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Knowledge is Power: Consumer Education and the Subprime Mortgage Market

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INTRODUCTION

Mr. Donald Wagner, a professor at North Park University in Chicago, refinanced his fixed rate mortgage in March of 2005 to assist his daughter with her college tuition.[1] Mr. Wagner's broker did not inform him that his interest rate would rise dramatically only one month after refinancing.[2] As a result of his pay option adjustable rate mortgage,[3] the principal of his loan has increased by $15,000 over the last two and a half years.[4] Mr. Wagner has been forced to borrow against his pension and 401(k) in order to make payments, and, to make matters worse, last summer he discovered that his loan includes a $12,000 prepayment penalty.[5] He now spends over sixty percent of his income on his mortgage payment, and states, "[I]t's only

1 Gretchen Morgenson, *Countrywide Subpoenaed by Illinois*, N.Y. TIMES, Dec. 13, 2007, at C1.

2 *Id.*

3 "These loans allow borrowers to pay only a fraction of the interest owed and none of the principal, resulting in a growing rather than a shrinking mortgage balance." *Id.* For further discussion of negative amortization see *infra* Part I.B.6.

4 Morgenson, *supra* note 1.

5 *Id.* For further discussion of prepayment penalties, see *infra* Part I.B.4.

[for] so long that I can do that."[6] Unfortunately, Mr. Wagner's story is not unique.[7]

Homeownership has long been the foundation of the American Dream,[8] but in recent years this dream has been cut short for many Americans.[9] In 2006 there were over 1.2 million residential foreclosures across the United States.[10] That is more than one foreclosure per *minute*.[11] This was a dramatic rise from the number of foreclosures in 2005, and numbers did not slow in 2007.[12] In November of 2007 alone there were a total of 201,950 foreclosure filings, the equivalent of one foreclosure for every 617 households across the country, a sixty-eight percent increase from number of foreclosures in November of 2006.[13] An overwhelming number of these foreclosures are attributable to subprime mortgages.[14]

It is estimated that "[a]t least one out of five subprime loans will end in foreclosure—representing the highest rate of U.S. foreclosures since the Great Depression."[15] These statistics prove that action needs to be taken in

6 Morgenson, *supra* note 1.

7 "Countrywide, the nation's largest mortgage lender and loan servicer, is coming under increased scrutiny as the home loan crisis deeps." *Id.* The Illinois Attorney General recently subpoenaed Countrywide documents "as part of the state's expanding inquiry into dubious lending practices that have trapped borrowers in high-cost mortgages they can no longer afford." *Id.*

8 "Owning a home has always been at the center of the American Dream." George W. Bush, President of the United States, President Bush Discusses Homeownership Financing, Address at the Rose Garden, (Aug. 31, 2007), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2007_presidential_documents&docid=pd03se07_txt-23.pdf.

9 *See* Debra Pogrund Stark, *Unmasking the Predatory Loan in Sheep's Clothing: A Legislative Proposal*, 21 HARV. BLACKLETTER L.J. 129, 133 (2005).

10 ASS'N OF CMTY. ORGS. FOR REFORM NOW, HOME INSECURITY: FORECLOSURES IN MIAMI-DADE COUNTY NEIGHBORHOODS 2 (2007), *available at* http://acorn.org/fileadmin/Reports/FL_Miami_Dade_County.pdf.

11 *Id.*

12 RealtyTrac, the publisher of the largest database of pre-foreclosure and foreclosures properties, reports that in 2006, there were 1,259,118 residential foreclosures in the United States. This is "up 42 percent from 2005 and [is at] a foreclosure rate of one foreclosure filing for every 92 U.S. households." Press Release, RealtyTrac.com, More Than 1.2 Million Foreclosure Filings Reported in 2006, (Jan. 25, 2006), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=1855&accnt=64847; *see also* John W. Schoen, *Spike in Foreclosures: Sen. Schumer Urges Federal Bailout Worth 'Hundreds of Millions' of Dollars,* MSNBC, Apr. 12, 2007, http://www.msnbc.msn.com/id/18059004/.

