questions: "who has lost their home to foreclosure[;] . . . what kind of mortgages different borrowers received[;] . . . [and] where the crisis had the greatest impact").

110. *See* BLACK'S LAW DICTIONARY 1102 (9th ed. 2009) (defining balloon-payment mortgage as "a mortgage requiring periodic payments for a specified time and a lump-sum payment of the outstanding balance at maturity")

111. Truth in Lending (Regulation Z), 12 C.F.R. § 1026.43(f) (2014).

112. *Id.* at § 1026.43(f)(2).

113. *Id.* at § 1026.43(e)(2).

iv. Equal Periodic Payments

The payments on a Qualified Mortgage must also be periodic and substantially equal.[114] This is to combat the perceived difficulties with "rate shock," which is experienced by borrowers when their interest rates reset on variable interest rate loans.[115] A lender could still write a variable rate loan and have it qualify as a qualified mortgage, but the lender must qualify the loan by using the highest interest rate possible during the first five years, as though that rate were in effect from the inception of the loan.[116] As a practical matter, with the interest rate restrictions discussed infra, a variable rate loan would be hard pressed to qualify as a Qualified Mortgage. Thus the CFPB has essentially eliminated variable rate loans from the marketplace, at least as to protections of the presumption or a safe harbor from litigation.

v. Limited Points and Fees.

Points and fees are limited to three percent of the loan amount for loans over $100,000.00; for loans between $60,000 and $100,000, $3,000 total; for loans between $20,000 and $60,000, five percent of the total loan amount; for loans between $12,500 and $20,000 $1,000, and for loans less than $12,500, eight percent of the total loan amount.[117]

vi. No Prepayment Penalties.

Prepayment penalties are prohibited unless the loan is a fixed rate loan, penalties are limited to the first three years, and the penalty is less than two percent for the first two years of the loan and one percent in year three.[118] Additionally, a lender must simultaneously offer a loan without a prepayment penalty on similar terms.[119]

vii. Interest Rate Restrictions

Interest rates are also strictly proscribed for a Qualified Mortgage to no more than 1.5 points higher than the Average Prime Offer Rate

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114. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 6408, 6421 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

115. *See id.* at 6478 (pointing out that potential payment shock for Qualified Mortgages could diminish if borrowers receive loans they can reasonably repay).

116. *See id.* at 6409 (establishing the general criteria for Qualified Mortgages requiring the calculation of monthly payments be based on the highest payment, which will apply for the first 5 years of the loan).

117. Truth in Lending (Regulation Z), 12 C.F.R. § 1026.43(e)(3) (2014).

118. *Id.* at § 1026.43(g).

119. *Id.* at § 1026.43(g)(3).

(APOR)[120] for the safe harbor and 3.5 points above the APOR[121] for the presumption.

viii. Asset and Income Verification and Debt to Income Ratio

Finally, a lender is required to verify assets and income[122] and the borrower's ratio of total monthly debt to total monthly income may not exceed forty-three percent for a mortgage to qualify as a Qualified Mortgage.[123]

ix. Exceptions to the Qualified Mortgage Requirements

The first of three exceptions recognized are loans eligible to be purchased[124] or guaranteed by The Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac).[125] Loans from the U.S. Department of Housing and Urban Development, U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, and the Rural Housing Service also meet the Qualified Mortgage Standard if they have regular periodic payments, are not negative amortizing loans, and do not exceed thirty years.[126] Presumably, such loans do not need to meet the verification requirements or the debt-to-income ratio set out in the regulation.[127] This exception was designed to avoid disrupting the market and expires the earlier of January 10, 2021, when the conservatorship of the Government Sponsored Enterprise ends, or when the federal agency issues rules to define a qualified mortgage under its programs.[128]

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120. *Id.* at § 1026.35(a)(2).

121. The "average prime offer rate" is defined in TILA section 129C (b)(2)(B) as the average prime offer rate for a comparable transaction as of the date on which the interest rate for the transaction is set, as published by the CFPB. Truth in Lending Act, 15 U.S.C. § 1640(f) (2012).

122. Truth in Lending (Regulation Z), 12 C.F.R. § 1026.43(2)(v) (2014).

123. *Id.* at § 1026.43(f)(2).

124. The loan does not actually have to be purchased by the governmental entity; just that it is eligible for purchase or guarantee. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 6408, 6617 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

125. *Id.* at 6617.

126. *Id.*

127. Note however, that such loans are usually subject to debt-to-income ratios and other requirements to be written or guaranteed by these agencies. *See B3-6-02: Debt-to-Income Ratios*, FANNIE MAE, https://www.fanniemae.com/content/guide/selling/b3/6/02.html (last visited Oct. 25, 2014) (stating different debt-to-income ratios than were issued by the Consumer Financial Protection Bureau).

128. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6617.

The second exception is for loans created by rural, small and community-based lenders. Due to special concerns surrounding these particular loans, the CFPB eased some of the Qualified Mortgage rules.[129] To qualify as a small lender, a lender must operate predominantly in rural or underserved areas, and the lender cannot write more than 500 first lien loans a year and cannot have assets that exceed $2 billion.[130] Fifty percent of the first liens originated by the lender must also be originated in counties that are rural or underserved as designated by the CFPB.[131]

The CFPB recognizes much of what occurred in the market was not the result of lending by small community based lenders.[132] In fact, the CFPB notes that the emphasis on relationship banking,[133] the long-term relationship with their customers, and the retention of the loan by the lenders led to fewer defaults and delinquencies and more accurate underwriting than the objective standards championed for larger lenders.[134] Such small lenders had limited access to the securitization markets and usually funded the loans with the deposits held for their customers, rather than capital from outside sources.[135]

Nevertheless, the CFPB decided to include small lenders in its regulations covering all covered transactions, but granted specific exceptions from certain requirements.[136] In the first of these, the CFPB adopted regulations allowing small rural lenders to originate a balloon payment Qualified Mortgage.[137] In addition the CFPB raised the maximum interest rate for the safe harbor from 1.5 above APOR to 3.5 above APOR,

129. *See* CONSUMER FIN. PROT. BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE, *supra* note 85, at 8 (stating that in response to special concerns over small creditors, there are special provisions for Qualified Mortgages held in portfolio by small creditors, including some types of balloon-payment mortgages).

130. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6409.

131. *Id.*

132. *See generally* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 35430, 35438 (June 12, 2013) (to be codified at 12 C.F.R. pt. 1026) (discussing market-wide data showing significantly lower mortgage loan delinquencies and charge-off rates at smaller banks than large banks).

133. *See* CONSUMER FIN. PROT. BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE, *supra* note 85, at 26 (instructing lenders that "[w]hether or not you complied with the ATR requirements is based on the information available during origination").

134. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 35438.

135. *Id.* at 35437.

136. CONSUMER FIN. PROT. BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE, *supra* note 84, at 8.

137. *Id.*

and the CFPB eliminated the requirement that a borrower's debt-to-income ratio must be forty-three percent or below.[138] The loans must still meet the general restrictions on Qualified Mortgages with respect to loan features and points and fees however, as well as that the lender must retain the loan in its portfolio for at least three years.[139]

The CFPB also permitted small lenders a temporary two-year transition period in which they can write balloon payment mortgages that qualify as a Qualified Mortgage, so long as the creditor retains the loan in its portfolio for at least three years (or transfers it to another small creditor),[140] writes no more than 500 first lien covered transactions per year, and has less than $2 billion in assets.[141] Small creditors are *not* however, limited for the two-year period to rural or underserved areas, as they were under the previous regulation.[142]

Finally, in an attempt to remove some of the burdens that certain organizations would have faced under the Ability-to-Repay Standard, the CFPB provided an exemption from the Ability-to-Repay requirements of Dodd-Frank for loans made by certain lenders designated by the U.S Department of the Treasury as Community Development Financial Institutions or designated by the U.S. Department of Housing and Urban Development as Community Housing Development Organization or a Downpayment Assistance Provider of Secondary Financing.[143] Additionally, creditors that are designated as non-profit under IRC 501(c)(3) and write less than 200 loans a year, provide credit only to low to moderate income consumers, and follow their own guidelines to determine the borrower's ability to repay the loans are also exempt from the Ability-to-Repay requirements of other lenders.[144]

ix. The Importance of Complying with The Ability-to-Repay Standard and Qualified Mortgage Standards: Gaining a Safe Harbor or Rebuttable Presumption and Avoiding Harsh Penalties

Section 1412(b)(1) of the Dodd-Frank Act states, "Any creditor with respect to any residential mortgage loan, and any assignee of such loan subject to liability under this title, may *presume* that the loan has met the

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138. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 35431, 35500.

139. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 6408, 6409 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

140. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 35477.

141. *Id.* at 35489.

142. *Id.* (emphasis added).

143. *Id.* at 35430.

144. *Id.*

requirements of subsection (a), if the loan is a qualified mortgage."[145] However, as the CFPB indicates in its final rule, the Dodd-Frank Act does not denote whether this presumption creates a safe harbor or merely creates a rebuttable presumption.[146] The CFPB ultimately determined to adopt *both* protections with the distinction being whether the loan being written is a "regular priced" loan or a "high priced" loan.

The CFPB's regulations provide for a *safe harbor* for loans that satisfy the requirements of a qualified mortgage and are not "higher priced" loans,[147] while a *rebuttable presumption* is created for "higher priced" loans.[148] What this means is that the final rule provided by the CFPB allows for a consumer to show a violation in regard to a subprime qualified mortgage by demonstrating at the origination of the loan that the consumer did not have enough residual income or assets to meet living expenses because their income was too low and their debt obligations were too high.[149] It should be noted that the final rule does clarify that this ability to rebut the presumption is diminished with time as the consumer demonstrates the ability to repay his loan.[150]

One of the reasons that it is important for a creditor to create Qualified Mortgages and gain the safe harbor or rebuttable presumption is that the Dodd-Frank Act creates special remedies for violating section 129C(a) of the Truth in Lending Act, the Ability-to-Repay requirement.[151] A consumer who brings an action within three years of a Truth in Lending 129C(a) violation may be able to recover damages equal to the sum of all finance charges and fees paid in addition to actual damages, statutory damages, court costs, and attorney fees.[152]

Additionally, if a mortgage does not meet the stringent standards set out in Dodd-Frank, a consumer may assert a violation by the creditor as matter of defense by recoupment or set off in a foreclosure proceeding.[153] This defense may be raised against any creditor, assignee, other holder of the residential mortgage loan, or anyone acting on their behalf who initi-

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145. Dodd-Frank, *supra* note 6, § 1412, 2145 (emphasis added).

146. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6408.

147. *Id.*

148. *See id.* at 6408–09 (noting that the line the CFPB is drawing is one that has long been recognized as a rule of thumb to separate prime loans from subprime loans).

149. *Id.* at 6409.

150. *Id.*

151. Dodd-Frank, *supra* note 6, § 1404, 2141; *see also* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6416 (explaining that Dodd-Frank creates special remedies for TILA violations).

152. Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6557.

153. Dodd-Frank, *supra* note 6, § 1413, 2148–49.

ates a judicial or nonjudicial foreclosure.[154] Collection of debt in connection with a residential mortgage loan also allows for this defense.[155] The amount that may be recouped is equal to the amount a valid claim brought in an original action, plus the consumer's costs in bringing the action, and reasonable attorney's fee.[156] What gives this defense real bite, however, is the fact that there is not a time limitation to bring this defense to a foreclosure action or a collection action.[157] A consumer is able to bring this defense even if the statute of limitation has expired in regard to a private action and is able to recoup or set off the amount they would have been entitled to if they had brought the action a day before the expiration of the time limit on a private action.[158]

IV. An Analysis of the Effects The Dodd-Frank Wall Street Reform and Consumer Protection Act Will Have on Homeownership

A. *Dodd-Frank's Effect on Homeownership for All Consumers*

With the changes presented in the Dodd-Frank Wall Street Reform and Consumer Protection Act going into effect on January 10, 2014, the big question that remains to be answered is, "[H]ow will Dodd-Frank affect the mortgage industry and in turn homeownership in America?"[159] There are two big impacts that Dodd-Frank's Ability-to-Repay and Qualified Mortgage Standards will have on the mortgage market: they are going to make loans and banking more expensive for consumers and they are going to decrease the amount of loans created.

It is true that section 1421(b)(2)(A)(vii) of the Dodd-Frank Wall Street Reform and Consumer Protection Act prevents the "total points and fees . . . payable in connection with the loan [to] exceed 3 percent of the total loan amount," however, lenders will need to offset this loss of income and

154. *Id.*

155. *Id.*

156. *Id.*; *see also* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6416 (explaining the special statutory damages are limited to three years of finance charges and fees).

157. *See* Dodd-Frank, *supra* note 6, § 1413, 2149 (stating when a "creditor, assignee, or other holder of a mortgage loan, initiates a judicial or nonjudicial foreclosure of the residential mortgage loan . . . a consumer may assert a violation by a creditor . . . as a matter of defense by recoupment or set off without regard for the time limit on a private action for damages").

158. *Id.*

159. *See* Press Release, Am. Bankers Ass'n, Mortgage Reform in 2014 (Mar. 2014), https://www.aba.com/Press/Documents/MortgageReform2014.pdf (outlining the many changes bankers will need to take into account when Dodd-Frank goes into effect on January 10, 2014).

consumers will be forced to pay more in alternate ways, such as servicing fees, other areas and services provided and higher interest rates.[160] Fannie Mae and Freddie Mac have announced that the guarantee fees they charge to lenders for servicing their thirty-year fixed-rate loans will rise an average of fourteen basis points.[161] A basis point is roughly 1/100th of one percent and consumers, before Dodd-Frank and the Great Recession, used to pay approximately eleven to thirteen basis points.[162] Now consumers are paying around fifty basis points and experts are predicting they could go as high as seventy to seventy-five basis points for a possible fifty percent increase over the next two years.[163] Bankers have already stated that any fee increase by Fannie Mae or Freddie Mac will likely be passed along to consumers.[164]

Another effect of banks and lenders having mortgages tightly regulated is that consumers will be paying new or higher fees in other banking activities.[165] From the loss of free checking accounts, to the closing or reduction in credit cards and their limits, consumers in today's market are hit with fees as high as twenty-five percent on a variety of bank products.[166] As a result, a whole segment of the population—the one Dodd-Frank was intended to protect—is being pushed out of the mainstream banking market and being corralled into much riskier, and financially dangerous, nontraditional financial arrangements such as payday loans and check cashers.[167]

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160. Dodd-Frank, *supra* note 6, § 1412, 2146; *see* Janna Herron, *Mortgage interest rates continue uphill climb*, LAS VEGAS REV.-J. (Dec. 28, 2013, 5:00 AM), http://www.reviewjournal.com/real-estate/mortgage-interest-rates-continue-uphill-climb (emphasizing the increase in interest rates in preparation of the Dodd-Frank regulations).

161. Michele Lerner, *The new mortgage rules that are likely to affect your next home purchase*, WASH. POST (Dec. 13, 2013), http://www.washingtonpost.com/realestate/the-new-mortgage-rules-that-are-likely-to-affect-your-next-home-purchase/2013/12/12/756fec90-5dba-11e3-be07-006c776266ed_story.html.

162. *Id.*

163. *Id.* It should be noted that if the expert predictions come true, the percentage change between what consumers used to be charged and the possible changes in the coming years will equal a staggering 581.81 percent.

164. *See* Herron, *supra* note 160 (noting that when new rules from the Federal Housing Finance Agency increase the fee Fannie Mae and Freddie Mac charge lenders to guarantee home loans, these costs will likely be passed on to consumers in the form or higher interest rates).

165. *See generally* Abby McCloskey, *Dodd-Frank's Costs Will Be Paid For By Low-Income Bank Customers*, FORBES (Sept. 26, 2013, 8:00 AM), http://www.forbes.com/sites/realspin/2013/09/26/dodd-franks-costs-will-be-paid-for-by-low-income-bank-customers (discussing the various ways consumers will be charged because of the Dodd-Frank regulations).

