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### The Mortgage Reform and Anti Predatory Act of 2007: Paving a Secure Path for Minorities in the Midst of the Subprime Debacle.

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**THE MORTGAGE REFORM AND ANTI PREDATORY ACT OF 2007:  
PAVING A SECURE PATH FOR MINORITIES IN THE  
MIDST OF THE SUBPRIME DEBACLE**

**EMILY JEFFCOTT\***

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## I. INTRODUCTION

### A. *The Subprime Lending Crisis*

Like millions of minority Americans suffering from poor credit ratings, Roshawn Hall's family wanted to purchase a home.<sup>1</sup> Three years ago, it seemed as if their dream was coming true: they purchased their first home, a four-bedroom house in a Houston, Texas subdivision with an initial monthly payment of \$1600.<sup>2</sup> Roshawn Hall secured 100% financing of their \$186,000 home with an interest rate that would reset after two years.<sup>3</sup> Unknown how the reset would affect him, Roshawn Hall believed he would be able to afford the home.<sup>4</sup> Unfortunately, approximately ten months ago, the interest rate reset raising his payments to a stellar \$2400 per month.<sup>5</sup> Roshawn Hall is currently forced to work three jobs in order to afford the rising payment; however, he also fears foreclosure.<sup>6</sup>

Many minority Americans are faced with Roshawn Hall's predicament.<sup>7</sup> The loan Roshawn Hall secured is often referred to as a "sub-

1. See Nancy Sarnoff & Purva Patel, *Creative Financing Tools Now Biting Homeowners*, HOU. CHRON., Aug. 19, 2007, at A1, available at [http://www.chron.com/CDA/archives/archive.mpl?id=2007\\_4407652](http://www.chron.com/CDA/archives/archive.mpl?id=2007_4407652) (describing the status of Roshawn Hall's credit standing).

2. *Id.* ("Despite their less-than-stellar credit, the Halls were able to finance 100 percent of the \$186,000 home with an interest rate that would reset after two years. The initial monthly payments were about \$1,600.").

3. *Id.* (explaining that loans that reset after two years are referred to as "2/28s"). The market for such loans is now virtually non-existent as most banks refuse to offer 2/28s because the payment adjustments are difficult for consumers to handle. *Id.*

4. *Id.* (referring to Hall's belief that, "[i]t seemed so affordable at the time," which led them to make the decision to finance their home through these loans).

5. *Id.* (noting that the mortgage payment hike to \$2400.00 is not the only increase). Like Roshawn Hall, a 2/28 loan subjects many people to semiannual mortgage payment increases. *Id.*

6. Nancy Sarnoff & Purva Patel, *Creative Financing Tools Now Biting Homeowners*, HOU. CHRON., Aug. 19, 2007, at A1, available at [http://www.chron.com/CDA/archives/archive.mpl?id=2007\\_4407652](http://www.chron.com/CDA/archives/archive.mpl?id=2007_4407652) (explaining why he works three jobs and what he is sacrificing, "I have to do it. It got so bad," Hall said. "I have to sacrifice sleep right now.").

7. Clifford Krauss, *Belatedly, Some States Move to Limit Damages from Subprime Lending*, N.Y. TIMES, Aug. 24, 2007, available at <http://select.nytimes.com/search/restricted/article?res=FB0C15F93B5E0C778EDDA10894DF404482> (outlining different states and their comparative increase in the number of foreclosure filings due to the subprime market). "In North Carolina, the number of foreclosure filings increased 6 percent in 2006

prime loan,” which starts with a low, manageable interest rate that resets after a few years to a higher, often unmanageable, interest rate.<sup>8</sup> Subprime lending is concentrated among low and moderate income borrowers.<sup>9</sup> Specifically, fifty percent of all subprime loans are found within African-American neighborhoods, as compared to only nine percent in predominantly White neighborhoods.<sup>10</sup>

However, not all subprime loans result in situations similar to Roshawn Hall’s.<sup>11</sup> Subprime loans often provide valuable services to those who typically cannot secure credit through typical “prime” lending avenues.<sup>12</sup> Subprime loans give borrowers access to credit to purchase homes, make home improvements, borrow against the equity in their homes, and many

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from 2005 and that is expected to climb to 10 percent this year, said Christopher Kukla, director of state legislative affairs at the Center for Responsible Lending in Durham.” *Id.*

8. Charles Schumer, Open Forum: Safeguarding Buyers from Abuse (Aug. 27, 2007), in NAT’L MORTGAGE NEWS 4, available at 2007 WLNR 16702890 (criticizing the usage of subprime loans in situations where consumers are not apt to pay the loan at the higher interest rate). U.S. Sen. Schumer also condemns those mortgage brokers who use predatory tactics to deceive minorities and the elderly into loans they cannot afford. *Id.*

9. Baher Azmy & David Reiss, *Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002*, 35 RUTGERS L.J. 645, 654–55 (2004) (noting the strong presence of subprime lending in lower income communities).

10. *Id.* (referring to the racial disparity amongst those receiving subprime credit); Mechele Dickerson, *Bankruptcy and Mortgage Lending: The Homeowner Dilemma*, 38 J. MARSHALL L. REV. 19, 34 (2004) (noting that steering tactics are often employed against minorities and the elderly to the extent that fifty-one percent of all refinanced loans in African-American communities are subprime).

11. See generally U.S. DEP’T OF HOUS. & URBAN DEV. & U.S. DEP’T OF TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 13, at 2–3 (2000), <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (stating that the majority of subprime loans are used for consumer debt as opposed to housing purposes); see also Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 331 (2005) (illustrating the disproportionate impact of subprime lending on racial minorities). Lenders hold an interest in consumer debt and a secured interest in a residence. *Id.* “More troubling . . . is the likelihood that subprime lenders—and predatory lenders—are deliberately targeting African Americans to exploit their vulnerability and historic disconnection from financial markets.” *Id.*

12. See HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 1 (2000) available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (listing various services provided by subprime lending that would not be normally available to those with sub-par credit scores); see also Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 308 (2005) (describing how subprime products are used to broaden access to credit). Subprime lending is often praised for its ability to provide accessible credit to those who would not normally be able to access such credit. *Id.* “It is also said that subprime lending provides an opportunity for previously excluded borrowers to improve their credit rating and eventually refinance—or ‘graduate’—to a prime loan.” *Id.*

other opportunities.<sup>13</sup> However, borrowers should only choose a subprime loan if the borrower can afford future interest rate hikes. For example, a borrower can afford an interest rate increase by planning and incorporating future additional income, such as a planned salary increase or the removal of a car note.

Nevertheless, as evidenced in the current state of the financial services industry, subprime lending leads to increased debt-to-income ratios and mortgage foreclosures.<sup>14</sup> This is partly the result of the mortgage broker's failure to fully explain interest rate increases and the borrower's failure to prepare for the effects of such interest rate increases.<sup>15</sup> Ultimately, the effect of subprime lending has led to a disastrous increase in the rates of foreclosure.<sup>16</sup> Approximately 500,000 subprime mortgage

13. See HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 2-3 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> ("By providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending provides an important service, enabling such borrowers to buy new homes, improve their homes, or access the equity in their homes for other purposes.").

14. See Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L.Q. REP. 460 (2006) (noting the escalating debt-to-income ratios and mortgage foreclosures are some of the downsides to the increased availability of credit to those with poor credit standing); see also David Reiss, *Subprime Standardization: How Rating Agencies Allow Predatory Lending to Flourish in the Secondary Mortgage Market*, 33 FLA. ST. U. L. REV. 985, 997 n.79 (2006) ("The term 'home equity loan' covers many different products; it includes the traditional second lien mortgage, but 'it more commonly today refers to first liens to borrowers with impaired credit histories' and/or high debt-to-income ratios.").

15. See generally Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L.Q. REP. 460-66 (2006) (discussing the growth of the subprime lending market and how predatory lending techniques have effectuated a rise in mortgage foreclosures for unsuspecting borrowers).

16. See Clifford Krauss, *Belatedly, Some States Move to Limit Damages from Subprime Lending*, N.Y. TIMES, Aug. 24, 2007, available at <http://query.nytimes.com/gst/fullpage.html?res=9406E4D8103AF937A1575BC0A9619C8B63> (arguing that foreclosures are expected to increase with adjustable-rate mortgages resetting and as a result, borrowers will face increased monthly payments). Defaulting is at least six times more probable for subprime loans as opposed to prime loans. *Id.* See also Heather M. Tashman, *The Subprime Lending Industry: An Industry in Crisis*, 124 BANKING L.J. 407 (2007) (identifying the delinquency rates among subprime loans).

According to the Center for Responsible Lending [CRL], in a report released in December 2006 studying more than 6 million subprime mortgages made from 1998 through the third quarter of 2006, one in five subprime mortgages made in the last two years is likely to go into foreclosure. At that rate, the CRL estimates that 1.1 million homeowners who took out subprime loans in the past two years would lose their homes in the next few years. These foreclosures will cost homeowners an estimated \$74.6 billion, primarily in equity, according to the CRL. *Id.*

borrowers began foreclosure proceedings within the last year,<sup>17</sup> and this figure is expected to double in the coming years.<sup>18</sup>

Additionally, there is a subset of brokers and lenders who employ deceptive and abusive practices to deceive unsuspecting minority.<sup>19</sup> This type of lending is referred to as predatory lending.<sup>20</sup> Though not all subprime loans can be considered predatory, virtually all predatory loans are subprime.<sup>21</sup> Predatory loans are often characterized by: (1) high-interest rates that exceed the amount necessary to cover the lender's risk,<sup>22</sup> (2) excessive fees and closing costs,<sup>23</sup> (3) lending based on home equity without regard to the borrower's ability to repay,<sup>24</sup> and (4) blatant fraud.<sup>25</sup>

Within the past decade, predatory lenders have entered the subprime lending market and continually focus on low-income minorities.<sup>26</sup> Addi-

17. Clifford Krauss, *Belatedly, Some States Move to Limit Damages from Subprime Lending*, N.Y. TIMES, Aug. 24, 2007, available at <http://query.nytimes.com/gst/fullpage.html?res=9406E4D8103AF937A1575BC0A9619C8B63> (illustrating the large amount of homeowners this year with subprime loans that have begun foreclosure proceedings). "The Mortgage Bankers Association reports that 550,000 homeowners with subprime loans began a foreclosure process over the last year, and specialists say that the number could double in the next couple of years." *Id.*

18. *Id.* (speculating that the amount of homeowners with subprime loans that foreclose will dramatically increase over the coming years).

19. See Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L.Q. REP. 460, 461 (2006) (defining predatory lenders as those who "prey on the most cash-strapped borrowers to fund their dubious business practices"). While predatory lending occurs in various forms ranging from small loans to vehicle financing, there is considerable attention and legislative reform aimed at predatory lending in the home mortgage market. *Id.*

20. See generally *id.* (defining predatory lending as "a syndrome of abusive loan terms or practices" that "are often targeted at vulnerable populations and result in devastating personal losses, including bankruptcy, poverty, and foreclosure"). Economists have characterized predatory loans as transactions containing deleterious and obscure terms that result in disproportionate harm to borrowers; such transactions will often require borrowers to waive any legal recourse. *Id.*

21. See generally Susan L. Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55 (2004) (concluding that although not all subprime loans are predatory, the tactics often used in subprime lending can be characterized as predatory).

22. Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1312 (2006).

23. *Id.*

24. *Id.*

25. *Id.*

26. See HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 2 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (showing predatory lending within the subprime market has dramatically increased since 1994); Baher Azmy & David Reiss, *Modeling a Response to*

tionally, there is predominance of subprime lending in African-American neighborhoods.<sup>27</sup> In August of 2007, U.S. Sen. Charles Schumer spoke before the Senate Housing Committee and reminded the committee that “African American, Hispanics, single mothers and the elderly are targeted everyday . . . enticed into mortgages with low ‘teaser’ rates that will only reset to future payments the borrowers cannot mathematically afford.”<sup>28</sup> Through their marketing tactics, predatory lenders often step over the bounds of decency in attempting to secure subprime loans.<sup>29</sup> To

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*Predatory Lending: The New Jersey Home Ownership Security Act of 2002*, 35 RUTGERS L.J. 645, 54–55 (2004).

Subprime lending is concentrated among low and moderate-income borrowers due in part to their typically lower income-to-asset ratios and shorter or weaker credit histories. More troubling, however, is the remarkable predominance of subprime lending in African-American neighborhoods. Nationwide, 50% of all loans in predominantly African-American neighborhoods are subprime, compared to only 9% in predominantly white neighborhoods. Controlling for income, the racial disparity becomes even starker: upper income African-Americans are twice as likely as low income white borrowers to receive subprime credit. *Id.*

27. See Laura Dietrich, *Massachusetts’ New Predatory Lending Law and the Expanding Rift Between Federal and State Lending Protection*, 26 B.C. THIRD WORLD L.J. 169, 181 (2006) (finding that a significant racial disparity exists in subprime lending that cannot be explained by differences in average incomes and may be a result of racial discrimination in the lending decision process). Various statistics show that while both African-Americans and Latinos are more likely to receive subprime loans than White borrowers, African-Americans are more vulnerable than Latinos when compared to White borrowers. *Id.* See also Baher Azmy & David Reiss, *Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002*, 35 RUTGERS L.J. 645, 654–55 (2004) (explaining that fifty percent of all loans in predominantly African-American neighborhoods are subprime).

28. Charles Schumer, Open Forum: Safeguarding Buyers from Abuse (Aug. 27, 2007), in NAT’L MORTGAGE NEWS 4, available at 2007 WLNR 16702890 (using an example provided by HUD and the U.S. Treasury where subprime loans were issued five times more frequently to African-American neighborhood households as to White neighborhood households).

29. Lloyd T. Wilson, Jr., *Sometimes Less is More: Utility, Preemption, and Hermeneutical Criticisms of Proposed Federal Regulation of Mortgage Brokers*, 59 S.C. L. REV. 61, 81 n. 88 (2007) (stating that a tool frequently used by a broker is to defuse the borrower’s feelings of caution and distrust, and create a connection between the broker and borrower to cultivate a false trust). “Predatory brokers then breach the trust they have engendered by exploiting the gaps in the proscriptive, educational, and counseling methodologies. Consumers believe that the broker who works with them also works for them. Unfortunately, the law generally does not support that understanding.” *Id.* at 81; see also Baher Azmy, *Squaring the Predatory Lending Circle*, 57 FLA. L. REV. 295, 333–35 (2005) (providing examples of predatory actions to “push” borrowers into predatory loans). Victims of predatory lending are usually those with little experience in the mortgage market, making them targets of unscrupulous lenders. *Id.* at 334. “Once they identify targets, predatory lenders engage in highly aggressive direct marketing techniques, almost always advertising

date, there has been no effective legislation that protects minorities from the consequences of predatory lending.<sup>30</sup>

### B. *Pending Anti-Predatory Lending Legislation*

The current legislation aimed at regulating subprime lending and preventing predatory lending has proven largely ineffective.<sup>31</sup> The primary statutes, the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act of 1974 (RESPA), and the Home Owner's Equity Protection Act of 1994 (HOEPA), generally provide communication requirements between lenders, brokers and borrowers.<sup>32</sup> Because these statutes have not provided the necessary protections to borrowers, states

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a way to consolidate outstanding debt, refinance a home, afford home repairs, or obtain needed cash." *Id.* at 333.

30. *See generally* HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 57-101 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> ("Unscrupulous actors in the lending market, including lenders, brokers contractors and appraisers, engage in abusive sales practices that harm consumers, but may not be prohibited under current law.").

31. *See* C. Lincoln Combs, *Banking Law and Regulation: Predatory Lending in Arizona*, 38 ARIZ. ST. L.J. 617, 621 (2006).