13 Press Release, Realtytrac.com, Foreclosure Activity Decreases 10 Percent in November (Dec. 19, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3797.

14 A study published by the Center for Responsible Lending in December 2006, found that "one out of five (19 percent) subprime mortgages originated during the past two years [2005 and 2006] will end in foreclosure." ELLEN SCHLOEMER ET AL., LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS 3 (2006), *available at* http://www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf.

15 Center for Responsible Lending, Subprime Mortgage Meltdown, http://www.responsiblelending.org/issues/mortgage/subprime-mortgage-crisis.html (last visited April 5, 2008). The subprime mortgage crisis has become so dire that, on January 10, 2008, Ben Bernanke, the Chairman of the Federal Reserve, "signaled the bank's willingness to lower interest rates to prevent housing and credit problems from causing a U.S. recession." Lorrie Grant, *Fed 'Stands Ready' to Avoid Economic Recession*, NPR.org, Jan. 10, 2008, http://www.npr.org/templates/story/story.php?storyId=17993667. Currently, the Federal Reserve reports that "[a]bout 21 percent of subprime adjustable rate mortgages are 90 days or more delinquent, and foreclosure rates are rising sharply . . . ." *Id.* As a result, "[s]ome 2 million

order to cure the current foreclosure epidemic, and that steps must be taken in order to prevent history from repeating itself in the future. Educating the public in order to reform the subprime mortgage industry is not an entirely new concept,[16] but given the amount of foreclosures that took place in 2006 and 2007, and those looming on the not so distant horizon, it is time that this idea is revisited.[17]

Foreclosures directly impact the lives of the families' whose homes are being foreclosed,[18] and cause these families severe emotional and financial trauma.[19] "For most homeowners, equity in a home represents a significant bulk of the resources accumulated over a lifetime."[20] The damaging effects of foreclosures are also experienced by the community as a whole.[21] Increased foreclosures can transform a once thriving community into an abandoned area.[22] If there is a concentration of foreclosures in a single community the result is "a decrease in overall property values, an increase in crime, and a corresponding need for greater law enforcement and other government services."[23] Due to these negative consequences asso-

homeowners are due to have their adjustable rate mortgages, or ARMs, reset over the next year and risk losing their homes." *Id.*

16 *See* Stark, *supra* note 9, at 130.

17 On September 18, 2007, RealtyTrac reported that, in August 2007, there were 239,851 foreclosure filings. This number is 37 percent higher than July of 2007, and 112 percent higher than August of 2006. "This is the highest number of foreclosure filings in a single month that RealtyTrac has reported since it began issuing the monthly report in January of 2005." Press Release, RealtyTrac.com, Foreclosure Activity Increases 37 Percent in August (Sept. 8, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3222&accnt=64847. James J. Saccacio, RealtyTrac's CEO commented, "The jump in foreclosure filings this month might be the beginning of the next wave of increased foreclosure activity, as a large number of subprime adjustable rate loans are beginning to reset now." *Id.*

18 "[A] predatory loan that results in a foreclosure can be a devastating event in the life of an individual subprime borrower." Siddhartha Venkatesan, *Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 208 (2003).

19 Baher Azmy & David Reiss, *Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002*, 35 RUTGERS L.J. 645, 663 (2004); Kurt Eggert, *Held up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 581 (2002).

20 Venkatesan, *supra* note 18, at 208. "[H]omes represent Americans' largest financial asset . . . ." Nathalie Martin & Ocean Tama y Sweet, *Mind Games: Rethinking BAPCPA's Debtor Education Provisions*, 31 S. Ill. U. L.J. 517, 521 (2007).