166. *Id.*

167. *Id.*

Another unintended consequence of capping the fees that are associated with loan origination and forcing banks to find other means of recouping cost will be higher mortgage interest rates for borrowers.[168] Home mortgage rates began to increase in late 2013 in anticipation of the Dodd-Frank regulations and were predicted to continue to rise in the first quarter of 2014.[169] Rates are expected to rise to above five percent in 2014, from around four percent at the end of 2013, and increase to roughly five and a third percent by 2015, close to a twenty-eight percent increase over two years.[170] If this prediction is accurate it will mean that for every $100,000 the average American borrower will pay an extra $77.88 a month and an extra $20,040.16 of interest over the course of the loan.[171] A higher interest rate, of course, is bad news for borrowers who will still have to meet the forty-three percent debt-to-income threshold to qualify for a loan.[172]

The biggest and most obvious change market analysts and other experts are predicting Dodd-Frank will have on the market is a decrease in lending, with one expert predicting a decrease as high as twenty percent.[173] The Mortgage Bankers Association believes that there will be a thirty-two percent decrease in money used to write new mortgages.[174] It is not hard to see why this is a possibility. Regulations by their very nature allow or stop some practice. In the case of Dodd-Frank, the regulations prevent certain lending practices from reaching a special status (non-qualified mortgagees do not gain a presumption or safe harbor), making loans that do not follow the regulations undesirable, such as lend-

168. *See* Herron, *supra* note 160 (highlighting reactions among banks, specifically increasing mortgage interest rates, in preparation of the Dodd-Frank regulations).

169. *Id.*

170. Reckard, *supra* note 67.

171. MORTGAGE CALCULATOR, http://www.bankrate.com/calculators/mortgages/mortgage-calculator.aspx?MSA=7240&MSA=7240&MSA=7240&MSA=7240&MSA=7240 (last visited Oct. 6, 2014) (calculating a $100,000 mortgage at four percent and 5.3 percent and subtracting the monthly totals and total interest from each other).

172. *See* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. 6408, 6409 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026) (stating the debt-to-income threshold to qualify as a qualified mortgage is forty-three percent).

173. *See* Nick Timiraos, *Study: New Mortgage Rules Could Shrink Lending By 20%*, WALL ST. J. (Oct. 28, 2012, 8:30 AM), http://blogs.wsj.com/developments/2012/10/26/study-new-mortgage-rules-could-shrink-lending-by-20 (discussing the American Action Forum's study that suggests pending mortgage regulations could result in nearly twenty percent fewer mortgages being issued in the coming years, preventing home sales and construction).

174. *See* Reckard, *supra* note 67 (stating the Mortgage Bankers Association "expects to see $1.19 trillion in new mortgages written during 2014, down 32% from $1.75 trillion [in 2013]").

ing to someone who has higher than a debt-to-income ratio of forty-three percent or has a low credit score.[175] Banks will also hesitate to make new mortgages because there are still a lot of unanswered questions about the regulations passed by the CFPB, and they do not want to face the legal ramifications of making non-Qualified Mortgages.[176] With mortgages being eight times as difficult to get now than they were pre-Great Recession,[177] the question becomes, "[I]f Dodd-Frank was meant to protect consumers but is going to prevent a large portion of the population from participating in homeownership, who is going to be excluded and is this going to be acceptable?"

B. *Bearing the Brunt of the Consequences: Minorities and the Negative Effects of Dodd-Frank*

Barney Frank, co-sponsor of the Dodd-Frank Wall Street Reform and Consumer Protection, is on the record saying that "it was a great mistake to push lower-income people into housing they couldn't afford and couldn't really handle once they had it."[178] Putting aside the political question of big versus small government control, and how far should government protections should go, this statement speaks volumes for how and whom the Dodd-Frank Act is meant to protect. The "how," as discussed supra, is by increasing the cost of mortgages and regulating the market so that lenders write fewer mortgages and virtually eliminate the smaller loans from being written. The "whom" is "lower-income people," which, when one looks at the demographics of race and income, is by and large made up of the African-American and Hispanic minority groups.[179] The three major features of Dodd-Frank that will affect African-Ameri-

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175. *See generally* Ability-to-Repay on Qualified Mortgage Standards Under the Truth in Lending Act, 78 Fed. Reg. at 6408 (explaining the regulations Dodd-Frank imposed on mortgage lending).

176. *See* Megan Hopkins, *Dodd-Frank impact on loan availability remains a concern*, HOUSINGWIRE.COM (June 18, 2013), http://www.housingwire.com/articles/dodd-frank-impact-loan-availability-remains-concern (discussing the possibility that some institutions may stop all mortgage lending for some time because the risk is too great if regulations are not complied with properly); *see also* FANNIE MAE, MORTGAGE LENDER SENTIMENT SURVEY: IMPACT OF QUALIFIED MORTGAGE RULES AND QUALITY CONTROL REVIEW 4 (2014), *available at* http://www.fanniemae.com/resources/file/research/mlss/pdf/mlss-aug2014-presentation.pdf (stating eighty percent of lenders surveyed do not plan to pursue non-Qualified Mortgage loans).

177. Richard Satran, *New, Tighter Mortgage Rules: Who's Squeezed Most?*, U.S. NEWS, http://realestate.aol.com/blog/2013/08/23/tighter-mortgage-rules-affordable-housing (last updated, Sept. 24, 2013, 1:36 PM).

178. Larry Kudlow, *In Praise (!) of Barney Frank*, CNBC (Aug. 20, 2010, 5:53 PM), http://www.cnbc.com/id/38791383.

179. *See Poverty Rate by Race/Ethnicity*, HENRY J. KAISER FAMILY FOUND., http://kff.org/other/state-indicator/poverty-rate-by-raceethnicity (last visited Oct. 6, 2014) (demon-

cans and Hispanics more than other racial and ethnic groups are the three percent cost cap on loans, the forty-three percent debt-to-income ratio, and the use of credit scores in the mortgage decision process.

One would think that a three percent cap on loan origination fees would provide a really big win for the "little guy." No more fast-talking salesman with a contract full of Greek, Latin, and legalese that hides the dreaded hidden fees and costs of doing business with a giant corporation that wants to take every last penny that it can get out of its customers. Knowing the lender can only charge three percent is going to make everything better, right? Unfortunately, the answer to that question is "no." Capping fees in this manner makes it more expensive for the bank to create mortgages.[180] Mortgages for $75,000 or less will be classified by banks as "high-cost loans" where the risk to the bank is great and the profit is low. People in the mortgage industry will simply stop making these loans because the fees on writing such loans do not cover the actual cost to the lender; the risk of losing money simply outweighs the monetary benefit that could be gained.[181] Loans from $100,000 to $160,000 do not fare any better because of the cap, and brokers will have trouble covering their costs and overhead in this price range, causing many in the mortgage industry to go after only the higher-priced home mortgages where they can get a better spread.[182] This move away from smaller mortgages is going to significantly impact African-Americans and Hispanics whose median home prices are $80,600 and $105,600 respectively, which falls well under the $160,000 price point at which it is estimated the fees will actually be profitable for mortgage brokers to write the loan.[183]

The second feature of Dodd-Frank, the forty-three percent debt-to-income threshold, is going to have two major impacts on minorities: first, a large portion of people will not be able to qualify for a mortgage; and

strating that African-Americans and Hispanics make up thirty-five and thirty-three percent respectively of those in poverty compared to thirteen percent of whites).

180. Tim Grant, *New mortgage regulations will squeeze working-class buyers*, PITTSBURGH POST-GAZETTE (Oct. 9, 2013, 12:00AM), http://www.post-gazette.com/business-news/2013/10/09/New-mortgage-regulations-will-squeeze-working-class-buyers/stories/201310090074.