Federal law already on the books, but so far ineffective in combating predatory lending, provides another possible definition. The Home Ownership and Equity Protection Act [HOEPA] is an attempt by the federal government to regulate certain types of high-cost loans. The HOEPA protections are triggered by loans that have an APR eight percent higher than an index tied to Treasury securities, or that have points and fees in excess of eight percent of the loan total or \$400, whichever is greater. Unfortunately for borrowers, predatory lenders have learned to easily evade this narrow definition of predatory lending to impose charges and fees that do not fit within the parameters of the HOEPA definition. Thus, almost no predatory loans are subject to its regulations. *Id.*

At the federal level, regulation has been mostly ineffective because of the lack of a "bright-line definition of 'predatory lending'" and the lobbying efforts of the mortgage industry. *Id.* at 617.

32. *See generally* Howard Mulligan, *Learning Curve: The Fair Mortgage Practices Act, TOTAL SECURITIZATION*, Aug. 6, 2007, at 12 (providing that TILA, RESPA and HOEPA all attempt to regulate the disclosures that mortgage brokers must provide to borrowers). "Although there is presently no federal regulation of mortgage brokers, there are several laws designed to address the informational asymmetry between mortgage brokers and borrowers." *Id.*



have been forced to enact their own anti-predatory legislation,<sup>33</sup> which has resulted in highly uneven practices among states.<sup>34</sup>

The subject of this comment, H.R. 3915, or The Mortgage Reform and Anti-Predatory Lending Act of 2007 (Act) is the U.S. House of Representative's attempt to achieve a bipartisan solution addressing concerns regarding unfair practices within the subprime lending market.<sup>35</sup> The bill is designed to enhance consumer protection by:

- (1) redefining mortgage origination requirements;<sup>36</sup>
- (2) resetting minimum standards for mortgage lending; and<sup>37</sup>
- (3) redefining high-cost mortgages and requirements pertaining to high-cost mortgages.<sup>38</sup>

Because of the current attention placed on the failure of the housing market, this bill is projected to be hotly debated and hopefully become enacted as federal law.<sup>39</sup>

### C. *Scope of the Comment*

This comment begins by discussing the subprime lending market and its effect on minorities, including the practices associated with predatory lending, and past federal and state responses aimed at curbing predatory lending. Part II of this comment analyzes the Act and discusses its potential problems and benefits if enacted. Finally, Part III suggests further

33. *See id.* (stating that federal legislative initiatives fail to adequately redress homeowners from brokers' abuse). Inadequacies in federal mortgage broker regulations have forced states to take matters into their own hands and introduce state regulation of mortgage brokers. *Id.* States act on the idea that they can act as gatekeepers against broker exploitation. *Id.*

34. *See id.* (asserting that state licensing is disproportionate). "Twenty-four states have no educational or experience requirements." *Id.* In addition, fourteen states have no annual reporting requirements to monitor the brokers post-licensing." *Id.* As a result of individual state regulation, highly uneven practices among states have created different brokerage standards across the nation. *Id.*

35. Press Release, Gov't Press Releases, Bachus-Gillmor-Pryce Introduce Subprime Lending Reform Legislation (July 13, 2007), available at [http://www.house.gov/apps/list/press/financialsvcs\\_dem/press102207.shtml](http://www.house.gov/apps/list/press/financialsvcs_dem/press102207.shtml) ("The Fair Mortgage Practices Act is the culmination of a 16-month effort to achieve a bipartisan solution to concerns about unfair practices within the subprime lending industry.").

36. *See generally* Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

37. *See generally id.*

38. *See generally id.*

39. *See generally* Matthew Graham, *H.R. 3915: a FRANK Discussion*, MORTGAGENEWS DAILY, [http://www.mortgagenewsdaily.com/1182007\\_HR\\_3915\\_Discussion.asp](http://www.mortgagenewsdaily.com/1182007_HR_3915_Discussion.asp) (last visited Apr. 22, 2008) (providing commentary on the upcoming H.R. 3915 vote).

regulatory action that would provide greater protection to consumers and curb the negative effects of subprime lending.

## II. LEGAL BACKGROUND

### A. *The Rise of the Subprime Lending Crisis*

Within the past ten years, the financial market has changed tremendously.<sup>40</sup> Until recently, a person with unsavory credit was unable to secure financial banking for mortgages.<sup>41</sup> Mortgage investors saw potential for this untapped demographic.<sup>42</sup> As a result, alternative, subprime loans emerged with different standards than conforming prime loans.<sup>43</sup> Typically, interest rates for conforming loans are primarily based on the risk of default.<sup>44</sup> In determining the risk of default, underwriters

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40. See, e.g., Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L.Q. REP. 460, 460 (2006) (recognizing the nationalization of banking and the ensuing removal of restrictions on interstate banking, which now provides consumers with a broader range of credit and financial services). This has resulted in greater competitiveness among financial institutions and an overall change among the financial services industry. *Id.*

41. See *id.* at 462 (fueling the change in the financial services industry was the increased availability of credit, via the emergence of subprime lending, to those who typically would not have access to credit).

42. Matthew Graham, *Current State of Mortgage Market*, MORTGAGENEWSAILY, [http://www.mortgagenewsdaily.com/1112007\\_State\\_of\\_the\\_Mortgage\\_Market.asp](http://www.mortgagenewsdaily.com/1112007_State_of_the_Mortgage_Market.asp) (last visited Apr. 22, 2008) (articulating that in order to accommodate this market, initially, alternative loans and higher interest rates were offered).

43. See Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 305 (2005) (contrasting uniform underwriting standards for prime lending and the lack of underwriting standards for those subscribing to subprime lending). “[U]nlike lenders in the prime market, subprime lenders subscribe to no uniform underwriting standards . . . Rather, a subprime lender employs its own underwriting matrix that designates a borrower as subprime[.]” *Id.* at 304–05. To compensate for the generally greater risk associated with subprime borrowers’ delinquency, default, and foreclosure, subprime loans have higher interest rates or origination charges than those of conventional prime loans. *Id.*; see also Matthew Graham, *Current State of Mortgage Market*, MORTGAGENEWSAILY, [http://www.mortgagenewsdaily.com/1112007\\_State\\_of\\_the\\_Mortgage\\_Market.asp](http://www.mortgagenewsdaily.com/1112007_State_of_the_Mortgage_Market.asp) (last visited Apr. 22, 2008).

Over time, default rates on certain “standard issue” mortgages have become very predictable. While there are many different types of mortgages, in recent history, but still before the period of so-called “meltdown,” a certain type of mortgage was by far the most common. This is a 30 year fixed mortgage, with documented income and assets, with a down payment of some sort (or compensating factors to offset it), and with a reasonably strong credit history. In general, these are the components of a “Conforming” loan. *Id.*

44. See Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 305 (2005) (employing different standards, as compared to prime lending, that designate a borrower as subprime). A borrower

look at several aspects of the mortgage: loan amount, credit score, documented income, liquid assets, amount borrowed compared to appraised value, and other factors.<sup>45</sup> Because of a lack of historical data relating to subprime loans, underwriters are forced to guess at what would be the best indicators of likelihood of default.<sup>46</sup> It is clear that the underwriters guessed incorrectly.

In addition to the lack of statistical data regarding risk of default, greed emerges as a culprit for the increase in predatory lending practices.<sup>47</sup> Predatory lenders focus on minorities and use tactics such as the “bait and switch” to lure individuals into subprime loans.<sup>48</sup> These lenders advise minority subprime borrowers of certain conditions, but at closing, those terms are in fact much worse than initially discussed.<sup>49</sup> Also, the practice of charging unjustifiably high fees on subprime loans is fla-

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may be considered to be subprime after a lender evaluates the borrower’s credit score, income and asset level in comparison to level of debt, and the borrower’s anticipated employment stability. *Id.* “The lender assigns the borrower a letter grade of A-, B, C, or D, representing correspondingly increased risk; the lender then charges more for loans it considers riskier.” *Id.*

45. Matthew Graham, *Current State of Mortgage Market*, MORTGAGENEWSAILY, [http://www.mortgagenewsdaily.com/1112007\\_State\\_of\\_the\\_Mortgage\\_Market.asp](http://www.mortgagenewsdaily.com/1112007_State_of_the_Mortgage_Market.asp) (last visited Apr. 22, 2008) (“In determining risk of default, investors look at several aspects of the mortgages that comprise MBS’s: loan amount, credit score, whether income was documented or not, liquid assets, amount borrower compared to appraised value, whether cash was taken out, and many more.”).

46. *Id.*

Interest rates were raised to account for increased risk of default and investors “guessed” at what would be the best indicators of likelihood of default. They knew it would be higher, but unlike the years and years of historical data behind conforming-type loans, there was no track record for these alternative loans. *Id.*

47. See Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government’s Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 388–90 (1994) (lenders prey on those who are particularly vulnerable homeowners). Those subject to predatory lending are often those who have substantial equity in their homes due to rising real estate and are short on money because of low/fixed incomes. *Id.*

48. See *Barkley v. Olympia Mortgage Co.*, No. 04-CV-875, 2007 U.S. Dist. WL 2437810, at 3, 4 (E.D.N.Y. Aug. 22, 2007) (acknowledging grounds for discrimination pursuant to 42 U.S.C. §§ 1981, 1982, and 1985(3) and the Fair Housing Act). “Moreover, it cannot be said that the plaintiffs’ fundamental accusation that racial considerations drove the conspiratorial engines is unsupported by the pleadings.” *Id.* at 23.

49. See *id.* at 3–4 (providing examples of “bait and switch” operations). In one example, an individual learns of the \$359,000 purchase price, and two mortgage financing at the loan closing. *Id.* at 3. Another individual learned she would also need two mortgages, one of which would require her to pay \$36,000 after fifteen years. *Id.* at 4. “[T]he complaints paint a clear picture of a carefully orchestrated, multi-player scheme in which the individual lawyers, lenders, and appraisers conspired at every step of the way to keep plaintiffs in the dark about the true terms of the deals they were entering into.” *Id.* at 12.

grant.<sup>50</sup> In typical prime lending situations, lenders set aside an escrow of money to be used for future payments of taxes and insurance.<sup>51</sup> However, in another attempt to persuade unknowing minorities, subprime lenders customarily do not provide for such escrow accounts; consequently, minority borrowers are actually quoted substantially less than what is owed.<sup>52</sup> Ultimately, the tactics employed misinform borrowers into thinking they cannot qualify for a better loan.<sup>53</sup>

The result of subprime lending is the fallout of today's housing market.<sup>54</sup> The combination of underwriters incorrectly predicting the risk of default among borrowers and the aggressive tactics used by predatory lenders have caused the greatest mortgage default experienced in

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50. See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1311–12 (2006) (explaining that subprime loans carry higher interest rates due to the high risk of default and pointing out that “[w]hile most subprime loans are not predatory, predatory loans are almost always subprime”).

Predatory loans are characterized by high interest rates and points that exceed the amount necessary to cover the lender's risk, excessive fees and closing costs that are usually financed as part of the loan, frequent refinancing or “loan flipping” with additional points and fees, lending based on home equity without regard to the borrower's ability to repay, and outright fraud. *Id.* at 1312.

51. Celeste M. Hammond, *Predatory Lending—A Legal Definition and Update*, 34 REAL EST. L.J. 176 (2005) (detailing common predatory loan terms). “Commonly mentioned predatory terms include . . . high appraisal costs; requirement of up front credit insurance; [and] yield spread premiums that area really prohibited ‘kickbacks’ to brokers.” *Id.* at 180. Predatory brokers may encourage potential borrowers to falsify information regarding their ability to pay back the loan, including encouraging applicants to inflate their income. *Id.* at 179.

52. *Id.* at 176 (illustrating how borrowers' misunderstanding of their loan terms). “At closing, the terms may be different from what the borrowers expected based upon the Good Faith Estimate required by Truth in Lending Act . . .” *Id.* at 180. Borrowers often find themselves victims of “bait and switch” tactics during closing, with more onerous terms and higher costs than originally expected. *Id.*

53. *Id.* at 176 (describing the origination practices of predatory lenders). “[S]ome borrowers who would qualify for prime loans will not be advised of any except sub-prime, and often predatory, products.” *Id.* at 180. According to research, the result is that approximately half of subprime borrowers actually could qualify for conventional financing at a lower cost. *Id.*

54. See *More Mortgage Misery*, BRISTOL EVENING POST, Jan. 24, 2008 (describing the credit fall out as a reason for the failure of the housing market); Matthew Graham, *Current State of Mortgage Market*, MORTGAGENEWS DAILY, [http://www.mortgagenewsdaily.com/1112007\\_State\\_of\\_the\\_Mortgage\\_Market.asp](http://www.mortgagenewsdaily.com/1112007_State_of_the_Mortgage_Market.asp) (last visited Apr. 22, 2008).

We have hundreds of thousands of families across the nation in homes that are worth less than what they owe. They need to refinance to get out of their ARMS, but cannot due to both lending guidelines and home values. These families default or short sell which causes the lenders to take serious damage, which in turn causes lending guidelines to be further restricted. We are only just on the way down now. The crash landing has not yet occurred. *Id.*

America's mortgage industry to date.<sup>55</sup> While most markets align with the swing of a pendulum, the subprime lending debacle toppled the pendulum resulting in the crash of today's housing market.

B. *Before The Mortgage Reform and Anti-Predatory Lending Act of 2006: The Truth in Lending Act, Real Estate Settlement Procedures Act, & Home Ownership & Equity Protection Act*

The history of mortgage reform regulation paints a picture of multiple federal attempts to provide protection to consumers while maintaining the freedoms associated with our market economy.<sup>56</sup> The Mortgage Reform and Anti-Predatory Lending Act of 2007 is not the federal government's attempt to recreate mortgage reform legislation.<sup>57</sup> Instead, it aims to improve the current existing legislation.<sup>58</sup> Thus, it is important to understand the fundamentals of previous mortgage reform legislation and the problems associated with each piece of legislation.

1. The Truth in Lending Act

In 1968, Congress created the Truth in Lending Act (TILA),<sup>59</sup> and charged the Federal Reserve Board with the responsibility of implementing TILA.<sup>60</sup> In order to implement TILA, the Federal Reserve Board

55. See Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 305 (2005).

56. See HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 1 (2000) available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> ("This report details the recommendations of the Department of Housing and Urban Development (HUD) and the Department of Treasury for legislative and regulatory action to combat predatory lending, while maintaining access to credit for low- and moderate-income borrowers.").

57. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=H110-3915> (last visited Apr. 22, 2008).

58. *Id.*

59. 15 U.S.C. § 1601 (2003).

The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices. *Id.*

60. 15 U.S.C. § 1604 (1996) (noting that "[t]he Board shall prescribe regulations to carry out the purposes of this subchapter").

created Regulation Z, which provides the strategic details of TILA.<sup>61</sup> Regulation Z requires “clear and conspicuous” disclosure of costs and key terms found in any lending arrangement.<sup>62</sup> Creditors must disclose finance charges, which are defined as “the sum of all charges, payable directly or indirectly to the person to whom the credit extend, and imposed directly or indirectly by the creditor as an incident to the extension of credit.”<sup>63</sup> Furthermore, Regulation Z requires disclosure of details relating to the annual percentage rate (APR).<sup>64</sup> The APR attempts to reflect the cost of credit expressed by comparing the costs of finance charges to the actual core amount financed.<sup>65</sup> However, the APR excludes certain costs such as title insurance, appraisal and documentation preparation fees, and thus, does not provide an accurate picture of the cost of credit.<sup>66</sup> Additionally, the Federal Reserve Board of Governors publishes standard forms that most lenders use in providing disclosure information to consumers.<sup>67</sup> TILA also requires that mortgage lenders give notice to borrowers of their right to withdraw from a loan within

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Except in the case of a mortgage referred to in section 1602(aa) of this title, these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. *Id.*

61. 12 C.F.R. § 226.1 (2003) (establishing the authority, coverage, purpose, enforcement and liability, and organization of the Federal Truth in Lending Act). “This regulation, known as Regulation Z, is issued by the Board of Governors of the Federal Reserve System to implement the Federal Truth in Lending Act, which is contained in title I of the Consumer Credit Protection Act, as amended (15 U.S.C. § 1601 et seq).” *Id.*

62. 15 U.S.C.A. § 1632 (West 2006) (“Information required by this subchapter shall be disclosed clearly and conspicuously, in accordance with regulations of the Board.”).