21 Venkatesan, *supra* note 18, at 208; Eggert, *supra* note 19, at 582; Azmy & Reiss, *supra* note 19, at 663. "Whole communities have been adversely affected by the phenomenon of predatory lending because aggressive mortgage brokers target specific neighborhoods within which to market these high-cost home loans, and the subsequent foreclosures in these areas have led to rows of boarded up homes being inhabited by gangs and drug dealers." Stark, *supra* note 9, at 130.

22 *See* Azmy & Reiss, *supra* note 19, at 663.

23 *Id.* "Neighborhoods become vulnerable . . . . Abandoned homes become targets for drug dealers and arson. . . . The need for police and fire services rises in relation to neighborhood decline, further burdening city resources. The increased costs for city services directly affects the proprietary interests of cities." Kathleen C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355, 375–76 (2006). In August of 2007, over 18,000 jobs in the mortgage industry were cut due to the meltdown in the subprime sector. David Ellis, *Job Cuts from Subprime: 18,000 and Counting*, CNNMONEY, Aug. 23, 2007, http://money.cnn.com/2007/08/22/news/economy/subprime_layoffs/index.htm. Some economists predict that additional job losses will be seen in housing-related industries. Home Depot "blamed the housing-market softness and turmoil in the

ciated with foreclosures, and the recent increase in the sheer number of foreclosures taking place, there is a dire need for the federal government to enact legislation that will give consumers the ability to protect themselves from the types of home loans that most often lead to foreclosure.[24]

The federal government should enact legislation requiring borrowers to participate in a consumer education program before borrowers can commit to loans containing adjustable interest rates,[25] prepayment penalties,[26] balloon payments,[27] that does or has the potential to negatively amortize,[28] or where points and fees will be financed along with the principal.[29] These terms, once mainly attributed to predatory loans, are now prevalent in many of today's subprime loans.[30] It has been argued that "[p]redatory lending is made possible by inadequate information, or, in technical jargon, asymmetric information held by lenders and borrowers . . . . Predatory lending would not exist, or would be relatively rare, if prospective borrowers understood the true nature of their loan contracts."[31] Logically, it seems to follow that the use of loan terms typically associated with predatory lending are also present in subprime loans due to unequal knowledge possessed by borrowers and lenders.[32] Providing borrowers with this education would give them the tools needed to correctly assess risks associated with these terms and allow them to make informed decisions. Furthermore, pre-purchase mortgage counseling has been shown to reduce the number of delinquent mortgage payments.[33]

Part I of this Comment explores prime, subprime and predatory loans, lays out why securitization has played a large role in the recent dramatic increase in subprime loans, and discusses blurring of the distinction between legitimate subprime and predatory loans. Part II continues with an

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subprime market for its drop in second-quarter profits." *Id.* General Motors also cites a weakened housing market for the reduced demand for their "full-size pickup trucks and SUVs." *Id.* As a result, General Motors has cut back on overtime available for its plant employees. *Id.* "Problems could spread to other retail segments, warns John Silvia, chief economist with Wachovia. Consumers faced with high interest rate mortgages are likely to cut back on spending. Without customers, retailers could be forced to trim their headcount." *Id.*

24 Though there is a need for the federal government to address foreclosures currently taking place, the purpose of this Comment is how to prevent this type of foreclosure epidemic from taking place again in the future.

25 An adjustable rate mortgage, or ARM, is a mortgage where the interest rate will change periodically over the life of the loan. HUD.gov, Adjustable Rate Mortgage (ARM): What is an ARM?, http://www.hud.gov/offices/hsg/sfh/ins/203armt.cfm (last visited April 5, 2008). *See infra* Part I.B.1.

26 *See infra* Part I.B.4.

27 *See infra* Part I.B.5.

28 *See infra* Part I.B.6.

29 *See infra* Part I.B.2.

30 *See infra* Part I.

31 Governor Edward M. Gramlich, Remarks at the Fair Housing Council of New York, Syracuse, New York (Apr. 14, 2000), *available at* http://www.federalreserve.gov/BOARDDOCS/Speeches/2000/200004142.htm.