181. *Id.*

182. *Id.*

183. *See* ROBERT L. BENNEFIELD, U.S. CENSUS BUREAU, HOME VALUES: 2000, at 3 (2003), *available at* http://www.census.gov/prod/2003pubs/c2kbr-20.pdf (charting median home prices by race and showing that African-Americans had a median home price of $80,600 and Hispanics had a median home price of $105,600); *see also* Drew Desilver, *Black incomes are up, but wealth isn't*, PEW RESEARCH CTR. (Aug. 30, 2013), http://www.pewresearch.org/fact-tank/2013/08/30/black-incomes-are-up-but-wealth-isnt (stating the average home value for a Black household is $75,040 as opposed to an average home value for a White household at $217,150).

second, it is going to limit the amount of money a person can borrow for a mortgage, and for minorities may cause them to be priced out of the market. Private research firms are predicting that ten to fifty percent of borrowers who would have qualified for a mortgage in 2013 will not be able to qualify for a loan with the Dodd-Frank in effect.[184] Even the CFPB admits this as a likely outcome of the policy.[185]

To measure someone's debt-to-income ratio, a lender will calculate a person's monthly debt repayments (including their prospective mortgage, and any other loan or alimony payments they must make) and divide that amount by their gross monthly income. This measurement is particularly problematic for minority groups because, while minority groups carry roughly the same amount of debt as white Americans,[186] there is a clear disparity in interest rates[187] and income levels.[188] This means, of course, that on average minorities will have higher debt-to-income ratios and, because of this higher ratio, will not be able to qualify for mortgages at higher percentage levels than their white counterparts. As a result of this requirement, minorities will have to settle for smaller loans and presumably smaller houses in less desirable neighborhoods, and will more than likely have a harder time finding a lender who will loan them money.[189]

The third aspect of Dodd-Frank that is going to cause problems for minorities is the use of credit scores in the mortgage application process. In a report to Congress, a study by the Federal Reserve found, "on average, blacks and Hispanics have lower credit scores than non-Hispanic whites."[190] While some argue there is no evidence that minorities face negative impacts because credit scores are simply a prediction of the bor-

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184. Satran, *supra* note 177.

185. *Id.*

186. *See The Color of Debt: Credit Card Debt by Race and Ethnicity*, DEMOS.ORG, http://www.demos.org/sites/default/files/publications/FACTSHEET_TheColorofDebt_Demos.pdf (last visited Sept. 20, 2014) (illustrating that, on average, white Americans carry $9,775 in credit card debt, Hispanics carry $10,002 in credit card debt, and African-Americans carry $7390 in credit card debt).

187. *See id.* (stating African-Americans paid an estimate seventeen percent annual percentage rate, Hispanics an estimated sixteen annual percentage rate, and white Americans an average fourteen annual percentage rate).

188. *See Table 697. Money Income of Families-Median Income by Race and Hispanic Origin in Current and Constant (2009) Dollars: 1990 to 2009*, CENSUS.GOV, http://www.census.gov/compendia/statab/2012/tables/12s0697.pdf (last visited Oct. 6, 2013) (diagraming that the median income for white Americans was $62,545, African-Americans was $38,409, and Hispanic Americans was $39,730).

189. *See* Grant, *supra* note 180 (explaining that lenders will be hesitant to loan money because of the three percent cap on fees).

190. BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 39, at S-2.

rowers future performance,[191] it is simple logic: if you make credit scores a factor in deciding to loan to the public and, because one of the criteria chosen to evaluate potential borrowers will cause certain racial and ethnic groups to be rejected more than another racial group, the criteria probably needs to be reevaluated or changed.

V. THE LEGAL IMPLICATIONS OF THE EFFECTS CAUSED BY DODD-FRANK

Fair housing and lending cases are a developing area of the law, and many of the issues associated with the topic are left ambiguous.[192] In an attempt to lessen the ambiguity, the Supreme Court has agreed in recent years to hear two fair housing claims; however, before each case could be brought before them, the parties settled.[193] Without guidance on how to interpret these cases, it is clear that large settlements and long drawn out legal processes will plague lenders, cities, and the victims associated with illegal fair housing and lending practices.[194]

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191. *See generally* Robert B. Avery et al., *Does Credit Scoring Produce a Disparate Impact?* (Fin. and Econ. Discussion Series, Working Paper No. 2010-58, 2010), *available at* http://www.federalreserve.gov/pubs/feds/2010/201058/201058pap.pdf (giving the opinion that credit scoring does not cause a disparate impact). It should be pointed out that information on race and credit scoring is very limited because credit models are proprietary and the sample size used by the authors may be considered too small to see any actual effect.

192. Annmarie Billotti et al., *Anatomy of a Fair Housing Case: A Primer on Litigating a Housing Discrimination Claim*, 27 CAL. REAL PROP. J. 30, 32 (2009), *available at* http://www.dfeh.ca.gov/res/docs/CivilRightsYear/Articles/AnatomyofAFairHousingCase.pdf.

193. *See* Adam Serwer, *Mount Holly settlement spares Fair Housing Act-for now,* MSNBC (Nov. 15, 2013, 10:41 AM), http://www.msnbc.com/msnbc/mount-holly-settlement-spares-fair-housing-act-for-now (explaining the settlement agreement reached in *Mt. Holly v. Mt. Holly Gardens* before the case could reach the Supreme Court); *see also* Joe Kimball, *St. Paul withdraws Supreme Court appeal on key housing-code case,* MINNPOST (Feb. 10, 2012), http://www.minnpost.com/two-cities/2012/02/st-paul-withdraws-supreme-court-appeal-key-housing-code-case (explaining the withdrawal of the city of St. Paul, Minnesota in the Supreme Court case of *Gallagher v. Magner*).

194. *See* Press Release, Dep't of Justice, Justice Dep't Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Fin. Corp. (Dec. 21, 2011), http://www.justice.gov/opa/pr/2011/December/11-ag-1694.html (recognizing a $335 million settlement by Countrywide Financial Corporation after they engaged in discriminatory practices from 2004 to 2008 against African-American and Hispanic Borrowers); Press Release, Dep't of Justice, Justice Dep't Reaches $21 Million Settlement to Resolve Allegations of Lending Discrimination by Suntrust Mortg. (May 31, 2012), http://www.justice.gov/opa/pr/2012/May/12-crt-695.html (discussing a $21 million settlement agreed to by SunTrust Mortgage Inc., after they engaged in discriminatory practices from 2005 to 2009 against African-American and Hispanic Borrowers); Press Release, Dep't of Justice, Justice Dep't Reaches Settlement with C&F Mortg. Corp. to Resolve Allegations of Lending Discrimination (Sept. 30, 2011), http://www.justice.gov/opa/pr/2011/September/11-crt-1297.html (echoing the settlement agreement that C&F Mortgage Corporation will pay, specifically $140,000, for discriminatory practices from 2007 to 2010); Press Release,

With a conservative estimate of over four million fair housing law violations a year and between roughly 25,000 and 30,000 claims and complaints being filed with the National Fair Housing Alliance (NFHA), Fair Housing Assistance Program (FHAP), and the Department of Housing and Urban Development (HUD), it is important to recognize the typical form these complaints take.[195] Common claims that fall under the heading of fair housing and lending are disparate impact, disparate treatment, failure to provide reasonable accommodation, and sexual harassment.[196] Disparate treatment includes the practice of intentionally dealing with persons differently because of their race, sex, national origin, age, or disability,[197] while failure to provide reasonable accommodations usually takes the form of certain rules, policies, practices, or services denying a handicapped person "the equal opportunity to use and enjoy a dwelling."[198] Finally, sexual harassment includes harassment "sufficiently severe or pervasive" to alter the conditions of the housing arrangement.[199] While disparate *treatment*, failure to provide reasonable accommodations and sexual harassment claims are very important for creditors and lender

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Dep't of Justice, Dep't. of Justice Reaches Settlement with Nat'l Mortg. Lender to Resolve Allegations of Lending Discrimination (Dec. 8, 2010), http://www.justice.gov/opa/pr/2010/December/10-crt-1406.html (summarizing a settlement agreement that PrimeLending has agreed to pay, specifically $2 million and modifications to their policies, for discriminatory practices from 2006 to 2009); Charlie Savage, *Wells Fargo Will Settle Mortgage Bias Charges*, N.Y. TIMES (July 12, 2012), http://www.nytimes.com/2012/07/13/business/wells-fargo-to-settle-mortgage-discrimination-charges.html?_r=0 (commenting on Well's Fargo agreeing to pay a $175 million settlement agreement for discriminating against African-American and Hispanic Borrowers between 2004 and 2009); Jessica Silver-Greenberg, *A.C.L.U. Sues Morgan Stanley Over Mortgage* Loans, N.Y. TIMES (Oct. 15, 2002), http://www.nytimes.com/2012/10/15/business/aclu-to-sue-morgan-stanley-over-mortgage-loans.html?_r=0 (claiming that the American Civil Liberties Union is currently suing Morgan Stanley for discriminatory practices against African-Americans).

195. NAT'L FAIR HOUS. ALLIANCE, FAIR HOUSING IN A CHANGING NATION: 2012 FAIR HOUSING TRENDS REPORT 5–6 (2012), *available at* http://www.nationalfairhousing.org/Portals/33/Fair%20Housing%20Trends%20Report%202012%20with%20date.pdf.