63. *Id.* (“The terms ‘annual percentage rate’ and ‘finance charge’ shall be disclosed more conspicuously than other terms, data, or information provided in connection with a transaction, except information relating to the identity of the creditor.”).

64. 12 C.F.R. § 226.5 (2007) (detailing the disclosure requirements a creditor shall provide to the consumer under the Federal Truth in Lending Act). “The terms finance charge and annual percentage rate, when required to be disclosed with a corresponding amount or percentage rate, shall be more conspicuous than any other required disclosure.” *Id.*

65. *Id.* § 226.22 (describing APR per Regulation Z as “the measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made”).

66. See HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 66 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (“While a single figure is easy to use, as presently designed, the APR excludes certain costs and does not therefore fully reflect the cost of credit. Congress has excluded, for example, title insurance, appraisal and document preparation fees. The Board has exclude application fees.”).

67. 15 U.S.C. § 1604 (1996).

three days of its finality.<sup>68</sup> This three-day period is extended to three years if the lender fails to properly disclose or commits a material violation of TILA.<sup>69</sup> Furthermore, borrowers facing possible foreclosure that have not exceeded the one year statute of limitations are looking to their original lending agreement to determine whether the lender fully complied with TILA requirements.<sup>70</sup> If the lender failed to do so, the borrower can rescind their loan/mortgage. The lender thus becomes another unsecured creditor who lacks priority to recover costs and must stand behind other secured creditors.

In the midst of the subprime lending crisis, two major criticisms of TILA have arisen: (1) no regulation against interest rates hikes,<sup>71</sup> and (2)

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The Board shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of subchapter and to aid the borrower or lessee in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures. In devising such forms, the Board shall consider the use by creditors or lessors of data processing or similar automated equipment. Nothing in this subchapter may be construed to require a creditor or lessor to use any such model form or clause prescribed by the Board under this section. A creditor or lessor shall be deemed to be in compliance with the disclosure provisions of this subchapter with respect to other than numerical disclosures if the creditor or lessor (1) uses any appropriate model form or clause as published by the Board, or (2) uses any such model form or clause and changes it by (A) deleting any information which is not required by this subchapter or (B) rearranging the format, if in making such deletion or rearranging the format, the creditor or lessor does not affect the substance, clarity, or meaningful sequence of the disclosure. *Id.*

68. 15 U.S.C.A. § 1635(a) (West 1995).

[T]he obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later, by notifying the creditor[.] *Id.*

69. *Id.* § 1635(f) (“An obligor’s right of rescission shall expire three years after the date of consummation of the transaction or upon the sale of the property, whichever occurs first[.]”).

70. Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 350 n. 256 (2005) (noting that both HOEPA and TILA maintain one year statutes of limitations for affirmative suits against lenders but can be raised at any time as a defense to foreclosure against assignees).

71. See generally Lloyd T. Wilson, Jr., *Effecting Responsibility in the Mortgage Broker-Borrower Relationship: A Role for Agency Principles in Predatory Lending Regulation*, 73 U. CIN. L. REV. 1471, 1498 (2005) (stating that the deficiencies in TILA could be corrected by an amendment which would not disturb the current bargain context of its mortgage lending process). “Fixing TILA’s deficiencies would not, however, appreciably increase the effectiveness of the disclosure as the mortgage broker would still have incentives to frustrate their informative effect.” *Id.* at 1498.

lack of enforcement of disclosure terms.<sup>72</sup> Therefore, while TILA provides a solution to borrowers who are unsuspectingly misled into obtaining a subprime loan, it provides no preventative measure, and borrowers are still potentially at risk for subprime loans that they will not be able to afford.<sup>73</sup>

## 2. Real Estate Settlement Act

In 1974 Congress created the Real Estate Settlement Act (RESPA) with the purpose of (1) implementing more effective disclosures to home buyers of settlement costs, and (2) preventing kickbacks or referral fees that unnecessarily increase settlement costs.<sup>74</sup> The specific details regarding RESPA implementation are found within Regulation X.<sup>75</sup> RESPA and Regulation X attempt to improve borrower disclosure by requiring

72. Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*; 14 CORNELL J.L. & PUB. POL'Y 199, 204 (2005) (discussing the Lending Act and the basics and critiques of TILA).

Critics have questioned the efficacy of TILA's mandatory disclosure regime based on both empirical evidence and theories regarding consumer behavior. Some of these critiques emphasize deficiencies in the disclosures themselves, while others focus on the ability or likelihood of consumers to utilize the disclosures. Put bluntly, many critics simply do not think that disclosure works. They doubt that TILA has achieved its purpose of reducing information asymmetries and facilitating comparison-shopping for credit, and ultimately stimulating a more competitive credit market. Specifically, such critics point to particular problem areas within the consumer credit market, such as the much-analyzed issue of predatory lending, as proof of the limits of disclosure remedies. *Id.*

73. *Affordable Real Estate Transactions*, 20 PROB. & PROP. 56, 58 (2006) (targeting low income borrowers with predatory and subprime loans). Those lenders of predatory and subprime loans use the leverage of the current equity of the low-income borrower. *Id.* Upon finalization of the subprime loan, the low-income borrower faces paying a high interest loan that he may not be able to afford. *Id.* Often, the only option available to low-income borrower is to foreclose the property. *Id.*

74. See Real Estate Settlement Procedures Act Amendments of 1975 (RESPA), 12 U.S.C.A. § 2601(b) (West 2001) (seeking to protect consumers against abusive practices and to ensure that consumers are provided with more timely information regarding the nature and costs of the settlement process); see also *Wash. Mut. Bank v. Super. Ct. Los Angeles County*, 75 Cal. App. 4th 773, 776, 779 (Cal. Ct. App. 1999) ("RESPA and Regulation X require certain disclosures be made to borrowers by lenders both at the time of application for a loan and at the time of closing of the loan, including disclosure of charges that the borrower will have to pay for settlement services such as credit reports, appraisal fees, recording fees, wire transfer fees, and other loan related services.").

75. Real Estate Settlement Procedures Act Amendments of 1975 (RESPA), 12 U.S.C.A. § 2601(b) (West 2001).

(b) It is the purpose of this chapter to effect certain changes in the settlement process for residential real estate that will result—

- (1) in more effective advance disclosure to home buyers and sellers of settlement costs;



disclosure throughout the application and closing process.<sup>76</sup> Specifically, at the time of application, the lender must provide the applicant with an informative pamphlet explaining the settlement process, including a good faith estimate of the charges for particular settlement.<sup>77</sup> The good faith estimate must be completed on a uniform settlement statement form known as the HUD-1.<sup>78</sup> The HUD-1 form must clearly and conspicuously itemize all charges upon which the borrower is responsible.<sup>79</sup> In addition, to prevent kickbacks or referral fees, RESPA prohibits a person from paying or receiving anything of value for business incidentals to or part of a real estate “settlement service,” involving a “federally related mortgage loan.”<sup>80</sup>

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- (2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;
  - (3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and
  - (4) in significant reform and modernization of local recordkeeping of land title information. *Id.*

76. Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 296 (2007) (explaining the impact of yield spread premiums on consumers, particularly minorities).

Specifically, the amended regulations require that “[a]ny other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, including a servicing release premium or yield spread premium” be disclosed to the borrower on the HUD-1 settlement statement. The amendment did not explicitly address whether the payment of yield spread premiums might run afoul of RESPA’s prohibition against kickbacks and unearned fees. *Id.*

77. 12 U.S.C.A. § 2604(a) (West 2001) (requiring that the secretary prepare and distribute books that provide borrowers to better understand the nature and costs of mortgages). “The Secretary shall prepare and distribute booklets to help persons borrowing money to finance the purchase of residential real estate better to understand the nature and costs of real estate settlement services. The Secretary shall distribute such booklets to all lenders which make federally related mortgage loans.” *Id.* “Each lender shall include with the booklet a good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary.” *Id.* § 2604(c).

78. *Id.* § 2603(a) (“The Secretary . . . shall develop and prescribe a standard form for the statement of settlement costs which shall be used . . . as the standard real estate settlement form in all transactions in the United States which involve federally related mortgage loans.”).

79. *Id.* (granting the HUD secretary the responsibility of creating a standard form of settlement costs). “Such form shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement and shall indicate whether any title insurance premium included in such charges covers or insures the lender’s interest in the property, the borrower’s interest, or both.” *Id.*

80. Real Estate Settlement Procedures Act Amendments of 1975 (RESPA), 12 U.S.C.A. § 2601(a)(b) (West 2001).

The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and

Despite its attempt to protect the borrower, neither RESPA nor Regulation X provides a provision that establishes a private right of action if a lender fails to comply with the HUD-1 form.<sup>81</sup> Instead, enforcement of the disclosure provisions of RESPA and Regulation X are delegated to the secretary of the Department of Housing and Urban Development.<sup>82</sup> If the secretary finds a violation, the lender and broker may be exposed to a penalty of the three times the amount of any charge paid for unlawful settlement services.<sup>83</sup> Although this penalty provides a measure of relief to the borrower, RESPA and Regulation X do not prevent against predatory lending nor provide a direct means for the borrower to recover if proper disclosure is not met.<sup>84</sup>

### 3. Home Ownership and Equity Protection Act

In 1994, Congress amended TILA through the Home Ownership and Equity Protection Act (HOEPA).<sup>85</sup> HOEPA purports to respond to the

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more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. *Id.*

*Wash. Mut. Bank*, 75 Cal. App. 4th at 779, 789 (defining a “settlement service” as “any service provided in connection with a real estate settlement” and includes services such as title searches, appraisals, credit reports, and loan processing.”). “Federally related mortgage loans” are defined as “loans secured by a first or subordinate lien on residential property designed for occupancy by one to four families and that are made in whole or in part by any lender whose deposits or accounts are federally insured or by a lender that is federally regulated.” *Id.*

81. 12 U.S.C.A. § 2604(d) (West 2001) (requiring that the booklets be delivered within three business days after the lender receives the application).

82. 24 C.F.R. § 3500.19(a) (2003).

83. 12 U.S.C.A. § 2607(d)(2) (West 2005).

Any person or persons who violate the prohibitions or limitations of this section shall be jointly and severally liable to the person or persons charged for the settlement service involved in the violation in an amount equal to three times the amount of any charge paid for such settlement service. *Id.*

84. Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 447–48 (2005) (noting that “administrative enforcement of the disclosure requirements of RESPA and Regulation X regarding settlement costs is the responsibility of the Secretary of the Department of Housing and Urban Development and other federal, state, and local agencies that have supervisory powers over lenders and others covered by RESPA.”).

85. 15 U.S.C.A § 1639 (West 1994) (providing specific disclosure requirements).

In addition to other disclosures required under this subchapter, for each mortgage referred to in section 1602(aa) of this title, the creditor shall provide the following disclosures in conspicuous type size: “You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application[.]” “If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligation under the loan.” *Id.*

problem of predatory home mortgage lending.<sup>86</sup> Simply, the amendments create a special class of high-cost mortgages that are subject to added regulation.<sup>87</sup> Not only are high-cost mortgages subject to special disclosure requirements, but also, more importantly, these mortgages are subject to strict restrictions on terms typically used by predatory lenders.<sup>88</sup> For example, several of the substantive requirements to a high-cost mortgage include: the loan must be amortized,<sup>89</sup> the loan may not include penalty interest rate increases activated by late payment,<sup>90</sup> and may not include balloon payments where the loan terms exceed five years.<sup>91</sup> In addition, lenders are prohibited from offering HOEPA covered loans based on the applicant's collateral rather than their ability to repay the debts.<sup>92</sup>

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86. Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 444 (1994) (stating that HOEPA was enacted in response to the problem of predatory lending).

87. See 15 U.S.C. §1602(aa)(1)(A)-(B) (1994) (identifying a class of high-cost mortgages subject to greater regulation); see Michael J. Pyle, Comment, *A "Flip" Look at Predatory Lending: Will the Fed's Revised Regulation Z End Abusive Refinancing Practices?*, 112 YALE L.J. 1919, 1922 (2003); see also Lisa Keyfetz, *The Home Ownership and Equity Protection Act of 1994: Extending Liability for Predatory Subprime Loans to Secondary Mortgage Market Participants*, 18 LOY. CONSUMER L. REV. 151, 173-76 (2005) (stating that HOEPA only applied to a certain class of mortgages that are deemed high cost when certain point and fee triggers have been met).

88. See Lisa Keyfetz, *The Home Ownership and Equity Protection Act of 1994: Extending Liability for Predatory Subprime Loans to Secondary Mortgage Market Participants*, 18 LOY. CONSUMER L. REV. 151, 173-76 (2005) ("HOEPA, an amendment to TILA, prohibits loans from including certain abusive terms, and also expands TILA's disclosure requirements.").

89. 12 C.F.R. § 226.32(d)(2) (2001) (defining negative amortization as "[a] payment schedule with regular periodic payments that cause the principal balance to increase.").

90. *Id.* § 226.32(d)(4) (defining an increased interest rate as "[a]n increase in the interest rate after default.").

91. *Id.* § 226.32(d)(1)(i) (defining a balloon payment as "a loan with a term of less than five years, a payment schedule with regular periodic payments that when aggregated do not fully amortize the outstanding principal balance"). The limitations of § 226.32(d)(1)(i) "do not apply to loans with maturities of less than one year, if the purpose of the loan is a 'bridge' loan connected with the acquisition or construction of a dwelling intended to become the consumer's principal dwelling." *Id.* § 226.32(d)(1)(ii).

92. 15 U.S.C.A. § 1639(h) (West 1994) (prohibiting a lender from extending credit without regard to the consumer's ability to repay). "A creditor shall not engage in a pattern or practice of extending credit to consumers under mortgages referred to in section 1602(aa) of this title based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, an employment." *Id.*

To qualify into the special class, HOEPA provides for a price threshold triggers.<sup>93</sup> The first price threshold trigger is based on the set interest rate.<sup>94</sup> If the APR is more than eight points above Treasury bill rates, then the trigger is met and the mortgage is subject to the restrictions.<sup>95</sup> The second trigger is based on the points and fees associated with the loan closing.<sup>96</sup> When points and fees exceed eight percent of the loan amount, the mortgage is considered high cost and subject to the additional restrictions.<sup>97</sup> To ensure that HOEPA provisions do not apply to loans, predatory lenders typically offer loans that fall just below HOEPA's standards.<sup>98</sup> Therefore, very few loans are subject to HOEPA

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93. Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2227 (2007) (explaining that price threshold triggers create a special class of mortgages).

Non-purchase money mortgage loans are covered under HOEPA if their terms exceed either one of two price threshold triggers. The first price threshold is based on the interest rate, while the second is based on the points and fees associated with closing the loan. If a mortgage loan is covered by the relatively narrow scope of HOEPA, then the lender must deliver a special advance warning at least three days prior to consummation. *Id.*

94. 15 U.S.C.A. § 1639(a)(2) (West 1994).