32 *See infra* note 106 and accompanying text.

33 ABDIGHANI HIRAD & PETER M. ZORN, A LITTLE KNOWLEDGE IS A GOOD THING: EMPIRICAL EVIDENCE OF THE EFFECTIVENESS OF PRE-PURCHASE HOMEOWNERSHIP COUNSELING (2001), *available at* http://freddiemac.com/corporate/reports/pdf/homebuyers_study.pdf.

assessment of the current federal legislation in place to help protect borrowers from predatory lending practices. Next, Part III surveys North Carolina, New Jersey and Illinois' predatory lending laws, all of which require consumer education for certain loans, and considers the success of these laws. This Comment then moves to propose a consumer education requirement when specific terms are included in a mortgage and discusses how to implement this requirement in Part IV, recommending that lenders be required to show proof that a borrower has completed the mandatory consumer education before the lender is allowed to securitize the borrower's loan. This Comment concludes with the story of Mr. Alvaro Cortez, a man who benefited from Illinois' consumer education requirement, and proves that consumer education can help in the fight against abusive loan terms which lead to foreclosure.

I. AS TIME HAS PASSED, THE LEGITIMATE SUBPRIME MARKET HAS TAKEN ON CHARACTERISTICS OF THE PREDATORY MARKET, BLURRING THE DISTINCTION BETWEEN THE TWO

Not long ago, there were "three markets for home mortgages: a prime market, a legitimate subprime market, and a predatory market."[34] The prime market[35] is, and always has been, for borrowers who have good credit histories and present relatively low risks of defaulting on their loans.[36] The legitimate subprime market made credit available for people who generally had lower credit scores[37] or for other reasons could not qualify for a prime mortgage.[38] Since these borrowers had less than perfect credit, lend-

34 Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1258 (2002).

35 "'Prime' loans are those made to 'low-risk borrowers with strong credit histories.'" David J. Weiner, Comment, *Assignee Liability in State Predatory Lending Laws: How Uncapped Punitive Damages Threaten The Secondary Mortgage Market*, 55 EMORY L.J. 535, 538 (2006) (quoting Engel & McCoy, *supra* note 34, at 1258). Because prime loans are made to borrowers with good credit histories, mortgage lenders actually compete to offer the best rates and terms to borrowers. *Id.* "This competition has resulted in constantly evolving, innovative loan products as well as sophisticated, automated underwriting processes. These advances . . . have led to the widespread availability of funds for prime borrowers." *Id.* at 538–39.

36 Engel & McCoy, *supra* note 34, at 1258.

37 Credit scores are how most lenders assess the risk of a particular loan. Most lenders look at a borrower's FICO score, a credit score developed by Fair Issac Corporation. Each borrower actually has three FICO scores, one for each of the three credit bureaus—Experian, TransUnion and Equifax. A borrower's FICO score is based on the following factors, and their relative weight to the overall score is indicated in parentheses: payment history (35%), amounts owed (30%), length of credit history (15%), new credit (10%), and types of credit used (10%). FICO scores affect the amounts that lenders are willing to lend and on what terms they are willing to do so. MyFICO.com, http://www.myfico.com/CreditEducation (last visited Mar. 22, 2008).

38 Engel & McCoy, *supra* note 34, at 1258; *see also* Azmy & Reiss, *supra* note 19, at 650–51 ("A subprime loan is typically intended to extend credit to a borrower who, for reasons such as a poor credit record, high debt-to-income ratio, or unstable employment history, cannot qualify for a conventional or prime mortgage loan."). The legitimate subprime mortgage market "provides a source of funds for credit-impaired borrowers and other borrowers that are unable to obtain credit in the prime market." DEPTS. OF TREASURY & HOUSING AND URBAN DEV., CURBING PREDATORY HOME MORTGAGE LENDING 27 (2000), http://www.huduser.org/publications/hsgfin/curbing.html [hereinafter CURBING]. The subprime market also extends credit to "creditworthy borrowers with variable or hard-to-document