196. *Anatomy of a Fair Housing Case*, HOW. UNIV. SCH. OF L. FAIR HOUS. CLINIC, http://www.howardfairhousing.org/additional_resources/59/73 (last visited Oct. 6, 2014); *see also* Billotti et al., *supra* note 192, at 32 (stating, in California, sexual harassment is also a common claim under fair housing).

197. *See* BLACK'S LAW DICTIONARY 570–71 (10th ed. 2009) (defining disparate impact as, "the adverse effect of a facially neutral practice (esp. an employment practice) that nonetheless discriminates against persons because of their race, sex, national origin, age, or disability and that is not justified by business necessity").

198. *See Anatomy of a Fair Housing Case*, *supra* note 196 (last visited Oct. 6, 2014) (explaining the reasons to bring a claim for failure to provide reasonable accommodations by citing 42 U.S.C. § 3604(f)(3)).

199. *See* Billotti et al., *supra* note 192, at 32 (explaining how a person brings a claim for sexual harassment in a fair housing case).

to be aware of and take into account when dealing with Dodd-Frank, the biggest worry is disparate *impact* claims.[200]

There are very few areas within antidiscrimination law that have brought about as much debate and argument as the disparate impact theory.[201] From its creation in the Civil Rights Act of 1964 under Title VII[202] to its development under Supreme Court precedent[203] and strengthening under the Civil Rights Act of 1991,[204] the disparate impact theory has been a source of confusion for courts and scholars alike while still being universally accepted.[205] Whereas disparate impact theory is largely developed in employment discrimination, disparate impact theory claims under Title VIII of the Civil Rights Act of 1968, commonly known as the Fair Housing Act, are much less settled.[206] Even though the CFPB has claimed that "they *do not expect* lenders to run afoul of fair-lending laws if they opt to issue only the most basic mortgages,"[207] lenders, creditors, and mortgage originators have every right to be worried that they may face these types of claims from both private individuals and the

200. *See* American Bankers Association et al., *Request for Guidance and Clarity on Disparate Impact and Dodd-Frank Mortgage Standards*, ABA.COM, (June 4, 2013), http://www.aba.com/Advocacy/LetterstoCongress/Documents/130604_joint_trade_ltr_re_disparate_impact.pdf (expressing fear of disparate impact claims against lenders that follow Dodd-Frank).

201. Michael Selmi, *Was the Disparate Impact Theory a Mistake?*, 53 UCLA L. REV. 701, 703 (2006).

202. 42 U.S.C. §§ 2000e–2000e-17 (2006) (corresponds to the Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241).

203. *See* Selmi, *supra* note 201, at 702–03 ("Together *Griggs* and *Washington v. Davis* are widely seen as two of the most influential civil rights decisions ever issued. The *Griggs* decision has been universally hailed as the most important development in employment discrimination law."); *see also* Griggs v. Duke Power Co., 401 U.S. 424, 436 (1971) (finding that a company's employment requirements of a high school diploma and an IQ test were discriminatory); Washington v. Davis 426 U.S. 229, 230 (1976) (declaring that a law is not unconstitutional solely due to the fact it has a racially disproportionate impact regardless of it reflecting a racially discriminatory reason).

204. *See* Rosemary Alito, *Disparate Impact Discrimination Under the 1991 Civil Rights Act*, 45 RUTGERS L. REV. 1011, 1014–19 (1993) (explaining the disparate impact provisions enacted in the Civil Rights Act of 1991).

205. Lindsey E. Sacher, *Through the Looking Glass and Beyond: The Future of Disparate Impact Doctrine Under Title VIII*, 61 CASE W. RES. L. REV. 603, 603 (2011); *see also* Deborah C. Malamud, *Values, Symbols, and Facts in the Affirmative Action Debate*, 95 MICH. L. REV. 1668, 1693 (1997) (discussing the distinction between disparate impact and affirmative action, and how conservatives fear that the disparate impact may become too difficult to defend against and consequently lead to the use of affirmative action in litigation).

206. *Id.*

207. *U.S. Regulators Say No Fair-lending Problem With New Mortgage Rules*, REUTERS (Oct. 22, 2013, 2:35 PM), http://www.reuters.com/article/2013/10/22/financial-regulation-fairlending-idUSL1N0IC1DW20131022 (emphasis added).

CFPB.[208] As stated before, lenders, creditors, and mortgage originators who face class action lending discrimination lawsuits can be charged with multi-million dollar settlements.[209]

A. *Disparate Impact: What is it, Where Did it Come From, and How Can a Lawyer Use it in Fair Housing and Lending Complaints?*

i. The Beginnings of Disparate Impact: *Griggs v. Dukes Power Co.*[210]

Black's Law Dictionary defines disparate impact as "the adverse effect of a facially neutral practice . . . that nonetheless discriminates against persons because of their race, sex, national origin, age, or disability and that is not justified by business necessity."[211] An example might be a fire department that requires all of their firemen be six feet tall. A number of men could satisfy this requirement but very few women could. The policy could be attacked under a disparate impact theory because it is on its face a neutral practice; however, the requirement will obviously exclude women, one of the protected classes established by the law.[212]

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208. *See* CONSUMER FIN. PROT. BUREAU, CFPB BULLETIN 2012–04 (FAIR LENDING), at 3 (2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf (establishing that the Consumer Financial Protection Bureau will use the legal doctrine of disparate impact in its exercise of its supervisory and enforcement duties); *see also* Andrew R. Johnson, *Regional Lenders Disclose Mortgage-Loan Probes*, WALL ST. J. (Aug. 9, 2013, 12:20 PM), http://online.wsj.com/news/articles/SB10001424127887323977304579000702161112162 (giving an example of the Consumer Financial Protection Bureau implementing the legal doctrine of disparate impact in its investigation against PNC Financial Group Inc. and SunTrust Banks Inc).

209. *See, e.g.* Press Release, Dep't of Justice, Justice Dep't Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Fin. Corp., *supra* note 194 (stating that the Justice Department had reached a $335 million settlement for discriminatory lending practices by Countrywide Financial Corporation); Press Release, Dep't of Justice, Justice Dep't Reaches $21 Million Settlement to Resolve Allegations of Lending Discrimination by Suntrust Mortg., *supra* note 194 (discussing a $21 million settlement against Suntrust Mortgage for allegations of lending discrimination); Press Release, Dep't of Justice, Justice Dep't Reaches Settlement with C&F Mortg. Corp. to Resolve Allegations of Lending Discrimination, *supra* note 194 (discussing a $140,000 settlement against C&F Mortgage corporation for allegations of discriminatory lending); *see also* Press Release, Dep't. of Justice, Dep't. of Justice Reaches Settlement with Nat'l. Mortg. Lender to Resolve Allegations of Lending Discrimination, *supra* note 194 (discussing an agreement by PrimeLending to pay $2 million to settle claims of discriminatory lending).

210. Griggs v. Duke Power Co., 401 U.S. 424 (1971).

211. BLACK'S LAW DICTIONARY, *supra* note 197, at 570–71.

212. *See* Satya Thallum et al., *Using Disparate Impact Analysis to Establish Discrimination in Lending*, 9 J.L. ECON. & POL'Y 417, 419 (2013) (using the six foot fire fighter requirement policy as an example for disparate impact).

The legal doctrine of disparate impact made its debut in 1971 in the landmark Supreme Court case *Griggs v. Dukes Power Co.*[213] In *Griggs*, the Supreme Court analyzed whether Title VII of the Civil Rights Act of 1964 prohibited employers from requiring such things as high school diplomas and passage of standardize general intelligence tests, as conditions of employment or transfers to other jobs within the company.[214] The defendants in the suit, Duke Power Company from North Carolina, had intentionally segregated its workforce so "no Negro had ever held a position [in the company] in any department other than the Labor Department," by instituting a policy nine years prior to the passage of the Civil Rights Act of 1964 requiring a high school education, or its equivalent, in order to be hired or to advance to other departments within the company.[215] In response to the Civil Rights Act of 1964, Duke Power Company amended this policy to allow employees who had worked for the company prior to September 1, 1965 to become eligible if they passed two standardized tests by achieving a score equivalent to the average high school graduate.[216]

The plaintiffs in *Griggs* argued that the requirement to pass the two tests "operated to render ineligible a markedly disproportionate number of Negroes" and was "unlawful under Title VII unless shown to be job related."[217]

In its holding, the Court focuses on the two prong objective of Congress when it created Title VII: equality in employment opportunities and the removal of obstacles that had operated in the past to discriminate against African-Americans and other nonwhite minorities in favor of white employees.[218] The Court explained, "[u]nder the Act, practices, procedures, or test neutral on their face, and even neutral in terms of intent, cannot be maintained if they operate to 'freeze' the status quo of prior discriminatory intent."[219] In other words, the Civil Rights Act of 1964 prevents overt discrimination but also practices that are fair in form but discriminatory in operation.[220] This, however, does not mean that those persons who belong to a group that had formerly been discrimi-

213. *Griggs*, 401 U.S. 424.