In addition to the disclosures required under paragraph (1), the creditor shall disclose—in the case of a credit transaction with a fixed rate of interest, the annual percentage rate and the amount of the regular monthly payment; or in the case of any other credit transaction, the annual percentage rate of the loan, the amount of the regular monthly payment, a statement that the interest rate and monthly payment may increase, and the amount of the maximum monthly payment, based on the maximum interest rate allowed pursuant to section 3806 of Title 12. *Id.*

95. See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1317–18 (2006) (describing the new HOEPA regulations contained 12 C.F.R. § 226.32(a)(1)(i)(2001)).

96. 15 U.S.C.A. § 1639 (West 1994) (discussing the annual percentage rate that is required to be disclosed).

97. See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1316 (2006).

98. See HUD-TREASURY TASK FORCE ON PREDATORY LENDING, CURBING PREDATORY HOME MORTGAGE LENDING 85 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf>.

HOEPA's disclosures and restricted loan terms and conditions are intended to increase the amount of information available to consumers about a set of high-cost loans, and to protect them from potentially abusive terms such a short-term balloon payments and negative amortization. However, evidence suggests that due to the high thresholds that a loan must exceed in order for HOEPA to apply, very few consumers in the subprime market benefit from the law's provisions. *Id.*

measures, and thus the protections offered by HOEPA are disingenuous at best.<sup>99</sup>

### C. *State Statutes Acting Against Predatory Lending*

The ineffectiveness of federal legislation has caused over twenty-five states to enact laws restricting predatory lending.<sup>100</sup> These laws generally include provisions that limit interest rates and fees that a lender may charge, prohibit lending to borrowers without their ability to repay, require refinancing to provide a net tangible financial benefit to the borrower, prohibit excessive prepayment penalties, full disclosure requirements and counseling for borrowers.

In 1999, North Carolina became the first state to enact predatory lending legislation.<sup>101</sup> Similar to HOEPA, the North Carolina statute defines high-cost loans, but the triggers are set at lower point levels than HOEPA triggers.<sup>102</sup> Thus, a greater number of loans are considered predatory as the enhanced triggers prompt earlier implementation of restrictions.<sup>103</sup> Additionally, the Georgia statute provides specific requirements for high-cost loans. For example, in addition to the aforementioned provisions, the statute prohibits balloon payments, call provisions giving a lender discretion to accelerate the loan, financing of any points or fees or charges to a third party, financing insurance premiums and “flipping” for all consumer home loans.<sup>104</sup> Ultimately, the North Carolina statute offers greater protection than HOEPA in preventing predatory lending.

Although the mortgage industry fears that state intervention would result in reduction of access to credit by borrowers and higher lending costs,

99. See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1317 (2006) (“Consumer advocates have criticized HOEPA as being ineffective in part because it is not sufficiently inclusive. First, very few subprime loans exceed the interest rate threshold. In fact, lenders may keep interest rates just below the HOEPA trigger in order to avoid the Act’s requirements.”).

100. Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 451 (2005) (explicating that the statutes effectiveness is undermined due to the weak enforcement provisions of federal lending statutes).

101. KEITH ERNST, JOHN FARRIS & ERIC STEIN, NORTH CAROLINA’S SUBPRIME HOME LOAN MARKET AFTER PREDATORY LENDING REFORM, A REPORT FROM THE CENTER FOR RESPONSIBLE LENDING, at iii (2002), available at [http://www.responsiblelending.org/pdfs/HMDA\\_Study\\_on\\_NC\\_Market.pdf](http://www.responsiblelending.org/pdfs/HMDA_Study_on_NC_Market.pdf) (“In 1999, North Carolina enacted the nation’s first state law to curb predatory mortgage lending.”).

102. N.C. GEN. STAT. ANN. § 24-1.1 (West 2004) (distinguishing North Carolina predatory lending statute from HOEPA).

103. *Id.* (emphasizing the lower threshold needed to trigger HOEPA).

104. *Id.* (enumerating specific protections provided by the North Carolina predatory lender statute).

consumer advocates have cited North Carolina as a success.<sup>105</sup> For example, studies have shown that although subprime lending continued to grow, in 2001, the statute prevented predatory lending on at least 31,500 loans.<sup>106</sup>

Similarly, the Georgia Fair Lending Act in its original form was the strongest anti-predatory lending legislation in the nation. The original statute created three categories of loans: (1) home loans, (2) covered home loans, and (3) high-cost home loans.<sup>107</sup> The covered home loans and high-cost home loans categories were defined based on a loan's APR or on points and fees charged.<sup>108</sup> The statute provided different restrictions for each category. The restrictions were similar to those implemented in North Carolina. However, there was one glaring exception; the Georgia Fair Lending Act provided that purchasers of high costs home loans were made "subject to all affirmative claims and any defenses with respect to the loan that the borrower could assert against the original creditor."<sup>109</sup> This provision caused rating agencies to refuse to rate mortgage-backed securities containing any loans originated in Georgia.<sup>110</sup>

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105. Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 452 (2005) ("The studies indicate that while subprime lending continued to thrive in North Carolina, the statute prevented predatory terms on 31,500 subprime loans that were made in 2000 and saved borrowers at least \$100 million.").

106. KEITH ERNST, JOHN FARRIS & ERIC STEIN, NORTH CAROLINA'S SUBPRIME HOME LOAN MARKET AFTER PREDATORY LENDING REFORM, A REPORT FROM THE CENTER FOR RESPONSIBLE LENDING, at iii (2002), available at [http://www.responsiblelending.org/pdfs/HMDA\\_Study\\_on\\_NC\\_Market.pdf](http://www.responsiblelending.org/pdfs/HMDA_Study_on_NC_Market.pdf) ("[B]y preventing predatory terms on 31,500 subprime loans made in North Carolina in 2000, the law is estimated to have saved borrowers more than \$100 million.").

107. GA. CODE ANN. § 7-6A-2(9) (Supp. 2002) (articulating the three categories of loans specified in the original statute).

108. *Id.* § 7-6A-2(6), (8), (19) (explaining how the home loan categories were defined based on APR points or on points and fees charged).

109. *Id.* § 7-6A-6 (distinguishing the Georgia and North Carolina statutes with regard to the restrictions imposed).

110. See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1321 (2006).

After the Georgia legislature enacted the GFLA, rating agencies responded by refusing to rate mortgage-backed securities secured by pools of residential loans containing any loans originated in Georgia after the effective date of the statute. One of the primary concerns of the rating agencies and lenders was that assignees would have unlimited liability for claims that the borrower could assert against the originator. In response, the Georgia legislature amended the assignee liability provision of the GFLA to add a safe harbor for lenders who exercise reasonable due diligence to avoid purchasing high-cost home loans and to limit the liability of those lenders who do not fit within the safe harbor. The rating agencies subsequently announced that they would again rate pools with Georgia loans. *Id.*

The rating agencies' voiced concern over the potential unlimited liability the borrower could assert against the original lender.<sup>111</sup> Georgia quickly reacted by amending the Georgia Fair Lending Act to include a safe harbor provision for those lenders who acted in reasonable due diligence in avoiding purchasing high-cost home loans, and additionally limited the liability of those lenders who did not fit within the provision.<sup>112</sup>

#### D. *Preemption of State Predatory Lending Regulations*

Although there has been demonstrated success in state anti-predatory lending legislation, federal preemption statutes now limit their effectiveness.<sup>113</sup> In 1996, the Office of Thrift Supervision (OTS) issued regulations limiting state regulatory powers over national banks.<sup>114</sup> Expounding on this statute and acting within the sixth Amendment of the U.S. Constitution, in 2004 the Federal Office of the Comptroller of Currency (OCC) issued 12 C.F.R. 7.4006, which applied to state-chartered operating subsidiaries of national banks.<sup>115</sup> This statute clarifies the OCC's exclusive power over national banks, regardless if the bank is a state originated bank.<sup>116</sup> The rules preempt any state law that obstructs, impairs or conditions a national bank's ability to exercise the power

111. *See id.* at 1339.

112. GA. CODE ANN. § 7-6A-6 (Supp. 2002) (explaining how the Georgia legislature amended the statute to protect good faith lenders).

113. Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 382-384 (2005) (calling into view that current preemption statutes would affect at least ten percent of the companies that engage in subprime lending).

114. 12 C.F.R. § 560.2(b) (1996) (indicating that the types of state laws that are preempted by part (a) of § 560.2 include state laws regarding licensing, registration, filings, credit enhancements, loan-to-value ratios, terms of credit, adjustments to interest rate, term to maturity of the loan, loan-related fees, escrow and impound accounts, access to and use of credit reports, advertising and disclosure, processing and sale of mortgages, and others); *see also* Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1339 (2006) (stating that the regulation specifically preempts state laws that impose requirements regarding licensing, credit terms, loan fees, disclosure requirements, origination and interest rate ceilings).

115. Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1917 (Jan. 13, 2004) (codified at 12 C.F.R. 34.4(a) (2005)); *see* Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1340 (2006) (preempting state laws that "obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized lending powers").

116. Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (explaining how the federal statutory authority extends to state and originated banks).

granted to it under federal law.<sup>117</sup> The constitutionality of the statute was upheld in the U.S. Supreme Court decision *Watters v. Wachovia*.<sup>118</sup> The Supreme Court specifically held that the OCC's federal regulation provides national banks with "the power to engage in real estate lending through an operating subsidiary, subject to the same terms and conditions that govern the national bank itself; that power cannot be significantly impaired or impeded by state law."<sup>119</sup> The statute does not preempt national banks from complying with state law in regards to the business of banking.<sup>120</sup> Therefore, causes of action will still exist under contract law, tort law, and various other types of laws.<sup>121</sup>

Many states worry that preemption statutes similar to the aforementioned may prevent states from experimenting with (and thus potentially preventing) laws regulating predatory lending.<sup>122</sup> In addition, consumer protection has traditionally been primarily been a state responsibility and the majority of federal involvement has been concurrent to state regulation.<sup>123</sup>

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117. *Id.* (explaining the way in which the statutory rules preempt any conflicting state laws or regulations).

118. See *Watters v. Wachovia*, 127 S. Ct. 1559, 1573 (2007) ("Watters' alternative argument, that 12 CFR § 7.4006 violates the Tenth Amendment to the Constitution, is unavailing. As we have previously explained, '[i]f a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States.' Regulation of national bank operations is a prerogative of Congress under the Commerce and Necessary and Proper Clauses. The Tenth Amendment, therefore, is not implicated here.").

119. *Id.* at 1572 (emphasizing that the National Bank Act already conveyed what § 7.4006 confirmed and clarified). "Beyond genuine dispute, state law may not significantly burden a national bank's own exercise of its real estate lending power, just as it may not curtail or hinder a national bank's efficient exercise of any other power, incidental or enumerated under the NBA." *Id.* at 1567–68.

120. 12 C.F.R. § 560.2(c) (1996) (explaining that state laws which only incidentally affect lending operations of the federal savings associations or state laws that are consistent with the purposes of § 560.2 are not preempted).

121. *Id.* (clarifying that § 560.2 does not preempt state laws concerning contract law, commercial law, real property law, homestead laws, tort law, criminal law, or any other law that the Office of Thrift Supervision finds furthers state interests); see Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1339 (2006) (providing that the regulation does not preempt state laws that only incidentally affect lending operations).

122. See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1361–1362 (2006) (preempting state anti-predatory lending statutes will reduce experimentation among the states and, thus, prolong a potential solution).

123. See *id.* at 1359–1360 (informing that consumer protection is generally a state handled matter and most federal involvement is in addition to state consumer protection laws).



### III. POTENTIAL PROBLEMS AND BENEFITS OF THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2007

On October 22, 2007, The Mortgage Reform and Anti-Predatory Lending Act (Act) was introduced by U.S. Rep. Bradley Miller and cosponsored by twenty-two of his colleagues.<sup>124</sup> By amending TILA, the Act purports to prevent the potentially catastrophic effects felt currently in the home mortgage market due to predatory subprime lending.<sup>125</sup> The Act divides the amendments into three distinct sections: (1) mortgage origination; (2) high-cost mortgages; and (3) minimum standards for mortgages.<sup>126</sup> This section will delve into the major provisions each section, discussing each provisions potential problems and benefits.

#### A. Amendments Pertaining to Mortgage Origination

A mortgage originator, as defined by the Act, is “any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain— (i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan.”<sup>127</sup> In an attempt to reduce the fraud and greed associated with subprime lending, federal regulators attempt to aim straight at the source: mortgage brokers.<sup>128</sup> The Act proposes regulating brokers by requiring states to impose licensing requirements for all brokers, establishing a nationwide mortgage broker registry, and prohibiting the steering of kick backs, otherwise known as yield spread premium (YSP).

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124. H.R. 3915 Mortgage Reform and Anti-Predatory Act of 2007, Bill Summary, available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.03915> (last visited Apr. 22, 2008) (noting that bill had twenty-seven co-sponsors when introduced in the U.S. House of Representatives).

125. Press Release, House Comm. on Fin. Servs., Comprehensive Mortgage Reform and Anti-Predatory Lending Legislation Introduced in the House (Oct. 22, 2007), available at [http://www.house.gov/apps/list/press/financialsvcs\\_dem/press102207.shtml](http://www.house.gov/apps/list/press/financialsvcs_dem/press102207.shtml) (arguing that the proposed legislation will “combat abuses in the mortgage lending market, and to provide basic protections to mortgage consumers and investors.”).

126. See Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 1(b) (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008) (listing table of contents).

127. *Id.* § 101 (defining “loan originator” for the purposes of the statute).

128. 24 C.F.R. § 3500.2(b) (1997) (defining mortgage broker for the first time as “a person (not an employee of a lender) who brings a borrower and lender together to obtain a federally related mortgage loan”).

### 1. Licensing and registry of Mortgage Brokers

Currently, the majority of states have passed legislation requiring mortgage brokers to obtain a license and/or register with the state agency charged with enforcing mortgage financial regulations.<sup>129</sup> However, the requirements differ between states; the majority of states employ some sort of combination of education, testing, criminal background checks, professional compliance audits and surety bond requirements.

The Act does not intend to preempt state legislation regarding licensing requirements.<sup>130</sup> Instead, the Act sets forth the minimum requirements for licenses: training and a background check before receiving a license, and continued education and ongoing training as a condition for maintaining and renewing a license.<sup>131</sup> If, after twenty-four months of the enactment of the Act, a state does not have in effect a state licensing law that meets the requirements set forth, the Act prescribes the secretary of Housing and Urban Development with the power to determine the specific, appropriate requirements.<sup>132</sup>

129. David Unseth, *What Level of Fiduciary Duty Should Mortgage Brokers Owe Their Borrowers?*, 75 WASH. U. L.Q. 1737, 1752–53 (1997).

States currently possess several methods for regulating mortgage brokers. First, states may impose licensing requirements on mortgage brokers. . . . In addition to licensing requirements, states can regulate the activities of mortgage brokers through various types of consumer protection laws that permit borrowers to sue mortgage providers for certain violations. These laws typically require lenders (including mortgage brokers) to disclose all relevant loan terms and fees, including any yield-spread premiums. *Id.*

130. See Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 104 (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008) (licensing of mortgage originator occurs when an originator qualifies under a qualifying state licensing law, because no pre-emption clause exists in the Act except as related to remedies against assignees, securitizes, or securitization vehicles).

131. *Id.* § 101 (establishing that the loan originators must meet annual continued education requirements in order to renew their licenses).