ers believed that they were more likely to default on their loans.[39] In order to compensate for this increased risk, subprime lenders have traditionally charged higher interest rates.[40] The predatory mortgage market has been described as a subset that grew out of the subprime mortgage market. Though most predatory lending takes place within the subprime market,[41] predatory loans are distinct from legitimate subprime loans.[42] Predatory lenders target borrowers "who, because of historical credit rationing, discrimination, and other social and economic forces, are disconnected from the credit market."[43] Predatory loans typically exhibit two or more of the following qualities: (1) terms that can result in great harm to borrowers,[44] (2) excessive points and fees,[45] (3) fraudulent or deceptive lending practices,[46] (4) lack of transparency,[47] and (5) borrowers' waiver of "meaningful legal redress."[48] The subprime mortgage market has rapidly grown in recent years and now many subprime loans exhibit the qualities that were once mainly associated with predatory lending.

A. The Boom in Subprime Lending Led to the Birth of the Predatory Market

The subprime mortgage industry has experienced tremendous growth since the mid-1990s. In 1994, the subprime industry accounted for only $35 billion of the nation's loans originated that year,[49] and by 2005 it had grown to $665 billion.[50] The explosion in the subprime market can be attributed to a number of factors, but most scholars agree that securitization

income. A subprime mortgage may be a first mortgage (for either purchasing a home or refinancing an existing mortgage), a second mortgage, or a home equity line of credit." *Id.* at 26.

39 A common characteristic of subprime lending is higher risk. "Lenders experience higher loan defaults and losses by subprime borrowers than by prime borrowers." CURBING, *supra* note 38, at 27.

40 Azmy & Reiss, *supra* note 19, at 651 ("Studies have estimated that subprime loans have on average a two and a half to four percentage points higher interest rate than prime loans."). Subprime loans also tend to have higher points and fees because of the higher origination and servicing costs associated with these loans. *Id.*

41 "Predatory lending generally occurs in the subprime mortgage market . . . ." CURBING, *supra* note 38, at 1.

42 Engel & McCoy, *supra* note 34, at 1261; Azmy & Reiss, *supra* note 19, at 650.

43 Engel & McCoy, *supra* note 34, at 1279.

44 *Id.* at 1260, 1261–65. These terms include but are not limited to lending without considering the borrower's ability to repay the loan, prepayment penalties, balloon payments, and negative amortization.

45 *Id.* at 1260, 1265–67.

46 *Id.* at 1260, 1267–68.

47 *Id.* at 1260, 1268–70.

48 *Id.* at 1260, 1270.

49 Azmy & Reiss, *supra* note 19, at 651–52.

50 SCHLOEMER, *supra* note 14, at 7. By 2006, outstanding subprime loans "account[ed] for about 14 percent of all first-lien mortgages." Ben S. Bernanke, Chairman, Board of Governors of the Fed. Reserve System, Speech at the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure and Competition, Chicago, Illinois (May 17, 2007), http://www.federalreserve.gov/newsevents/speech/bernanke20070517a.htm. "Subprime mortgages made up 22% of new loans in 2005, compared to 8% in 2003 . . . ." *How We Got into the Subprime Lending Mess*, KNOWLEDGE@WHARTON, Sept. 19, 2007, http://knowledge.wharton.upenn.edu/article.cfm?articleid=1812 [hereinafter *Lending Mess*].

of subprime loans for their sale to third-party investors has been the driving force behind the market's rapid growth.[51] Securitization,[52] increased availability of diverse mortgage products, and increased incentives to lend to people with low and moderate incomes have all been cited as reasons that led to the birth of the predatory lending market.[53] The rapid growth in the subprime market has also lead to a rapid growth in predatory lending, and now many subprime loans exhibit the qualities that were once only found in predatory loans.