214. *Id.* at 425–26 (1971).

215. Griggs v. Duke Power Co., 420 F.2d 1225, 1228–29 (4th Cir. 1970).

216. *Id.* at 1229.

217. *Griggs*, 401 U.S. 424, 429 (1971).

218. *See id.* at 429–30 ("The objective of Congress in the enactment of Title VII is plain from the language of the statute. It was to achieve equality of employment opportunities and remove barriers that have operated in the past to favor an identifiable group of white employees over other employees.").

219. *Griggs*, 401 U.S. 424, 430 (1971).

220. *Id.* at 431.

nated against would be given a guaranteed job; the Act simply requires "the removal of artificial, arbitrary, and unnecessary barriers to employment when the barriers operate invidiously to discriminate on the basis of racial or other impermissible classification."[221] An employer can avoid claims such as these if the practice can reasonably be shown to be a business necessity relating to job performance.[222] Consequently, because Duke Power Company could not demonstrate that the two tests requiring passage were a reasonable measure of the job performance or a business necessity, the Court ruled that it had violated the Civil Rights Act of 1964.[223]

ii. Disparate Impact Theory in Fair Housing and Lending Claims

As stated supra, disparate impact theory is largely developed in employment discrimination, and while it has been expanded to include claims under Title VIII of the Civil Rights Act of 1968 (commonly known as the Fair Housing Act) the validity of the theory is much less settled in those types of cases.[224] The purpose of the Fair Housing Act is to "provide, within constitutional limitations, for fair housing throughout the United States."[225] The Act prohibits discrimination in housing on grounds not only of race but also of "color, religion, sex, familial status and national origin."[226] Promulgating the Act was one of the ways that Congress responded to severe societal pressures and rioting in urban areas caused by "economic deprivation, social isolation, and psychological alienation" of African-Americans during the 1960s.[227]

In passing the Fair Housing Act, Congress eliminated discriminatory practices in housing, adding one more prohibition to the list of discriminatory practices they had already outlawed in the areas of voting, educa-

221. *Id.* at 430–431.

222. *Id.* at 431.

223. *Id.* at 436.

224. Sacher, *supra* note 205, at 603.

225. 42 U.S.C. § 3601 (2006).

226. *Id.* at § 3604(a) ("it [is] unlawful to refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of *race, color, religion, sex, familial status, or national origin*") (emphasis added).

227. *See* Brian Patrick Larkin, Note, *The Forty-Year "First Step": The Fair Housing Act as an Incomplete Tool for Suburban Integration*, 107 COLUM. L. REV. 1617, 1622 (2007) (discussing the National Advisory Commission on Civil Disorders (popularly known as the "Kerner Commission"), created by President Lyndon Johnson to understand factors contributing to civil unrest in the 1960s, which concluded "[a]ll Americans sought both the material assets of the capitalist system and its subsequent psychological benefits of dignity and peace of mind . . . [but] neither of these two American aspirations was attainable for the majority of black households").

tion, public accommodation, and employment.[228] The legislative history makes clear that Congress intended the Act to end discrimination in housing practices by strategically targeting middle-class African-Americans by extending equal opportunities in housing choice and orchestrating integrated living patterns.[229] To meet these goals, the Act provides a victim of housing and fair lending discrimination standing to file a lawsuit to seek relief from injuries and damages suffered from the discrimination.[230]

The Fair Housing Act has three major impacts on the housing market.[231] First, it prohibited sellers and renters from discriminating in transactions.[232] Second, the Act prevented intermediary actors, such as real estate agents and mortgage brokers, from discriminating in their assistance of transactions.[233] Third, the Act commanded the Federal Government to affirmatively promote fair housing by making the Secretary for Housing and Urban Development responsible for investigating complaints and empowering the Attorney General to bring suits against those who engage in discrimination.[234]

Even though the Supreme Court has recently granted review of two fair housing disparate impact cases,[235] both of which had been dismissed

228. *See* 114 CONG. REC. 3421–22 (1968) (statement of Sen. Walter Mondale) (noting that housing was one of the major sectors of American life where discrimination remained, and that fair housing needed to be added to the list of discriminatory practices outlawed by Congress thus "achieving equality in opportunity and education for the Negro").

229. Larkin, *supra* note 227, at 1625; *see also* 114 CONG. REC. 2279 (statement of Sen. Edward Brooke) ("Fair housing [choice and opportunity] does not promise to end the ghetto . . . but it will make it possible for those who have the resources to escape."); Richard H. Sander, *Individual Rights and Demographic Realities: The Problem of Fair Housing*, 82 NW. U. L. REV. 874, 919–21 (1988) (arguing that one reason for the Act was a belief that removing discrimination was essential for creating an economic and political environment in which integration could develop).

230. *See* 42 U.S.C. § 3612–13 (2006) (providing in detail how and why a person can file a claim under the Fair Housing Act).

231. *See* Sander, *supra* note 229, at 880 (explaining the Fair Housing Act "created a three-pronged attack upon housing discrimination").

232. *Id.*; *see also* § 3604 (making it illegal to "discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling . . . because of race, color, religion, sex, familial status, or national origin").

233. Sander, *supra* note 229, at 880; *see also* § 3608 (prohibiting intermediary actors associated with the buyer, seller, or renter from discriminating against said parties).

234. *Id.*; *see also* § 3610 (describing in detail the duties and powers given to the Secretary for Housing and Urban Development and to the Attorney General to investigate and prosecute housing discrimination).

235. Mt. Holly Citizens in Action, Inc. v. Township of Mount Holly, 658 F.3d 375 (3d Cir.), *cert. granted,* 133 S. Ct. 2824 (2013), *and cert. dismissed*, 134 S. Ct. 636 (2013); Magner v. Gallagher, 619 F.3d 823 (8th Cir.), *cert. granted*, 132 S. Ct. 548 (2011), *and cert. dismissed*, 132 S. Ct. 1306 (2012).

before being heard due to settlement by the parties out of court,[236] the Court's decision in *Metropolitan Development Corp. v. Village of Arlington* suggests that, if confronted with a disparate impact claim under Title VIII, the Court would recognize the claim.[237] In addition to this inference, all of the circuit courts have addressed the issue of whether it is possible to use the theory, and all agree the Fair Housing Act of 1968 allows for the use of the disparate impact theory in fair housing and lending cases.[238]

There are three camps in which a circuit court finds itself with regard to methods for testing disparate impact claims: the Seventh Circuit Balancing Test, the Third Circuit Burden Shifting Test, and the undecided camp of the Fifth Circuit, Eleventh Circuit, and D.C. Circuit that would allow

236. *See* Serwer, *supra* note 193 (explaining the settlement agreement reached in *Mt. Holly v. Mt. Holly Gardens* before the case could reach the Supreme Court); *see also* Kimball, *supra* note 193 (explaining the withdrawal of the city of St. Paul, Minnesota in the Supreme Court case of *Gallagher v. Magner*).

237. *See* Vill. of Arlington Heights v. Metro. Hous. Dev. Corp., 429 U.S. 252, 265–67, 271 (1977) (commenting on the unorthodox approach of the Court of Appeals and remanding the case for "further consideration of respondent's statutory [Title VIII] claims").