132. See *id.*

If . . . the Secretary determines that a State does not have in place by law or regulation a system for licensing and registering loan originators that meets the requirements of sections 104 and 105 and subsection (d) or does not participate in the Nationwide Mortgage Licensing System and Registry, the Secretary shall provide for the establishment and maintenance of a system for the licensing and registration by the Secretary of loan originators operating in such State as State-licensed loan originators. *Id.*

In particular the Act provides that state can only meet the requirements for a satisfactory state licensing system if the supervising authority is constructed in such a way to provide effective termination or suspension of a license for a violation of state or federal law, ensures that all state licenses loan originators are registered with the Nationwide Mortgage Licensing System and Registry, and that violations and enforcement actions are regularly reported to the Nationwide Mortgage Licensing System and Registry. *Id.*

In addition to requiring broker licensing, the Act also requires that all brokers participate in a nationwide registry regime.<sup>133</sup> The Act does not detail which nationwide registry will be used to house mortgage broker information.<sup>134</sup> The Act only lists that the registry must, at a minimum, provide a unique identifier for each mortgage broker and the relevant information regarding those mortgage brokers.<sup>135</sup> The relevant information to be disclosed is left to the discretion of the secretary of Housing and Urban Development.<sup>136</sup>

As minorities are often deceived by brokers into accepting higher interest rates than are warranted by their credit standing,<sup>137</sup> requiring background checks and training prior to licensing provides a measure of

133. *Id.*

If the Secretary has not certified any registry as a qualified nationwide registration regime by the end of the 18-month period beginning on the date of the enactment of the Mortgage Reform and Anti-Predatory Lending Act of 2007, or if a certified nationwide registration regime fails to meet the requirements under this title for such a regime, the Secretary shall establish a qualified nationwide registration regime that provides a comprehensive licensing and supervisory database for mortgage originators to carry out the purposes of this section and the effective regulation of mortgage originators licensed under a qualifying State licensing law or by the Secretary under paragraph (2). *Id.*

134. *See generally id.*

135. *See* Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 101 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

In determining whether to certify a nationwide registration regime, the Secretary shall determine that the regime at a minimum— (A) provides and maintains a unique identifier for each mortgage originator participating in the regime; and (B) provides relevant and timely information to consumers, industry participants, and Federal and State regulatory agencies (including any enforcement actions relating to any mortgage originator). *Id.*

The purpose of the unique identifier is to assist public access to information regarding loan originators, including their employment history as well as disciplinary and enforcement proceedings against them. *Id.*

136. *See id.* (stating that at a minimum mortgage broker shall provide fingerprints for submission to the FBI as well as personal history and experience for identification purposes).

137. *See* Laura Dietrich, *Massachusetts' New Predatory Lending Law and the Expanding Rift Between Federal and State Lending Protection*, 26 B.C. THIRD WORLD L.J. 169, 174 (2006) (stating that brokers are able to convince borrowers to accept higher interest rates than are warranted by their credit). Brokers are able to persuade borrowers to accept unjustifiably high interest rates because borrowers are typically unaware or misinformed about their actual credit status. *Id.* If borrowers erroneously believe they have bad credit, they are likely to accept excessively high interest rates offered by unscrupulous lenders. *Id.*

protection against unsavory and incompetent brokers.<sup>138</sup> However, because the majority of states currently implement licensing laws that meet the Act's basic requirements, this provision is inherently duplicitous.<sup>139</sup> Additionally, there exists an additional fear that a broker that will promote himself as "federally approved" in addition to "state approved."<sup>140</sup>

Also, the Act entails an unnecessary amount of work. The Act does not preempt state laws establishing licensing requirements.<sup>141</sup> Thus, between states, the licensing requirements could differ significantly.<sup>142</sup> It is unduly burdensome to require a broker of multiple states to abide by separate licensing requirements and maintain a separate license for each state.<sup>143</sup> The Act charges the secretary of Housing and Urban Develop-

138. See David Unseth, *What Level of Fiduciary Duty Should Mortgage Brokers Owe Their Borrowers?*, 75 WASH. U. L.Q. 1737, 1751–52 (1997) (describing the various ways in which states regulate mortgage brokers, while illustrating that only a minority of states consider the competence of the broker when issuing licenses).

139. See *id.* (providing statistical information on which states maintain some sort of licensing requirements over mortgage brokers).

Currently, thirty-nine states require some level of licensing for mortgage brokers. Twenty-nine states require the payment of a fee and proof of a minimum net worth and/or pledge of a surety bond in order to receive a license. Six states require proof of the person's competence as a mortgage broker (written test/prior lending experience) in addition to other monetary requirements. Four states impose an even greater requirement on mortgage brokers by subjecting them to the licensing requirements imposed on real estate brokers. *Id.*

140. See generally Eric C. Bartley, . . . *And Federal Regulation for All: Federally Regulating the Mortgage Banking Industry*, 2006 MICH. ST. L. REV. 477, 480 (2006) (opining that without consistent regulatory standards, the industry open itself to unsavory business practices). This could impair honest multi-state lenders by reducing their efficiency and hampering their ability to conduct interstate business. *Id.*; Brian Brady, *H.R. 3915: Mortgage Reform and Anti-Predatory Lending Act of 2007*, <http://www.bloodhoundrealty.com/BloodhoundBlog/?p=2103> (last visited Mar. 12, 2008) ("Mandatory licensing will cause consumers to place undue trust in the 'government-approved' originator.").

141. See generally David Unseth, *What Level of Fiduciary Duty Should Mortgage Brokers Owe Their Borrowers?*, 75 WASH. U. L.Q. 1737, 1750–53 (1997) (showing that the regulation of mortgage brokers is done by both the states and the federal government).

142. See Eric C. Bartley, . . . *And Federal Regulation for All: Federally Regulating the Mortgage Banking Industry*, 2006 MICH. ST. L. REV. 477, 480 (2006) (stating that each state has unique licensing requirements). Each state imposes different educational and experience requirements on industry participants. *Id.* Additionally, the monetary requirements that act as entry barriers are extremely low under the current system. *Id.* Together, this increases the likelihood of predatory lending practices. *Id.*

143. *Id.* (explaining the licensing procedures and requirements that multi-state lenders must follow).

[By requiring multi-state lenders to first obtain license in each state] means that they must meet each state's unique licensing requirements. Once the lenders have obtained the licenses, they must continuously monitor the licensing requirements of each state for changes. Should a state change its requirements, the companies must adjust their structure or business practices accordingly if they wish to continue operating in

ment with the duty of creating a nationwide wide registry of mortgage brokers if an independent registry is not certified within twenty-four months of the Act's implementation.<sup>144</sup> Instead of suffering through dissimilar licensing laws amongst states and the additional work of creating a separate national registry, implementation of federal licensing system that simultaneously creates a nationwide registry would be significantly more cost and time efficient.<sup>145</sup>

Similar to the Act, H.R. 3012, the Fair Mortgages Practices Act, prohibits a person from engaging as a mortgage originator without first obtaining and maintaining a registered/licensed mortgage originator.<sup>146</sup> In addition, H.R. 3012 recommends that states should implement Residen-

that state. While this is arguably a cost of doing business, it may become unduly burdensome. *Id.*

In addition to litigation costs from noncompliance, the costs of obtaining training and other requirements to comply with each state's regulations can increase exponentially. *Id.*

144. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 107 (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008).

(a) IN GENERAL.— The provisions of this section and section 408 shall take effect for States that do not meet the minimum standards set forth in this title for State-licensed loan originators, if and only if, by the end of a 3-year period beginning on the date of the enactment of this Act the State does not have in place by law or regulation the minimum requirements for licensing State-licensed loan originators that meet the specifications of this title and does not participate in the Nationwide Mortgage Licensing System.

(b) BACK UP LICENSING SYSTEM.—The Secretary of Housing and Urban Development . . . shall provide for the establishment and maintenance of a system of licensed loan originators.

(c) ADMINISTRATION.—

(1) IN GENERAL.— The Secretary shall either maintain and administer the system established under this title or enter into a contract with the Nationwide Mortgage Licensing System to administer the system. *Id.*

145. See Eric C. Bartley, . . . *And Federal Regulation for All: Federally Regulating the Mortgage Banking Industry*, 2006 MICH. ST. L. REV. 477, 499–500 (2006) (proposing a national registration similar to the Securities Exchange Commission). Each business would be required to file a registration statement containing basic information about the company before being permitted to enter the industry. *Id.* This will create national consistency for levels of experience and education, setting a minimum requirement for entry and additional certifications for specified types of loans. *Id.* A national licensing organization can also provide for a mandatory background check on all applicants prior to licensing, prohibiting those convicted of fraud from obtaining a license, and impose a monetary barrier that is standard across all fifty states. *Id.*

146. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 103(a) (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008) (“In General— A person may not engage in the business of a loan originator without first obtaining and maintaining a registration as a registered loan originator or a license as a State-licensed loan originator.”).

tial Mortgage Licensing System (RLMS).<sup>147</sup> The RLMS will allow both lenders and brokers to apply and renew their license.<sup>148</sup> Neil Milner, a proponent of RLMS states that “[t]he national licensing system and repository will enhance the state regulator’s ability to protect consumers through an increased ability to hold industry professionals accountable for their actions.”<sup>149</sup>

Although there is no specified national registry regime currently in place, many fear the effects of its future implementation.<sup>150</sup> The Mortgage Bankers Association is concerned with a potential security breach.<sup>151</sup> The database will potentially hold a large amount of personal identifying information, creating the potential for a security breach and resulting in the inappropriate disclosure of that data.<sup>152</sup> Furthermore, in

147. Heather Morton, *The Residential Mortgage Licensing System*, STATE LEGISLATURES MAG., Aug. 31, 2007, available at [http://www.ncsl.org/magazine/extra\\_mortonarticle.htm](http://www.ncsl.org/magazine/extra_mortonarticle.htm) (last visited Apr. 22, 2008).

Beginning in 2004, the Conference of State Banking Supervisors and the American Association of Residential Mortgage Regulators created a mortgage application to increase uniformity between states. Eventually the Conference of State Banking Supervisors and the American Association of Residential Mortgage Regulators joined forces with National Association of Securities Dealers, Inc. to create an internet-based system, or Residential Mortgage Licensing System. *Id.*

148. *New Mortgage Licensing System May Benefit States, Lenders and Consumers*, MORTGAGENEWS DAILY, Feb. 23, 2007, [http://www.MortgageNewsDaily.com/2232007\\_RMLS.asp](http://www.MortgageNewsDaily.com/2232007_RMLS.asp) (reporting that an internet-based central licensing system will give lenders more flexibility as to monitoring the status of multi-state licenses and applications and as to paying licensing fees).

149. *Id.* (explaining that Neil Milner is president and CEO of the Conference of State Banking Supervisors, one of the co-founding companies of RLMS).

150. Heather Morton, *The Residential Mortgage Licensing System*, STATE LEGISLATURES MAG., Aug. 31, 2007, available at [http://www.ncsl.org/magazine/extra\\_mortonarticle.htm](http://www.ncsl.org/magazine/extra_mortonarticle.htm) (describing the criticisms that the RMLS faces by the industry). “The National Association of Mortgage Brokers (NAMB) is concerned that the system is too narrowly focused to effectively protect consumers.” *Id.* Others believe that the RMLS “will create a false sense of security for consumers and government agencies because many bad actors will continue to be able to move freely from bank to lender and back again without fear of being detected by the proposed registry.” *Id.*

151. *Id.*

The Mortgage Bankers Association (MBA) is concerned that the database will hold a large amount of personal identifying information that will create the potential for a security breach and inappropriate disclosure of that data. In the event of a breach, it is unclear who will be held accountable. MBA also questions the cost benefit and efficiency of a system that will cost \$4.3 million to start, paid by the states, and an estimated \$6.5 million annually to maintain, which will be paid for by the mortgage industry. *Id.*

152. *See id.* (establishing concerns that due to the large total of personal identifying information held in the national mortgage licensing database, the likelihood of a security breach is greater).

the event of a breach, it is unclear who will be held accountable and will react appropriately and efficiently.<sup>153</sup>

To effectively regulate mortgage brokers, the Act should incorporate provisions found in proposed H.R. 3012, which provide stringent federal licensing requirements while dually creating a nationwide registry regime.<sup>154</sup> It is necessary to incorporate stringent security measures to prevent the breach of any private information.<sup>155</sup> These actions would benefit not only minorities, but borrowers, brokers, states and the federal government by: (1) streamlining the licensing process; (2) reducing the regulatory burden; (3) improving the efficiency and effectiveness of state supervision; (4) increasing accountability among the mortgage industry; and (5) reducing fraud and predatory lending practices.<sup>156</sup>

## 2. Prohibition of Yield Spread Premium as Compensation to Originators

Section 103 of the Act prohibits a loan originator from receiving any incentive compensation, specifically a YSP.<sup>157</sup> A YSP, is a “premium”

153. *See id.* (“MBA officials have expressed concern that the system does not recognize the differences between mortgage bankers and mortgage brokers.”).

154. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 101 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008).

In order to increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud, the States, through the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, are hereby encouraged to establish a Nationwide Mortgage Licensing System and registry for the residential mortgage industry that accomplishes all of the following objectives:

- (1) Provides uniform mortgage applications and reporting requirements for State-licensed loan originators.
- (2) Provides a comprehensive licensing and supervisory database.
- (3) Aggregates and improves the flow of information to and between regulators.
- (4) Provides increased licensee accountability and tracking.
- (5) Streamlines the licensing process and reduces the regulatory burden.
- (6) Enhances consumer protections and supports anti-fraud measures. *Id.*

155. *See generally* Heather Morton, *The Residential Mortgage Licensing System*, STATE LEGISLATURES MAG., Aug. 31, 2007, *available at* [http://www.ncsl.org/magazine/extra\\_mortonarticle.htm](http://www.ncsl.org/magazine/extra_mortonarticle.htm) (identifying the fact that a security breach could jeopardize the disclosure of a substantial amount of personal information).

156. *See generally* Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 101 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008) (articulating the advantages of establishing a mortgage licensing system).

157. *See id.* § 103 (“No mortgage originator may receive from any person, and no person may pay to any mortgage originator, directly or indirectly, any incentive compensation, including yield spread premium or equivalent compensation or gain, that is based on, or varies with, the terms of any residential mortgage loan.”). The Act goes on to specifi-

paid by a lender to a broker for securing a mortgage at a higher interest rates, meaning the higher the interest rate, the more YSP points allotted.<sup>158</sup> YSPs are often considered as indirect fees for borrowers, as the payments of the YSP results in a higher interest rate.<sup>159</sup>

Although at face value this is seemingly unbeneficial to the borrower, YSPs allow mortgage brokers to compete with retail banks when it comes to quoting interest rates and fees.<sup>160</sup> When applied appropriately, YSPs allow mortgage brokers the ability to provide borrowers with a variety of borrowing options.<sup>161</sup> The higher the interest rate, the higher the YSP, which can be used to deflect closing costs.<sup>162</sup> Furthermore, YSPs often cover the costs of originating the loan such as loan officer commissions, processor salaries, office overhead, etc.<sup>163</sup> For example, if a borrower desires a no-cost closing loan, a broker can deflect closing costs by taking income on the YSP.<sup>164</sup> The prohibition of YSPs would lead to the unavailability of zero point loans and zero closing cost refinance pro-

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cally state that the maximum amount of damages recoverable by a consumer for violation of the Act is three times the total amount of direct and indirect compensation by the loan originator in connection to the mortgage loan including attorney's fees and costs. *Id.* § 124.

158. See generally Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 442 (2005) ("The payment of yield spread premium occurs when the lender pays the broken an indirect compensation for securing mortgage at an interest rate higher than that which the lender would have been willing to agree for the particular mortgage.").

159. See *id.* at 453 (contending that YSPs are considered indirect fees to the borrower because the payment of premiums typically results in a higher interest rate to the borrower).