B. Characteristics of the Predatory Market Adopted by the Subprime Market

The term "predatory loan" is extremely malleable, and there is no single widely accepted definition.[54] Occasionally, authors describe predatory loans as, "'a mismatch between the needs and capacity of the borrower,' which results in a loan with terms so disadvantageous to a particular borrower that there is little likelihood that the borrower can repay the loan."[55] However, not all scholars or regulators agree that this is the definition of a predatory loan.[56] Some have hesitated to give the term a definition at all,

51 Securitization is the process through which lenders "sell mortgages to financial intermediaries, who in turn pool mortgages and sell the cash flows as structured securities." Bernanke, *supra* note 50. Securitization began to be widely used "in the 1980s, and, by 1993, sixty percent of home-mortgage loans were securitized. . . . It is now routine for lenders to originate loans and sell them to secondary-market institutions, which provide[s] a steady stream of capital to lend." Engel & McCoy, *supra* note 34, at 1273–74. For a discussion of the steps in the securitization process, see Eggert, *supra* note 19, at 538–41. Rapid securitization allows lenders to recoup the money they have lent almost immediately. *Id.* at 546.

> The lender can [then] use this infusion of capital to make a new round of loans. This quick churning of loan principal allows even an institution without a great amount of fixed capital to make a huge amount of loans . . . . [T]his ability to leverage is particularly useful to smaller, disreputable companies that otherwise would have difficulty funding a large number of loans.

Id. Securitization has mostly done away with long-term relationships between lenders and borrowers. "In the world of securitization, with its ever churning markets, there are few long term relationships, but only the financial equivalents of one night stands." *Id.* at 551; *see* Azmy & Reiss, *supra* note 19, at 652–53; Baher Azmy, *Squaring the Predatory Lending Circle*, 57 FLA. L. REV. 295, 313–20 (2005).

52 "[T]he practice of selling mortgages to investors may have contributed to the weakening of underwriting standards. [W]hen an originator sells a loan and its servicing rights, the risks (including, of course, any risks associated with poor underwriting) are largely passed on to the investors . . . ." Bernanke, *supra* note 50. "About 56 percent of the home mortgage market is now securitized, compared with only 10 percent in 1980 and less than 1 percent in 1970." Ben S. Bernanke, Chairman, Board of Governors of the Fed. Reserve System, Speech at the Federal Reserve Bank of Kansas City's Economic Symposium, Jackson Hole, Wyoming (Aug. 31, 2007), http://www.federalreserve.gov/newsevents/speech/bernanke20070831a.htm.

53 Engel & McCoy, *supra* note 34, at 1273–80.

54 "[E]ven defining a core concept of 'predatory lending' has eluded regulators . . . because, as with the doctrine of unconscionability, its manifestations are generally context-specific." Azmy & Reiss, *supra* note 19, at 649.

55 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, 153–54 (2005) (quoting Eggert, *supra* note 19, at 511).

56 Since whether a loan's terms are predatory is highly fact specific, when New Jersey adopted the Home Ownership Security Act in 2002, the legislature declined to adopt a definition of "predatory lending." Azmy & Reiss, *supra* note 19, at 649.

believing that a set definition could prove to be too limiting, as what may be considered predatory in one loan may not be considered predatory in another.[57] As discussed above, for our purposes, we can define predatory loans as loans which typically exhibit two or more of the following qualities: (1) terms that can result in great harm to borrowers[58], (2) excessive points and fees[59], (3) fraudulent or deceptive lending practices,[60] (4) lack of transparency,[61] and (5) terms that require borrowers' waiver of "meaningful legal redress."[62] Examples of mortgage terms which exhibit these qualities may include lending without considering the borrower's ability to repay, financing excessive points and fees, loan flipping, prepayment penalties, balloon payments, and negative amortization.[63] Many of these terms are regularly used in subprime mortgages, and can adversely affect borrowers.[64]

1. Lending without Considering Borrowers' Ability to Repay Will Likely Lead to Foreclosure

When lenders make adjustable rate subprime mortgages, they only consider the borrower's ability to repay the loan's current monthly payment.[65] The lender does not consider whether the borrower will be able to

57 *Id.*; Eggert, *supra* note 19, at 511–13.