238. *See* Sacher, *supra* note 205, at 603–04 (citing various cases to show that all federal district courts have affirmed the use of disparate impact in fair housing and lending cases); *see also* Langlois v. Abington Hous. Auth., 207 F.3d 43, 49–50 (1st Cir. 2000) (recognizing the consensus among circuit courts that the "Fair Housing Act prohibits actions that have and unjustified disparate racial impact"); Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926, 935 (2d Cir. 1988) (discussing the practical concern of looking at the intent behind a facially neutral law that may result in disparate impact cases); Resident Advisory Bd. v. Rizzo, 564 F.2d 126, 149–50 (3d Cir. 1977) (finding that urban renewal activities had essentially removed all black families from the area, creating an all-white community and therefore providing evidence of discrimination); Betsey v. Turtle Creek Assocs., 736 F.2d 983, 988–99 (4th Cir. 1984) (remanding the case to the lower court to reevaluate whether there is a *prima facie* case of discriminatory impact); United States v. Mitchell, 580 F.2d 789, 791–92 (5th Cir. 1978) (finding that the "Fair Housing Act prohibits not only direct discrimination but practices with racially discouraging effects"); Arthur v. City of Toledo, 782 F.2d 565, 575 (6th Cir. 1986) (applying three of the four factors from the Seventh Circuit Test to determine the discriminatory effect); Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights, 558 F.2d 1283, 1290 (7th Cir. 1977) (applying a four factor test to determine the presence of disparate impact); Oti Kaga, Inc. v. S.D. Hous. Dev. Auth., 342 F.3d 871, 883 (8th Cir. 2003) (discussing disparate impact as it relates to Oti Kaga's allegations); Keith v. Volpe, 858 F.2d 467, 483 (9th Cir. 1988) (addressing the Seventh Circuit's four factor test and determining that the court is not required to show a strong showings of all four factors); Mountain Side Mobile Estates P'ship v. HUD, 56 F.3d 1234, 1250–51 (10th Cir. 1995) (identifying the relationship that disparate impact and disparate treatment have with regard to discrimination cases); Jackson v. Okaloosa County, Fla., 21 F.3d 1531, 1543 (11th Cir. 1994) (applying the disparate income theory to determine that discriminatory effects were present); Samaritan Inns, Inc. v. District of Columbia, 114 F.3d 1227, 1233-34 (D.C. Cir. 1997) (discussing Section 813(c) of the Fair Housing Act).

disparate impact claims under Title VIII but have not decided the proper test to analyze the claims under.[239]

The Seventh Circuit Balancing Test was established in *Metropolitan Housing Development Corp v. Village of Arlington Heights* (*Arlington Heights II*)[240] and has been reevaluated and modified by the Second, Sixth, and Tenth Circuits.[241] In *Arlington Heights II*, the Seventh Circuit identified the four factors a court should balance when assessing a disparate impact claim:

> (1) how strong is the plaintiff's showing of discriminatory effect; (2) is there some evidence of discriminatory intent, though not enough to satisfy the constitutional standard of Washington v. Davis; (3) what is the defendant's interest in taking the action complained of; and (4) does the plaintiff seek to compel the defendant to affirmatively provide housing for members of minority groups or merely to restrain the defendant from interfering with individual property owners who wish to provide such housing.[242]

Under the first factor, a plaintiff in a fair housing violation claim can challenge a facially neutral decision by showing at least one of the two kinds of discriminatory effects.[243] The first type of discriminatory effect is a showing that the decision has a greater effect on one minority group over another, and the second type is based on how it affects the community.[244] For example, if the decision perpetuates segregation within a community, thereby violating the goal of the Fair Housing Act and affecting the community as a whole, it does not matter the extent the disparate effect has on different racial groups.[245] It is important to note that conduct adversely affecting both whites and minorities is not an obstacle to

239. *See* John W. McGee, *Mt. Holly v. Mt. Holly Gardens: Disparate Impact and The Fair Housing Act*, 41 REAL EST. L.J. 429, 440–46 (2013) (explaining how each circuit tests disparate impact claims).

240. *Metro. Hous. Dev. Corp.*, 558 F.2d 1283, 1290.

241. *See* Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926, 935-36 (2d Cir. 1988) (stating that the four factors should be "considered in a final determination on the merits rather than as a requirement for a prima facie case"); *see also Arthur*, 782 F.2d at 575 (adopting the first, third and fourth factors from the Seventh Circuit's Balancing Test); *Mountain Side Mobile Estates*, 56 F.3d at 1252 (10th Cir. 1995) (adopting a modified version of the Seventh Circuit Balancing Test by rejecting the second factor in the Seventh Circuit Test).

242. *Metro. Hous. Dev. Corp.*, 558 F.2d 1283, 1290.

243. *Id.*

244. *Id.*

245. *Id.*

recovery, and what will be analyzed and considered by the court is the strength of the discriminatory effect.[246]

The second criterion, whether there is some evidence of discriminatory intent, when analyzed under the Seventh Circuit Balancing Test is considered by the court to be the least important.[247] The reason the court takes this view is because "discriminatory intent before relief can be granted . . . is often a burden that is impossible to satisfy" and a "strict focus on intent" could allow discrimination to go unpunished in the absence of racism.[248] This factor is considered so unimportant that when the Second Circuit adopted this test in *Huntington Branch, NAACP v. Town of Huntington*, it rejected this criterion altogether.[249]

The third factor a court using the Seventh Circuit Balancing Test must take into consideration is the defendant's interest in taking the action that caused a discriminatory effect. This element largely revolves around whether a person, private entity, or governmental entity is acting within a legally protected right or scope of authority.[250] If they are acting in the capacity, the court is less likely to find an action to violate the Fair Housing Act.[251]

The final issue to consider when using the Seventh Circuit Test is to determine and weigh the relief that the plaintiff is seeking.[252] If the plaintiff is seeking to compel the defendant to take affirmative action, such as compelling the defendant to construct integrated housing or utilize his own land for a particular purpose, the court should be reluctant to grant relief; to do so would be a massive judicial intrusion on private autonomy.[253] However, if the plaintiff is seeking to prevent the defendant from interfering with their attempts to build integrated housing on their own land, the court should be more willing to grant relief.[254]

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246. *See id.* at 1291 (finding that the plaintiff's claim is "relatively weak" or at least hard to determine with regard to the discriminatory effect, however, the court does not rule out the plaintiff's claim because either an entire minority group is not discriminated against or because only whites are affected).

247. *Id.* at 1292.

248. *Id.* at 1290.

249. Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926, 935 (2d Cir. 1988).

250. *See Metro. Hous. Dev. Corp.*, 558 F.2d 1283, 1293 (giving examples of when a court is likely to find a violation of the Fair Housing Act).

251. *Id.*

252. *Id.*

253. *Id.*

254. *Id.*

The Burden Shifting Test, first introduced by the Third Circuit in *Resident Advisory Board v. Rizzo*[255] and adopted in various forms by the First,[256] Fourth,[257] Eighth,[258] and Ninth Circuits,[259] is based on a test established for Title VII employment discrimination cases.[260] In a case under the Burden Shifting Test a "plaintiff makes a prima facie case by showing a statistical discriminatory impact."[261] The burden of proof then shifts to the defendant who must show "both a justification which serves a legitimate, bona fide interest and that no alternative course of action could be adopted that would enable the interest to be served with less discriminatory impact."[262] In the modified versions of this test established by the Eighth and Ninth Circuit, if the defendant can provide a justification, then the burden shifts back to the plaintiff to show an alternative that is less discriminatory but serves the same purpose.[263]

B. *Formally Adding Teeth to Disparate Impact Claims Under the Fair Housing Act: The Department of Housing and Urban Development's Discriminatory Effect Rule*

In February 2013, disparate impact claims received a huge boost from the Department of Housing and Urban Development's (HUD) *Implementation of the Fair Housing Act's Discriminatory Effect Standard; Final Rule*.[264] This final rule formalized HUD's "long-held interpretation of the availability of 'Discriminatory effects' liability under the Fair Housing Act" by establishing a three-part burden-shifting test.[265] Under this test, the plaintiff first has the duty to prove a prima facie case that a practice

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255. Resident Advisory Bd. v. Rizzo, 564 F.2d 126 (3d Cir. 1977) (merging Supreme Court tests for discriminatory effect).

256. Langlois v. Abington Hous. Auth., 207 F.3d 43 (1st Cir. 2000) (holding residential preference alone, absent intentional discrimination, is not a violation of Fair Housing Act).

257. Betsey v. Turtle Creek Assocs., 736 F.2d 983 (4th Cir. 1984) (holding that a defendant in a discriminatory impact housing case must show a "business necessity sufficiently compelling" to justify policy).