160. See Manley Williams & Kirk D. Jensen, *Yield Spread Premiums: HUD's Clarification and Lingering Concerns*, 119 BANKING L.J. 129, 140 (2002) (examining the Real Estate Settlement Procedures Act's history and policy, along with HUD's 1999 policy statement, the litigation following that statement, and the 2001 HUD policy statement). "The court agreed with HUD that lender payments like YSPs provide flexibility which benefits both lenders and borrowers by enabling borrowers to reduce up-front costs associated with loan origination." *Id.* at 140.

161. See Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 453 (2005) (maintaining that HUD purports to give consumers who are unable to pay direct fees the ability to obtain home loans through the usage of YSPs).

162. Robert D. Ashby, *Is Yield Spread Premium Good or Bad for Consumers?*, FLA. MORTGAGE REP., Nov. 15, 2007, <http://floridamortgageplanner.typepad.com/certifiedmortgageplanner/2007/11/is-yield-spread.html> ("YSP is simply a payment for increasing the rate on the loan in order to cover costs OR pay the mortgage broker.").

163. *Id.* (detailing how the YSP can be used by a mortgage broker to cover his charges as well as other closing costs).

164. *Id.* (providing that if a buyer with minimal cash to cover closing costs, the broker can increase the rate and cover closing costs with money generated from the YSP).



grams.<sup>165</sup> The borrower would be left with the option of a lower rate, high-closing cost mortgage.<sup>166</sup>

The Act's prohibition of YSPs stems from improper disclosure and usage of YSPs.<sup>167</sup> For example, from 1995-2001, the steering of African-American borrowers into higher-cost subprime loans, whose income qualified them for lower interest loans, increased a drastic 686%.<sup>168</sup> Minority borrowers are often not disclosed of the purpose of the YSP and its relationship to the interest rate.<sup>169</sup> In addition, when YSPs are not used to deflect closing costs, they are left as a bonus payment to the broker, which the broker has not provided a compensable service to the borrower.<sup>170</sup> Therefore, instead of prohibiting YSPs, the Act should regulate the usages of YSPs and require full disclosure of their use.<sup>171</sup> Usage of YSPs should be limited to one of many lending options to defer closing costs.<sup>172</sup> Currently, under RESPA, it is illegal to not disclose a YSP on

165. *Id.* (explaining that YSP's can provide a benefit to consumers by proving a method to pay minimal closing costs).

166. *Id.* ("If you decide to pay the mortgage broker in 'cash at closing,' then there is no YSP and you receive what is called the 'par rate' on the wholesale side of lending. Of course, that means you have to pay all the other closing costs at closing in cash to close as well as to receive that rate.").

167. Robert D. Ashby, *Is Yield Spread Premium Good or Bad for Consumers?*, FLA. MORTGAGE REP., Nov. 15, 2007, <http://floridamortgageplanner.typepad.com/certifiedmortgageplanner/2007/11/is-yield-spread.html> ("The key to YSP providing a benefit rests in the need to find an ethical mortgage broker.").

168. A. Mechele Dickerson, *Bankruptcy and Mortgage Lending: The Homeowner Dilemma*, 38 J. MARSHALL L. REV. 19, 34 (2004) (discussing the dramatic rise in subprime rates in African-American communities while conventional loans declined among the same community of borrowers).

169. *See Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums: Hearing before the S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 2 (2002) (statement of Prof. Howell E. Jackson), available at [http://banking.senate.gov/02\\_01hr/010802/jackson.htm](http://banking.senate.gov/02_01hr/010802/jackson.htm) ("The results indicated that mortgage brokers charged two racial groups—African-Americans and Hispanics—substantially more for settlement services than they did other borrowers.").

170. *See id.* ("My best estimate is that borrowers, on average, enjoy 25 cents of benefit for each dollar paid in yield spread premiums. In other words, the vast majority of yield spread premiums—on the order of seventy-five percent—serve only to increase the compensation of mortgage brokers.").

171. Robert D. Ashby, *Is Yield Spread Premium Good or Bad for Consumers?*, FLA. MORTGAGE REP., Nov. 15, 2007, <http://floridamortgageplanner.typepad.com/certifiedmortgageplanner/2007/11/is-yield-spread.html> (arguing that Congress should make full disclosure of how much a mortgage broker is making one of the limitations of a YSP).

172. *See* Manley Williams & Kirk D. Jensen, *Yield Spread Premiums: HUD's Clarification and Lingering Concerns*, 119 BANKING L.J. 129, 140 (2002) (discussing how the reasonableness approach promotes the power of the consumer to get a decrease of up-front expenses associated with loan closing).

the Good Faith Estimate of Closing Costs form.<sup>173</sup> As this disclosure does not include the purpose of YSPs, requiring additional disclosure, detailing the exact usage and purpose of the YSP will provide the borrower with adequate knowledge.

### B. *Amendments to the Definition of High-Cost Mortgages*

During the early 1990s, minorities were subject to reverse redlining tactics.<sup>174</sup> In response to such tactics, Congress amended TILA, enacting HOEPA, which provided enhanced disclosure requirements for high-cost mortgages.<sup>175</sup> Enhanced disclosures are required if a mortgage meets

173. See Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10080, 86 (Mar. 1, 1999) (“Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application . . . . Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement.”).

174. See Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 THEORETICAL INQUIRIES L. 323, 334–35 (2006) (investigating the relationship between the consumer credit structure and culture, focusing on cultural identity and cultural change).

Reverse red-lining” involves targeting vulnerable populations such as racial minorities, women and the elderly (with the elderly African-American woman fitting all three categories and thus a frequent target) in high-pressure marketing of very high-cost credit that has a high likelihood of only being repaid by foreclosure on a home.

*Id.*

This is partially due to creditors’ development of tactics designed to appeal to minority populations who have traditionally been excluded from banking and consumer culture. *Id.* Some racial minorities continue to utilize the subprime market out of habit, even after achieving a level of financial stability that would enable them to seek loans from conventional lenders. *Id.* This can be viewed as cultural exploitation with the result that wealth is redistributed from minorities and the poor to their creditors and the creditors’ investors. *Id.*

See also Regina Austin, *Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 AM. U. L. REV. 1217, 1218–19 (2004) (discussing high-pressure marketing of subprime loans to women, minorities, low-income earners and senior citizens). “Predatory lending is ‘characterized [by] a combination of unfair loan terms [particularly high interest rates and fees] and pressure tactics that limit the information and choices available to borrowers, especially those targeted because of particular vulnerabilities.’” *Id.* at 1218.

175. See Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L.Q. REP. 460, 467 (2006) (noting that certain disclosures must be made to the borrower prior to the consummation of a given transaction). HOEPA also imposes limitations on particular loan terms and practices that may be considered predatory. *Id.*; see generally Judith M. Scheiderer, *Title Regulation and Litigation Update*, 59 CONSUMER FIN. L.Q. REP. 162 (2005) (providing the HOEPA “triggers”). “Creditors must comply with the HOEPA rules if the total points and fees payable by the consumer at or before

one of two triggers defined for high-cost mortgages.<sup>176</sup> If either of the triggers is met, the borrower must provide special disclosures including information regarding the APR, the amount of regular payments, and a warning that the borrowers' home might be lost through foreclosure if the borrowers go through with the transaction. These disclosures must be made at least three days prior to consummation of the transaction.<sup>177</sup>

TILA originally defined high-cost mortgages as those mortgages that were secured by the borrower's principal dwelling, the APR was more than ten percentage points above the yield on U.S. Treasury ratings, the total points and fees associated with the loan exceeded eight percent of the total loan amount, or, in some cases, a specified dollar amount.<sup>178</sup> In an attempt to increase the number of loans that are subject to HOEPA protections, the Federal Reserve Board amended Regulation Z in 2002.<sup>179</sup> Specifically, the 2002 amendments lowered the APR requirement from ten percentage points above the comparable U.S. Treasury rate to eight percentage points above the rate for first-lien mortgages.<sup>180</sup>

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loan consummation exceed the greater of \$400 or eight percent of the total loan amount.”  
*Id.*

176. *See* 15 U.S.C. § 1602(a) (1994).

A mortgage referred to in this subsection means a consumer credit transaction that is secured by the consumer's principal dwelling, other than a residential mortgage transaction, a reverse mortgage transaction, or a transaction under an open end credit plan, if — (A) the annual percentage rate at consummation of the transaction will exceed by more than 10 percentage points the yield on Treasury securities having comparable periods of maturity on the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or (B) the total points and fees payable by the consumer at or before closing will exceed the greater of (i) 8 percent of the total loan amount; or (ii) \$400. *Id.*

177. 15 U.S.C.A. § 1639(a)-(b) (West 1994) (requiring the specific disclosure that “[i]f you obtain this loan . . . [y]ou could lose your home”).

178. *Id.* § 1602(a) (describing how TILA determines whether a mortgage is high cost).

179. Donald C. Lampe, *Predatory Lending Initiatives, Legislation and Litigation: Federal Regulation, State Law and Preemption*, 56 CONSUMER FIN. L.Q. REP. 78, 80 (2002) (stating that the October 1, 2002 amendments are intended to expand the scope of HOEPA to cover more loans, as the evidence indicates that very few loans previously were being made subject to HOEPA and section 32).

The effect of the 2002 revisions to the section 32 substantive provisions is four-fold: (1) They expand the scope of the mortgage loans subject to HOEPA by lowering the “triggers;” (2) add to the list of prohibited acts and practices; (3) strengthen HOEPA's prohibition on lending without regard to repayment ability; and (4) enhance the HOEPA early disclosure requirements. *Id.*

180. *Id.* (“lowering the APR ‘trigger’ from ten percent above the U.S. Treasury rate to eight percent above the Treasury rate for first lien loans”).

The Act does not alter the APR requirements.<sup>181</sup> Instead, the Act amends the total points and fees requirement.<sup>182</sup> The Act defines a high-cost mortgage as one where the total points and fees exceed five percent of the total loan.<sup>183</sup> Focusing on subprime lending, the Act sets forth to amend TILA to take into account adjustable rate mortgages (ARMs).<sup>184</sup> Per the Act, the interest rate used in determining the APR must be the maximum rate charged during the term of the loan.<sup>185</sup> This will prevent brokers from using low-introductory rates as a measure to exclude mortgages from the high-cost definition. In addition, to prevent lenders from inserting unnecessary transactional fees<sup>186</sup> into mortgages, the Act prohibits lenders from charging fees without full disclosure.<sup>187</sup>

The Act provides an additional protection to minorities by including the costs of single premium credit insurance within the definition of mortgage fees.<sup>188</sup> Single premium credit insurance is often viewed as preda-

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181. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 301 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

182. *Id.*

183. *Id.* § 101 (“[I]n the case of a loan for \$20,000 or more, 5 percent of the total loan amount; or (II) in the case of a loan for less than \$20,000, the lesser of 8 percent of the total loan amount or \$1,000.”).

184. *Id.* § 301.

185. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 101 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008) (“In the case of any other loan in which the rate may vary at any time during the term of the loan for any reason, the interest charged on the loan at the maximum rate that may be charged during the term of the loan.”).

186. See Nicholas Bagley, Comment, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274, 2282 (2004) (“An unscrupulous lender can avoid HOEPA simply by ‘packing’ a mortgage loan with a litany of unnecessary costs for providing certain named services that are related to, but technically independent of, the mortgage itself.”).

187. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 101 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

In the case of an extension of credit that is secured by the dwelling of a consumer, under which the annual rate of interest is variable, or with respect to which the regular payments may otherwise be variable, in addition to the other disclosures required under this subsection, the disclosures provided under this subsection shall state the maximum amount of the regular required payments on the loan, based on the maximum interest rate allowed, introduced with the following language in conspicuous type size and format: “Your payment can go as high as \$1124,” the blank to be filled in with the maximum possible payment amount. *Id.*

188. *Id.*

tory in nature,<sup>189</sup> and it takes on various forms: life, disability and unemployment.<sup>190</sup> Credit life insurance pays off a borrower's mortgage in the event of death,<sup>191</sup> and credit disability/ unemployment covers a borrower's monthly payment up to a prescribed dollar amount or amount of time in the event of an injury or unemployment.<sup>192</sup> This type of insurance, however, often only provides coverage for ten years, and costs thousands of dollars.<sup>193</sup> Because the majority of subprime borrowers do not have the funds to pay the one time insurance premium at closing,<sup>194</sup> borrowers typically finance the costs for ten, fifteen or even thirty years.<sup>195</sup> Borrowers thus continue to pay for a service that has potentially long expired.<sup>196</sup> The inclusion of single premium insurance as a fee allows it to be included in the overall percentage of fees.<sup>197</sup> Therefore, if the total per-

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189. Michael D. Larson, *Lenders Drop Single-Premium Credit Insurance*, BANKRATE.COM, July 26, 2001, <http://www.bankrate.com/brm/news/mtg/20010726a.asp>.

Advocates say single-premium coverage is predatory for a number of reasons. For one thing, lenders use high-pressure sales tactics to get unsophisticated borrowers to sign up for as many credit policies as possible. Consumers aren't reminded that they have the coverage because it shows up just once on closing documents, rather than each month in a line item on the monthly statement. As a result, unscrupulous lenders have an easier time slipping single-premium credit insurance into loans without borrowers being the wiser. *Id.*

190. *Id.* ("Credit life typically pays off a borrower's loan in the event of death while credit disability and credit unemployment covers a customer's monthly payments up to a certain dollar amount or for a prescribed amount of time in the event of an injury or layoff.").

191. *Id.*

192. *Id.* ("Borrowers can pay for [credit insurance] coverage on a single-premium or monthly basis.").

193. *Id.* (stating a lender may sell a borrower a five-year credit disability policy for the price of \$3000).

194. Michael D. Larson, *Lenders Drop Single-Premium Credit Insurance*, BANKRATE.COM, July 26, 2001, <http://www.bankrate.com/brm/news/mtg/20010726a.asp>.

195. *Id.*

196. *Id.* (asserting that because borrowers finance their one-time premiums into their mortgage loan, an overpriced product because even more expensive as borrows pay interest on the premium for the credit insurance, rather than only the premium itself).

197. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 301 (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

Premiums or other charges payable at or before closing for any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract, except that insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis shall not be considered financed by the creditor. *Id.*

centage of fees exceeds the five percent trigger, unlike the previous eight percent requirement,<sup>198</sup> enhanced disclosure is required.<sup>199</sup>

### C. *Minimum Standards of Mortgages*

In considering whether a borrower is eligible for a mortgage, the Act places a duty on the broker to perform a good faith inquiry as to whether the borrower can repay the loan.<sup>200</sup> Furthermore, the Act prohibits brokers from refinancing loans unless there is a net tangible benefit to borrowers.<sup>201</sup> Finally, prior to extending a high-cost mortgage, the Act requires that borrowers receive counseling on the advisability of the transaction.<sup>202</sup>

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198. See Donald C. Lampe, *Predatory Lending Initiatives, Legislation and Litigation: Federal Regulation, State Law and Preemption*, 56 CONSUMER FIN. L.Q. REP. 78, 80–81 (2002).

The specific changes to Regulation Z include: An expanded right of rescission under section 226.23 to include violation of the new consumer protection provisions; lowering the APR “trigger” from ten percent above the U.S. Treasury rate to eight percent above the Treasury rate for first lien loans; inclusion within the definition of “points and fees” of credit insurance premiums—the eight percent “trigger” for points and fees otherwise remains unchanged; expanding the section 226.32(c) disclosure requirement to include certain balloon payments and the amount borrowed in a refinancing transaction; and adding a limitation on “due on demand” clauses. *Id.*

199. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 301 (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

The total points and fees payable in connection with the loan exceed— (I) in the case of a loan for \$20,000 or more, 5 percent of the total loan amount; or (II) in the case of a loan for less than \$20,000, the lesser of 8 percent of the total loan amount or \$1,000. *Id.*

200. *Id.* § 201.