> Defining 'Predatory lending' is difficult because it encompasses many actions that seem, on their face, to be indistinguishable from legitimate lending activities. Predatory lending can be divided into two sets of activities. The first set consists of those activities that are either clearly illegal or unconscionable by their very nature. These per se improper activities include such actions as misrepresenting the terms of the loans and forging the signatures of borrowers on loan documents.
>
> The second set of activities that make up predatory lending are those that bedevil the regulators of the lending industry: activities that are legal but, when misused by unprincipled lenders, cause borrowers to pay interest rates and fees higher than the market and the borrowers' credit rating would justify. Practices such as balloon payments, adjustable rate mortgages, rapid refinancing of existing loans, and even high interest rates and fees could be used in non-predatory loans.

Eggert, *supra* note 19, at 513. "[S]ome community activists have brushed definitional issues aside, reasoning that 'you know predatory lending when you see it.'" Engel & McCoy, *supra* note 34, at 1260.

58 Engel & McCoy, *supra* note 34, at 1260, 1261–65.

59 *Id.* at 1260, 1265–67.

60 *Id.* at 1260, 1267–68.

61 *Id.* at 1260, 1268–70.

62 *Id.* at 1260, 1270.

63 Azmy & Reiss, *supra* note 19, at 657–62; Keyfetz, *supra* note 55, at 155–58; Eggert, *supra* note 19, at 515–22. In many situations, these terms can be considered predatory when paired with the already higher interest rates and points and fees that accompany subprime loans. Azmy & Reiss, *supra* note 19, at 655.

64 *See* SCHLOEMER, *supra* note 14, at 5. "Subprime mortgages routinely include features that increase the risk of foreclosure. Such features include adjustable interest rates, balloon payments, prepayment penalties, and loans with limited documentation of borrowers' loan qualifications." *Id.*

65 In recent years, subprime lenders have predominately offered adjustable rate mortgages (ARMs). "'Exploding' loans or 2/28s operate as two-year loans that lead to another bad ARM or even foreclosure after the introductory teaser rate expires. Because subprime lenders typically qualify borrowers based on the introductory payment amount, most borrowers cannot afford to remain in these arrangements . . . ." *Ending Mortgage Abuse: Safeguarding Homebuyers: Hearing Before the Subcomm. on Hous., Transp., and Cmty. Dev.*, 110th Cong. 5 (2007) (statement of Michael Calhoun, Presi-

repay the loan when the introductory teaser rate expires, or when the interest rate resets at a higher rate.[66] Given that predatory and subprime loans are often not first mortgages,[67] lenders base the amount of the loan on the amount of equity that the borrower has in his or her home.[68] This practice of "asset based lending"[69] is likely to lead to default and foreclosure, robbing the borrower of any equity he or she may have accumulated in his or her home.[70]

2. Financing Excessive Points and Fees Disguises the Cost of the Loan

Predatory and subprime lenders often charge much higher points and fees[71] than are charged for prime loans.[72] In addition to carrying higher points and fees, instead of paying for these in cash, many times borrowers

dent, Ctr. for Responsible Lending) [hereinafter *Ending Mortgage Abuse*, Calhoun Testimony], *available at* http://www.responsiblelending.org/pdfs/062304-calhoun-housetestimony.pdf.

66 The Borrower's Protection Act of 2007, proposed by Senators Schumer, Brown, and Casey would "[r]equire sensible underwriting to ensure that the borrower has the ability to repay a loan, taking into account payment increases, countering the practice of subprime lenders that underwrite to an artificially low initial 'teaser' rate . . . ." *Id.* at 8.