258. Oti Kaga, Inc. v. S.D. Hous. Dev. Auth., 342 F.3d 871 (8th Cir. 2003) (affirming lower court decision that adverse impact on a protected minority group is not enough on its own to show that the policy impacts disparately).

259. Keith v. Volpe, 858 F.2d 467 (9th Cir. 1988) (holding that the city violated the Fair Housing Act because practice adversely effected low-income citizens only).

260. *See Rizzo*, 564 F.2d 126, 148–49 (using Title VII as a guide to a Title VII claim).

261. McGee, *supra* note 239, at 442–43.

262. *Id.*

263. *Id.* at 443.

264. *See* Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11460 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100) (discussing how the Department of Housing and Urban Development has "interpreted and enforced the Fair Housing Act").

265. *Id.* at 11460.

"results in, or would predictably result in, a discriminatory effect on the basis of a protected characteristic."[266] If this is done, the burden of proof shifts to the defendant who must then prove that the discriminatory practice from the plaintiff's prima facie case is "necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests."[267] If the defendant can satisfy this requirement, the plaintiff can still establish liability if they can prove the "substantial, legitimate, nondiscriminatory interest could be served by a practice that has a less discriminatory effect."[268]

While the final rule seemingly helps to clear the split among the circuit courts over what test to use in fair housing disparate impact claims, it did not resolve the uncertainty the mortgage lending industry has surrounding disparate impact liability and compliance with Dodd-Frank. HUD notes that commentators expressed concern that the rule could lead to lawsuits for lenders who comply with Dodd-Frank and its requirements of using credit scores and other underwriting criteria.[269] Unfortunately, HUD declined to offer assurance that lenders would be protected for their compliance of the Ability-to-Repay Standard or Qualified Mortgage Standard and instead opined, without any rationale, that it does not believe the new rule will prompt any lawsuits challenging compliance with Dodd-Frank.[270] It has since reiterated that this rule is simply a long-existing standard held by the federal courts of appeal and has been recognized by the mortgage lending industry for at least the past eighteen years.[271]

VI. A Modest Proposal to Improve Regulation

Based on this research, it appears clear that the unintended consequences of the Dodd-Frank regulations will increase the calls for revision or outright repeal of Dodd-Frank. As the pendulum of regulation has swung far in the direction of overregulation, any attempts towards deregulation should be examined to determine if they are moving the pendulum too far to the underregulation side.

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266. *Id.*

267. *Id.*

268. *Id.*

269. *Id.* at 11475–76 (listing the various issues that many commentators believe will arise from the practices the rule may create).

270. *See id.* (explaining that the mortgage lending industry has recognized disparate impact claims—since, at the very least, the creation of the Joint Policy Statement—and detailing HUD's rationale for choosing not to minimize lender liability).

271. *See id.* (explaining that the mortgage lending industry has recognized disparate impact claims—since, at the very least, the creation of the Joint Policy Statement—and detailing HUD's rationale for choosing not to minimize lender liability).

We are not calling for the repeal of all regulation with respect to housing in the United States; those that call for a full "free market" overlook that such markets only achieve their equilibrium when there is full knowledge, low barriers to entry and exit, fungible products, a large number of firms relative to the market, and a complete mobility of buyers and sellers in the market.[272] The market for housing loans has relatively few of these characteristics, so a call to completely deregulate the market would be untenable. Likewise removing all responsibility for the loans made by lenders or the personal responsibility of the borrower to borrow responsibly is equally untenable. We also recognize that a wholesale repeal of the Ability-to-Repay regulations is unrealistic. However, there are certain provisions that could be modified to better serve the housing market.

First, we propose a different standard for determining when a consumer could bring an action against a lender. While it sounds appropriate to make it a "reasonable" basis for determining that a consumer had a "reasonable" ability to repay the loan, this standard is far too vague to put into practice in today's automated world. Lenders will most certainly *not* venture into loans that are not subject to the safe harbor (at least in the short term).[273] Instead, lenders will only write "qualified loans" and only to the most qualified borrowers.[274] This restricts the markets ability to innovate and design new products to meet demand, and eliminates a whole segment of the market that may, as a whole, be both responsible and profitable.

We suggest that the safe harbor be established for not just the product characteristics but also for the underwriting characteristics. For example, a scale of "points" could be established that provides a number of points for each characteristic. Borrowers scoring high enough would be subject to the safe harbor, while those below a certain point, could be required to bring on additional co-signers, put more money down, or maintain a balance in an account to cover deficiencies. The lending industry uses a very similar type of underwriting system now to determine interest rates and even the eligibility of borrowers. Incorporating such a system should neither be too costly for lenders, nor overly difficult to regulate.

272. *See Perfect Competition*, AMOSWEB ENCYCLONOMIC WEBPEDIA, http://www.amosweb.com/cgi-bin/awb_nav.pl?s=wpd&c=dsp&k=perfect+competition (last visited Oct. 26, 2014) (defining "perfect competition" as "[a]n ideal market structure characterized by a large number of small firms, identical products sold by all firms, freedom of entry into and exit out of the industry, and perfect knowledge of prices and technology").

273. *See* FANNIE MAE, *supra* note 176, at 4.

274. *See id.* at 7–8 (stating eighty-four percent of lenders surveyed expect ninety percent or more of their loans to be Qualified Mortgages, and only six percent of lenders surveyed are expecting to ease credit standards in the near future).

Second, we propose that lenders be required to retain some responsibility for the loans they make by requiring that they retain a certain percentage of the risk of default on the loans. Lenders should be required to maintain certain capital reserve requirements, much like insurers are required to do today, and the investments of those capital reserves should be sufficiently diversified (and stable) to be able to handle the inevitable downturns. Penalties should be in the hands of regulators, not in the hands of the borrower or their attorneys.

Third, we also believe that those firms that are "too big to fail" should be broken up into smaller companies similar to the breakup of the Bell telephone system in 1982–1984.[275] This would lessen the risk that any one company would be able to affect the market, and spread the risk of widespread default in any one type of loan to more firms.

Fourth, borrowers that execute a "strategic default" should be pursued by the lenders or by the regulators for the agreement they made, perhaps through the tax mechanisms.

Finally, mandatory education should be required for each first-time homebuyer. Borrowers should bear at least some responsibility to determine if a loan is appropriate for them. To fund education and other social programs to assist homeowners, a surcharge could be placed on each loan written.

VII. Conclusion

Thomas Jefferson once said, "The political institutions of America, its various soils and climates, opened a certain resource to the unfortunate and to the enterprising of every country and insured to them the acquisition and free possession of property."[276] Unfortunately, the political institutions that Thomas Jefferson spoke of have changed course. The Dodd-Frank Wall Street Reform and Consumer Protection Act is going to change the very core of the United States of America. The "American Dream" of owning a home is going to be very difficult for lower and middle class families to achieve and there is going to be a disparate impact felt by minorities in conjunction with the regulations lenders will need to follow to be in compliance with the Ability-To-Repay and Qualified Mortgage Standards.

275. *See generally* Bob Adelmann, *The Breakup of Ma Bell*, The New American (May 12, 2010), http://www.thenewamerican.com/economy/sectors/item/4297-the-breakup-of-ma-bell (describing the rise of the Bell system to monopoly status, and then further discussing its breakup in 1984).

276. Thomas Jefferson, *The Declaration on Taking Arms: July 6, 1775*, *in* Journals of the Continental Congress (1775), *available at* http://avalon.law.yale.edu/18th_century/contcong_07-06-75.asp.

There is still a chance that these segments of society will be able to fight back in the courtroom. Even with HUD's formalization of a disparate impact theory of liability under the Fair Housing Act, there are still several questions and issues that need to be resolved before any litigant will be successful in a courtroom. Specifically, courts will need to answer and resolve issues surrounding how to properly evaluate whether a disparate impact exists, what will qualify as a "substantial, legitimate, nondiscriminatory interest,"[277] whether Title VIII challenges will be able to overcome the missing provisions that are present in Title VII, and how the ruling and interpretation on certifying a class in class action lawsuits in *Wal-Mart v. Dukes*[278] affects these type of claims. In any event, the changes and damage that Dodd-Frank has caused to the American Dream will be felt for years to come.

277. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11460, 11460 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100).
278. Wal-Mart Store, Inc. v. Dukes, 131 S. Ct. 2541 (2011).