[N]o 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, and assessments. *Id.*

201. See *id.* § 202 (“[T]he refinanced loan will provide a net tangible benefit to the consumer.”).

202. See *id.* § 303 (referring to, “No counselor may certify that a consumer has received counseling on the advisability of the high-cost mortgage unless the counselor can verify that the consumer has received each statement required . . . by this section or the Real Estate Settlement Procedures Act of 1974 with respect to the transaction.”).

### 1. Good Faith Establishment of Ability to Repay

In 2002, minorities were at least 2.5 times more likely to obtain a subprime loan than White borrowers.<sup>203</sup> Consequently, foreclosures are focused in predominantly minority neighborhoods.<sup>204</sup> Title II of the Act sets for the minimum standards of residential mortgages.<sup>205</sup> The Act prevents a lender from extending a residential mortgage loan unless the lender first makes a reasonable good faith effort to determine that the borrower will have the ability to repay the loan under its terms, including all the taxes, insurance and assessments associated with the mortgage.<sup>206</sup> This will assist in ensuring that minorities will be able to afford their mortgages, and thus protect the value of their neighborhood. Additionally, this provision applies to the borrower who maintains multiple loans against the same property.<sup>207</sup> The lender is charged with taking into account all of the payments on the property.<sup>208</sup> This good faith determina-

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203. See Laura Dietrich, *Massachusetts' New Predatory Lending Law and the Expanding Rift Between Federal and State Lending Protection*, 26 B.C. THIRD WORLD L.J. 169, 181 (2006) ("In 2002, African-American borrowers were 3.6 times more likely than white borrowers to receive subprime home purchase loans; Latino borrowers were 2.5 times more likely than white borrowers.").

204. See generally *id.* at 184 (noting the corollary between the concentration of subprime lenders in low to moderate-income neighborhoods and the unusually high foreclosure rates associated with such neighborhoods).

205. See Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. §§ 201–203 (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008) (enumerating the "Minimum standards for residential mortgage loans").

206. See *id.* § 201.

In accordance with regulations prescribed jointly by the Federal banking agencies, in consultation with the Commission, 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, and assessments. *Id.*

207. See *id.*

If the creditor knows, or has reason to know, that 1 or more residential mortgage loans secured by the same dwelling will be made to the same consumer, the creditor shall make a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the combined payments of all loans on the same dwelling according to the terms of those loans and all applicable taxes, insurance, and assessments. *Id.*

208. See *id.*

If the creditor knows, or has reason to know, that 1 or more residential mortgage loans secured by the same dwelling will be made to the same consumer, the creditor shall make a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the combined

tion must be made through documented and verified information.<sup>209</sup> Typically, ability to repay is determined through analyses of the borrower's current and expected income, credit history, other obligations, employment status, debt-to-income ratio and other equity.<sup>210</sup>

While criticism abounds that this provision will force brokers to super-vice borrowers, it remains that it is in the best interest of the majority that borrowers be able to afford their mortgages. Many borrowers act under the guidance of their brokers. Because the Act requires brokers to obtain and maintain a license, it reasonably follows that brokers should only offer loans that a borrower can repay.

## 2. Net Tangible Benefit

Title II also requires that the originator of the subprime loan determine that refinancing creates a "net tangible benefit" to the consumer.<sup>211</sup> To meet this requirement, subprime loans must fit within the Qualified Safe Harbor Mortgage.<sup>212</sup> This means that subprime loans are only acceptable

payments of all loans on the same dwelling according to the terms of those loans and all applicable taxes, insurance, and assessments. *Id.*

209. *See id.* This verified information must be based on the consumer's "reasonable ability to repay the combined payments of all loans on the same dwelling[.]" *Id.*

210. *See* Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 201 (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008) (listing the factors to be considered by the creditor when making their determination).

211. *See id.* § 202.

Net Tangible Benefit for Refinancing of Residential Mortgage Loans.—

(1) **IN GENERAL.**— In accordance with regulations prescribed under paragraph (3), no creditor may extend credit in connection with any residential mortgage loan that involves a refinancing of a prior existing residential mortgage loan unless the creditor reasonably and in good faith determines, at the time the loan is consummated and on the basis of information known by or obtained in good faith by the creditor, that the refinanced loan will provide a net tangible benefit to the consumer.

(2) **CERTAIN LOANS PROVIDING NO NET TANGIBLE BENEFIT.**— A residential mortgage loan that involves a refinancing of a prior existing residential mortgage loan shall not be considered to provide a net tangible benefit to the consumer if the costs of the refinanced loan, including points, fees and other charges, exceed the amount of any newly advanced principal without any corresponding changes in the terms of the refinanced loan that are advantageous to the consumer.

(3) **NET TANGIBLE BENEFIT.**— The Federal banking agencies shall jointly prescribe regulations defining the term 'net tangible benefit' for purposes of this subsection. *Id.*

212. *See id.* § 203 ("REBUTTABLE PRESUMPTION- Any presumption established under paragraph (1) with respect to any residential mortgage loan shall be rebuttable only—(A) against the creditor of such loan; and (B) if such loan is a qualified safe harbor mortgage.").



if they are income verified, underwritten based on fully indexed standard (plus taxes and insurance), are not negatively amortizing and the debt-to-income ratio does not exceed fifty percent.<sup>213</sup> In addition, the loan must have a margin of less three percent over its index, or is at a fixed rate for the first seven years.<sup>214</sup> Finally, Title II prohibits subprime prepayment penalties and limits prepayment penalties on prime loans to three years and bans arbitration on any residential mortgage.<sup>215</sup>

Title II provides exemplary protection to the borrower. Ensuring that borrowers retain the ability to repay their mortgages will prevent illusory lending. The prohibition of prepayment penalties will further deter a common predatory lending practice and allow a borrower to repay a subprime loan in the manner that is best suited.

### 3. Expansion of Housing Counseling

In 1965, the Department of Housing and Urban Development (HUD) was created to develop and execute policy on discrimination in city housing.<sup>216</sup> Currently, through HUD, housing counseling exists for all buyers, but many are not aware or chose not to participate in a counseling session prior to obtaining a mortgage. The Act requires that prior to the extension of any high-cost mortgage, the broker must receive certification from a counselor approved by HUD that the borrower has received counseling on the advisability of the loan transaction.<sup>217</sup>

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213. *See id.* (“The term ‘qualified safe harbor mortgage’ means a residential mortgage which does not cause the consumer’s total monthly debts, including amounts under the loan, to exceed 50 percent of his or her monthly gross income or such other maximum percentage of such income.”).

214. *See id.* (“The periodic payment amount for principal and interest are fixed for a minimum of 5 years under the terms of the loan.”).

215. *See* Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 203 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008) (“In the case of a variable rate loan the annual percentage rate varies based on a margin that is less than 3 percent over a single generally accepted rate index that is the basis for determining the rate of interest for the mortgage.”).

216. *See generally* The History of the U.S. Dep’t of Housing and Urban Development, <http://www.hud.gov/library/bookshelf12/hudhistory.cfm> (last visited Apr. 22, 2008) (detailing timeline of HUD’s history).

217. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 301 (1st Sess. 2007), *available at* <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

(1) IN GENERAL— A creditor may not extend credit to a consumer under a high-cost mortgage without first receiving certification from a counselor that is approved by the Secretary of Housing and Urban Development, or at the discretion of the Secretary, a state housing finance authority, that the consumer has received counseling on

The Act does not delve into the details of the type of counseling provided to the borrower. The Act leaves discretion to HUD to determine counseling needs.

While requiring counseling is an effective first step, the Act should be amended to include housing counseling provisions found within H.R. 3012. H.R. 3012 amends the Department of Housing and Urban Development Act to create an Office of Housing Counseling within the Office of the Secretary.<sup>218</sup> H.R. 3012 charges the Office of Housing Counseling with developing and organizing counseling methods and opportunities,<sup>219</sup> and, furthermore, grants the authority to create an advisory committee in which to determine the best methods of counseling to homebuyers.<sup>220</sup> In

the advisability of the mortgage. Such counselor shall not be employed by the creditor or an affiliate of the creditor or be affiliated with the creditor.

(2) **DISCLOSURES REQUIRED PRIOR TO COUNSELING**— No counselor may certify that a consumer has received counseling on the advisability of the high-cost mortgage unless the counselor can verify that the consumer has received each statement required (in connection with such loan) by this section or the Real Estate Settlement Procedures Act of 1974 with respect to the transaction.

(3) **REGULATIONS**— The Secretary of Housing and Urban Development may prescribe such regulations as the Secretary determines to be appropriate to carry out the requirements of paragraph (1). *Id.*

218. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 312(g) (1st Sess. 2007) available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008).

219. *Id.*

(B) **SPECIFIC FUNCTIONS**.— The Director shall carry out the functions assigned to the Director and the Office under this section and any other provisions of law. Such functions shall include establishing rules necessary for—

(i) the counseling procedures under section 106(h)(1) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(h)(1)).] *Id.*

220. *Id.* § 312(g)(4).

(4) **ADVISORY COMMITTEE**.—

(A) **IN GENERAL**.— The Secretary shall appoint an advisory committee to provide advice and oversight regarding the carrying out of the functions of the Director.

(B) **MEMBERS**.— Such advisory committee shall consist of not more than 12 individuals, and the membership of the committee shall equally represent all aspects of the mortgage and real estate industry, including consumers.

(C) **TERMS**.— Except as provided in subparagraph (D), each member of the advisory committee shall be appointed for a term of 3 years. Members may be reappointed at the discretion of the Secretary.

(D) **TERMS OF INITIAL APPOINTEES**.— As designated by the Secretary at the time of appointment, of the members first appointed to the advisory committee, 4 shall be appointed for a term of 1 year and 4 shall be appointed for a term of 2 years.

(E) **PROHIBITION OF PAY; TRAVEL EXPENSES**.—Members of the advisory committee shall serve without pay, but shall receive travel expenses, includ-

addition, the secretary is empowered to establish standards for materials and forms to be used by homeownership counseling services.<sup>221</sup> In order to ensure awareness of counseling services, H.R. 3012 implements a full-scale marketing campaign that enhances the awareness and benefits of counseling prior to the obtaining a mortgage loan. This marketing campaign is directed specifically towards many groups of minorities: those persons facing mortgage foreclosure, persons considering subprime mortgage loan to purchase primary dwelling, elderly persons, persons who face language barriers, low-income persons and others potentially vulnerable consumers.<sup>222</sup> This assists in curtailing the predatory lending practices against minorities. As many minorities cannot speak English, counseling services assists non-English speaking borrowers in understanding the full effects of their financial actions.

Similar to the counseling requirements, the H.R. 3012 requires that the secretary prepare, at least once every five years, a booklet to assist borrowers' understanding of the nature and costs of mortgage loans.<sup>223</sup> The booklet contains a description and explanation of the nature and pur-

ing per diem in lieu of subsistence, in accordance with applicable provisions under subchapter I of chapter 57 of title 5, United States Code. *Id.*

221. *Id.* § 313(a)(h)(2) (“(2) STANDARDS FOR MATERIALS.—The Secretary . . . shall establish standards for materials and forms to be used, as appropriate, by organizations providing homeownership counseling services, including any recipients of assistance pursuant to subsection (a)(4).”).

222. *Id.* § 313(h)(4).

(4) NATIONAL PUBLIC SERVICE MULTIMEDIA CAMPAIGNS TO PROMOTE HOUSING COUNSELING.—

(A) IN GENERAL.—The Director of Housing Counseling shall develop, implement, and conduct national public service multimedia campaigns designed to make persons facing mortgage foreclosure, persons considering a subprime mortgage loan to purchase a home, elderly persons, persons who face language barriers, low-income persons, and other potentially vulnerable consumers aware that it is advisable, before seeking or maintaining a residential mortgage loan, to obtain homeownership counseling from an unbiased and reliable sources and that such homeownership counseling is available, including through programs sponsored by the Secretary of Housing and Urban Development.

(B) CONTACT INFORMATION.—Each segment of the multimedia campaign under subparagraph (A) shall publicize the toll-free telephone number and web site of the Department of Housing and Urban Development through which persons seeking housing counseling can locate a housing counseling agency in their State that is certified by the Secretary of Housing and Urban Development and can provide advice on buying a home, renting, defaults, foreclosures, credit issues, and reverse mortgages. *Id.*

223. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 318 (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008) (“(a) PREPARATION AND DISTRIBUTION.— The Secretary shall prepare, at least once every 5 years, a booklet to help consumers applying for federally related mortgage loans to understand the nature and costs of real estate settlement services.”).

poses of the costs associated to a mortgage loan, and at a minimum, the description and explanation must include specific information concerning balloon payments, prepayment penalties; and the trade off between closing costs and the interest rate over the life of the loan.<sup>224</sup>

In order to provide borrowers with disclosure of necessary information prior to entering into a high-cost mortgage, the disclosure provisions of H.R. 3012 should be included within the Act.

#### IV. INCORPORATION OF H.R. 3012 TO THE MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT OF 2007

As the previous section indicates, certain measures of the Act should be expanded to include provisions found within proposed H.R. 3012. This section delves into matter issues wholly untouched the Act, but because they deal with issues surrounding subprime lending and predatory practices, they should be included to the Act. While H.R. 3012 is pending review, the mortgage lending industry would be best served if all measures were incorporated in one complete resolution. Specifically, provisions regarding simplification of lending disclosures, prohibition of abusive practices and prevention of mortgage fraud provide the best protection to borrowers against predatory lending and the adverse effects of subprime lending.

##### A. *Simplification of Lending Disclosures*

“For many borrowers, reading a mortgage agreement is a bit like trying to decipher hieroglyphics.”<sup>225</sup> The disclosure forms mandated by the Truth in Lending Act have fallen fall short of their goal of simplifying disclosures primarily because of the increased complexity of disclo-

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224. *Id.* § 318.

(b) CONTENTS.—Each booklet shall be in such form and detail as the Secretary shall prescribe and, in addition to such other information as the Secretary may provide, shall include in plain and understandable language the following information:

(1) A description and explanation of the nature and purpose of the costs incident to a real estate settlement or a federally related mortgage loan. The description and explanation shall provide general information about the mortgage process as well as specific information concerning, at a minimum—

(A) balloon payments;

(B) prepayment penalties; and

(C) the trade-off between closing costs and the interest rate over the life of the loan. *Id.*

225. Bob Tedeschi, *Simplification: A Complex Job*, N.Y. TIMES, July 6, 2007, available at <http://homefinance.nytimes.com/nyt/article/mortgage-column-by-bob-tedeschi/2007.07.06.08mort/> (quoting the author’s view that borrowers’ have a complex job comprehending mortgage agreements). Particularly, truth-in-lending documents have been traditionally confusing for borrowers to understand, thus simplification is desired by borrowers. *Id.*

tures.<sup>226</sup> The provisions set forth in H.R. 3012 should be incorporated into the Act. H.R. 3012 sets forth to amend the Truth in Lending Act to provide additional disclosure requirements. The H.R. 3012 requires that a mortgage may not be consummated unless:

- (1) the mortgagee under the mortgage has provided to the consumer the written disclosure required under subsection (b) at least 3 days before the date of the settlement and the execution of the mortgage;
- and (2) the consumer has signed the disclosure under subsection (b)(1) and returned such disclosure to the mortgagee.<sup>227</sup>

Subsection (b) requires the written disclosure to include a “statement of mortgage facts,” which is a single-page disclosure including pertinent facts regarding the mortgage and requires signature of the borrower prior to finalization of the mortgage.<sup>228</sup> The disclosure includes pertinent information regarding the amount of any prepayment fee, the initial interest rate, the maximum possible interest rate, the amount of initial monthly payment due under the mortgage plus monthly amounts due for taxes and insurance, the amount of any late payment fees and a brief description of the consequences of making any payment late or defaulting on the mortgage.<sup>229</sup> Most importantly, prior to the signature line, a conspicuous statement in bold typeface, capital letters, in the largest font oth-

226. *Id.* (stating the complexity of truth-in-lending disclosure forms and their impact on the complexity of mortgages). “[F]ederal regulators and mortgage-industry officials say that truth-in-lending disclosure forms, mandated in the 1970s by the federal government, have fallen far short of their goal, in part because of the increased complexity of mortgages.” *Id.*

227. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 201(a) (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008) (quoting the text of the House report).

228. *Id.* § 201(a).

229. *Id.*

(1) STATEMENT OF MORTGAGE FACTS.—A single page, written disclosure regarding the mortgage with the heading “Your Basic Mortgage Facts” that sets forth, in accordance with such requirements as the Board shall, by regulation, establish—

- (A) the amount of the principal obligation under the mortgage;
- (B) the loan-to-value ratio for the mortgage;
- (C) the final maturity date for the mortgage;
- (D) the amount and due date for any balloon payment under the mortgage;
- (E) the amount of any prepayment fee to be charged if the mortgage is paid in full before the final maturity date for the mortgage;
- (F) the initial interest rate under the mortgage expressed as an annual percentage rate, and the amount of the monthly payment due under such rate;
- (G) the duration during which such initial interest rate will be charged;
- (H) the fully indexed rate of interest under the mortgage expressed as an annual percentage rate and the amount of the monthly payment due under such rate;

erwise used in the disclosure stating “DO NOT SIGN THIS IF YOU DON’T UNDERSTAND.”<sup>230</sup>

These practices would ensure that prior to consummation of the mortgage, minority borrowers have been provided with a simple, yet informative written statement regarding the terms and conditions of their mortgage.

### B. *Prohibition of Abusive Practices*

In 2004, a report, prepared for the HUD, concluded that minorities are frequent subjects of discrimination by mortgage lenders.<sup>231</sup> Mortgage servicing and non-traditional mortgage provisions cause the majority of lending problems associated with subprime loans. Unlike prime loans, subprime loans often do not provide an escrow account for taxes and

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(I) the maximum possible rate of interest under the mortgage expressed as an annual percentage rate and the amount of the monthly payment due under such rate;

(J) the monthly household income of the mortgagor upon which the mortgage is based;

(K) the amount of initial monthly payment due under the mortgage, and the amount of such initial monthly payment plus monthly amounts due for taxes and insurance on the property subject to the mortgage, both expressed as a percentage of the monthly household income of the mortgagor;

(L) the amount of the fully indexed monthly payment due under the mortgage, and the amount of such fully indexed monthly payment plus monthly amounts due for taxes and insurance on the property subject to the mortgage, both expressed as a percentage of the monthly household income of the mortgagor;

(M) the amount of any points to be paid by the mortgagor under the mortgage and the aggregate amount of any other closing costs in connection with the mortgage;

(N) the amount of any late payment fees and a brief description of the consequences of making any payment late or defaulting on the mortgage, including foreclosure[.] *Id.*

230. *Id.* (“(R) immediately above such blank space, a conspicuous statement in bold typeface, in all capital letters, in a font at least equal in size to the largest font otherwise used in the disclosure, as follows: ‘DO NOT SIGN THIS IF YOU DON’T UNDERSTAND IT!’”).

231. FAIR HOUS. ORG., ASS’N OF CMTY. ORGS. FOR REFORM NOW, SEPARATE AND UNEQUAL: PREDATORY LENDING IN AMERICA 42 (2004), [http://www.acorn.org/fileadmin/Community\\_Reinvestment/Reports/S\\_and\\_E\\_2004/separate\\_and\\_unequal\\_2004.pdf](http://www.acorn.org/fileadmin/Community_Reinvestment/Reports/S_and_E_2004/separate_and_unequal_2004.pdf).

Minorities receive a larger share of subprime purchase loans than of prime purchase loans. In 2002 African-Americans received 12.4% of the conventional home purchase loans originated by subprime lenders, 3.4 times greater than their 3.7% share of the home purchase loans made by prime lenders. Latinos received 15.1% of the home purchase loans made by subprime lenders, a 2.1 times greater share than their 7.1% share of conventional home purchase loans made by prime lenders. *Id.*

insurance costs.<sup>232</sup> Thus, the true monthly amount owed by the consumer seems significantly less than actually owed.<sup>233</sup> H.R. 3012 amends the Truth in Lending Act to require that a creditor to establish an escrow or impound account for the payment of taxes hazard insurance.<sup>234</sup> If a consumer decides to opt out of escrow services, the creditor must timely provide a written disclosure that advises the consumer of the responsibilities of the consumer and the resulting implications for any failure to pay non-escrowed items.<sup>235</sup>

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232. Nikitra S. Bailey, *Financial Apartheid: Subprime Mortgage Lending and the Failed Promise of Sustainable Homeownership for People of Color*, NAACP SPECIAL EDITION, July/Aug. 2007, at 13, available at [http://www.naacp.org/pdfs/advocate/sped\\_0707.pdf](http://www.naacp.org/pdfs/advocate/sped_0707.pdf) (“Today, because [hybrid adjustable-rate mortgages (HARMS)] and other abusive practices (for example, not setting up escrow accounts for taxes and insurance, which is routinely done in the prime market) are the rule rather than the exception on subprime loans, predatory lending has become almost synonymous with subprime mortgage lending.”).

233. *See id.* at 15 (urging banking regulators to “require lenders affiliated with banks . . . to consider the monthly payment that a [hybrid adjustable-rate mortgage (HARM)] is scheduled to adjust to when determining whether the borrower can afford to pay it” and identifying “the practice of charging borrowers higher rates by not verifying income, and of not escrowing for taxes and insurance; both practices are not common in the prime market and dramatically increase the risk of foreclosure for subprime loans.”).

234. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 401(a) (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008) (“A creditor, in connection with the formation or consummation of a subprime mortgage, shall establish . . . an escrow or impound account for the payment of taxes and hazard insurance as provided in, and in accordance with, this section, unless such an account already exists.”).

235. *Id.* § 402(a).

(g) Disclosure Notice Required for Consumers Who Opt Out of Escrow Services.—

(1) IN GENERAL.— If an impound, trust, or other type of account for the payment of property taxes, insurance premiums, or other purposes relating to property securing a consumer credit transaction is not established in connection with any consumer credit transaction secured by the principal dwelling of the consumer, or if a consumer chooses, at any time after such an account is established in connection with any such transaction, to close such account, the creditor shall provide a timely and clearly written disclosure to the consumer that advises the consumer of the responsibilities of the consumer and implications for the consumer in the absence of any such account, including—

(A) information concerning any applicable fees associated with either the nonestablishment of any such account at the time of the transaction, or any subsequent closure of any such account;

(B) clear and prominent notice that the consumer is responsible for personally and directly paying the non-escrowed items, in addition to paying the mortgage loan payment, in the absence of any such account; and

(C) a clear explanation of the consequences of any failure to pay non-escrowed items, including the possible requirement for direct placement of insurance by the creditor and the potentially higher cost (including any

In addition, H.R. 3012 prohibits transaction in which a consumer must pay a prepayment penalty for paying all or a portion of the principle before the date it is due.<sup>236</sup> Furthermore, H.R. 3012 provides the Federal Board of Governors with the authority to prescribe regulations to guide creditors in evaluating the consumer's ability to repay the transaction under the terms of the transaction.<sup>237</sup>

### C. *Prevention of Mortgage Fraud*

Misappraisal of property has often been the source of fraud in mortgage lending. H.R. 3012 amends the Truth in Lending Act to require a qualified appraiser to conduct a physical inspection of the mortgaged property prior to the securitization of the subprime loan.<sup>238</sup> A qualified appraiser is one who is certified or licensed by the state and performs the appraisal in conformity with the uniform Standards of Professional Appraisal Practice.<sup>239</sup> Any lender found to obtain an appraisal as required is

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potential commission payments to the servicer) or reduced coverage for the consumer in the event of any such creditor-placed insurance. *Id.*

236. *Id.* § 411(b).

In the case of a consumer credit transaction secured by the consumer's principal residence with a fixed interest rate for an introductory period that resets to a variable interest rate after such period, the transaction may not contain terms under which a consumer must pay a prepayment penalty for paying all or part of the principal before the date on which the principal is due at any time after the beginning of the 120-day period ending on the date of the reset to a variable interest rate. *Id.*

237. *Id.* § 412(c) ("The Board . . . shall prescribe regulations in accordance with section 105, or issue guidance, that encourages any creditor with respect to a consumer credit transaction secured by the consumer's principal residence to evaluate the consumer's ability to repay the transaction under the terms of the transaction.").

238. *Id.* § 601(a).

(1) IN GENERAL.—A creditor may not extend credit in the form of a subprime mortgage to any consumer without first obtaining a written appraisal of the property to be mortgaged prepared in accordance with the requirements of this subsection.

(2) APPRAISAL REQUIREMENTS.—

(A) PHYSICAL INSPECTION.—An appraisal of property to be secured by a subprime mortgage does not meet the requirement of this subsection unless it is performed by a qualified appraiser who conducts a physical inspection of the mortgaged property. *Id.*

239. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 601(a) (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008).

(C) For purposes of this subsection, the term "qualified appraiser" means a person who—

(i) is certified or licensed by the State in which property to be appraised is located; and

(ii) performs each appraisal in conformity with the Uniform Standards of Professional Appraisal Practice and Title XI of the Financial Institutions Reform, Recovery, and



liable to the consumer for \$2000.00.<sup>240</sup> Furthermore, H.R. 3012 would deliver incentives those lenders who abide within the framework provided.<sup>241</sup> The incentive is the form of CRA credit, which is an assessment of a lender's operating status in a community. The higher the evaluation, the better the lender.<sup>242</sup>

## V. CONCLUSION

Through regulating adverse subprime and predatory lending, the Act is a step forward for minorities. Amending TILA to require licensing and the establishment of a nationwide registry will provide accountable brokers between and among all of the states. However, the Act should incorporate uniform federal licensing requirements that simultaneously compile a nationwide registry of brokers. This would: (1) streamline the licensing process; (2) reduce the regulatory burden; (3) improve the efficiency and effectiveness of state supervision; (4) increase accountability among the mortgage industry; and (5) reduce fraud and predatory lending practices.<sup>243</sup> The current recommendation by the Act causes a lack of

Enforcement Act of 1989, and the regulations prescribed under such title, as in effect on the date of the appraisal. *Id.*

240. *Id.* ("In addition to any other liability to any person under this title, a creditor found to have willfully failed to obtain an appraisal as required in this subsection shall be liable to the consumer for the sum of \$2,000.").

241. *Id.* § 701(a).

242. *Id.*

EFFORTS ON BEHALF OF SUB PRIME BORROWERS.—In assessing and taking into account, under subsection (a), the record of a regulated financial institution, the appropriate Federal financial supervisory agency may consider as a factor, in accordance with such guidelines as the agency may issue, any of the following programs undertaken by the institution:

(1) A program to provide or support the provision of home ownership or credit counseling to low- and moderate-income consumer borrowers through programs reasonably available to the consumer that have been certified or approved by the Secretary of Housing and Urban Development for such purpose.

(2) A program to provide or support the provision of foreclosure-prevention counseling and other prevention efforts to low- and moderate-income consumer borrowers through programs reasonably available to the consumer that have been certified or approved by the Secretary of Housing and Urban Development for such purpose.

(3) A program to transition low- and moderate-income consumer borrowers from higher-cost mortgage loans to lower-cost mortgage loans. *Id.*

243. Heather Morton, *The Residential Mortgage Licensing System*, STATE LEGISLATURES MAG., Aug. 31, 2007, available at [http://www.ncsl.org/magazine/extra\\_mortonarticle.htm](http://www.ncsl.org/magazine/extra_mortonarticle.htm) (outlining the primary goals of the national licensing system). Currently, at least twenty-nine state mortgage regulatory agencies and eleven states have agreed to use the licensing system. *Id.*

uniformity of licensing requirements between states and additional, independent work in the form of the nationwide registry.

Additionally, the Act's complete prohibition of YSPs is too harsh as it removes some of the beneficial uses of YSPs. Instead, the usage of YSPs should be regulated to provide multiple borrowing options.<sup>244</sup>

In addition, the amendment to TILA's definition of a high-cost mortgage will encompass a greater number of predatory loans. Although the Act does not lower the maximum APR rate defining high-cost mortgages, the Act does lower the percentage for which fees and costs can attribute the entire cost a loan.<sup>245</sup> This will protect minorities from being deceived into purchasing a mortgage they cannot afford. Furthermore, the Act expands the definition of fees to include single-premium insurance and prohibits the inclusion of transaction fees without proper disclosure.<sup>246</sup> These amendments to TILA will allow HOEPA's enhanced disclosures to effectively reach a greater number of minorities.

Also, by placing the duty on brokers to ensure that borrowers can afford their mortgages, the Act puts the responsibility of lending in those who know best: the direct contact to the often unsophisticated minority borrower.<sup>247</sup> This will ensure that brokers do not (and cannot) lend to minorities without good faith, documented knowledge of their ability to repay.<sup>248</sup> By forcing brokers to only refinance when there is a discernable advantage to the borrower, the Act will ensure that unscrupulous lending to minorities through the refinance market will be limited. The Act's counseling requirement will also place an additional protective layer on the financial transaction. Not only must the broker have reason-

244. See Jessica Fogel, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 453 (2005) (stating that YSPs can be used to pay direct fees and offer borrowers zero cost loans).

245. Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. § 301 (1st Sess. 2007), available at <http://www.govtrack.us/congress/billtext.xpd?bill=h110-3915> (last visited Apr. 22, 2008).

246. *Id.*

The total points and fees payable in connection with the loan exceed— (I) in the case of a loan for \$20,000 or more, 5 percent of the total loan amount; or (II) in the case of a loan for less than \$20,000, the lesser of 8 percent of the total loan amount or \$1,000.

*Id.*

247. See *id.* § 201.

[N]o 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, and assessments. *Id.*

248. *Id.*

able belief that the borrower can repay, the broker must also have certification that the borrower has received counseling from an approved HUD counselor.<sup>249</sup>

Finally, proposed H.R. 3012 contains provisions that fit appropriately within the Act. Specifically, stringent disclosure requirements will ensure that in addition to verbal disclosure, borrowers have simple, clear written disclosure of their financial transaction.<sup>250</sup> The prohibition of abusive practices and prevention of mortgage fraud ensures the lenders are complying with sound lending principles. The deterrence and rewards system set forth by H.R. 3012 provide a manner in which to evaluate lender compliance.<sup>251</sup> The additions of these provisions would enhance the effectiveness of the Act.

In totality, the subprime lending market has caused not only enormous damage to minorities and their communities, but also significant damage to the world market.<sup>252</sup> Because state regulation is limited, it is necessary to promulgate effective federal legislation that will tackle the roots and continuing effects of subprime lending. H.R. 3915 is an approach in the right direction and through additional regulation, as found in H.R. 3012, the negative effects of subprime lending may be reduced significantly.

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249. *Id.* § 301.

250. Fair Mortgages Practices Act of 2007, H.R. 3012, 110th Cong. § 201(a) (1st Sess. 2007), available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-3012> (last visited Apr. 22, 2008).

251. *Id.* § 701.

252. Heather Timmons & Julia Werdigier, *Asia and Europe Stocks Follow Wall Street*, N.Y. TIMES, Mar. 14, 2007, available at <http://query.nytimes.com/gst/fullpage.html?res=9901E2DB1E31F937A25750C0A9619C8B63&sec=&spon=&pagewanted=print> (stating that Asian and European stock markets have tumbled in response to consequence of loose practices in the U.S. housing market).