67 *See* Azmy & Reiss, *supra* note 19, at 656–57. "Over 80% of subprime lending—the market within which predatory lending occurs—is not for the purchase of a home but, rather, primarily for cash-out refinancings or to consolidate preexisting consumer debt." *Id.* at 664.

68 *Id.* at 657; *see also* Azmy, *supra* note 51, at 309.

69 Asset based lending is the "'pattern or practice' of making mortgage loans based solely on the value of the property securing the loan, without considering the borrower's capacity to repay." CURBING, *supra* note 38, at 5. Asset based lending is particularly problematic when connected to adjustable rate mortgages, which are commonly paired with prepayment penalties. Ruth Simon, *Mortgage Refinancing Gets Tougher—As Adjustable Loans Reset at Higher Rates, Homeowners Find Themselves Stuck Due to Prepayment Penalties, Tighter Credit*, WALL ST. J., Feb. 8, 2007, at D1. In addition to the prepayment penalties required when refinancing (which can cost thousands of dollars), when housing prices flatten out, lenders tighten their lending standards, making it more difficult for borrowers to refinance. *Id.*

70 Azmy & Reiss, *supra* note 19, at 657; Eggert, *supra* note 19, at 515. This problem is amplified by the fact that these loans are no longer in the hands of the brokers who made them. These loans will have been securitized and the loan will be in the hands of an investor. *See* Azmy & Reiss, *supra* note 19, at 657; Eggert, *supra* note 19, at 515. In sum, this practice is harmful to investors as well as to borrowers.

> Subprime mortgage brokers, lenders, securitizers, and investors are operating in a market that rewards business practices that directly undermine homeowners and sustainable homeownership. Markets function effectively when transactions are likely to benefit all parties involved, but we don't have that situation in subprime lending. The unfortunate truth is that brokers, lenders and investors have reaped enormous gains by originating loans with payments that explode in two short years, requiring homeowners, like clockwork, to refinance to a new subprime loan. Brokers and lenders benefit from this regular and lucrative fee income, but homeowners lose the financial benefit of appreciation as their wealth is stripped away. Worse, when appreciation stops and the families cannot sell or refinance their homes, these loans bring families to foreclosure and ruin.

Ending Mortgage Abuse, Calhoun Testimony, *supra* note 65, at 2–3.

71 "Points are fees paid to the lender or broker for the loan . . . . A home loan often involves many fees, such as loan origination or underwriting fees, broker fees, and transaction, settlement, and closing costs." FederalReserve.gov, Obtain All Important Cost Information, http://www.federalreserve.gov/pubs/mortgage/mortb_1.htm (last visited Mar. 18, 2008).

72 *See* Azmy & Reiss, *supra* note 19, at 657; Eggert, *supra* note 19, at 514. "Many subprime lenders charge fees totaling eight percent of the loan amount or more." *Id.*

finance these points and fees along with the total loan amount. This means that the high interest rate that already applies to the principal amount of the loan is now also being applied to the points and fees associated with the loan.[73] Financing points and fees makes it difficult for a borrower to discern the loan's true cost.[74] The practice of "loan flipping" compounds the problems associated with excessive points and fees.[75]

3. Loan Flipping Strips Equity from the Borrower's Home

Loan flipping is the practice of repeatedly refinancing a loan "within a short period of time with little or no benefit to the borrower."[76] Borrowers typically have their loans flipped at the urging of a lender in order to lower their monthly payments or to consolidate unsecured debt.[77] Sometimes lenders engage in flipping with the awareness that the borrower cannot afford the terms of the new loan, thereby assuring that the borrower will have to refinance the loan again.[78] Lenders engage in this practice in order to profit from the additional points and fees generated by the new loans.[79] These loans progressively strip the borrower of the equity that he or she had accumulated in his or her home.[80] This practice is even more unsettling because excessive refinancing can trap borrowers in an equity-

73 Azmy & Reiss, *supra* note 19, at 657.

74 *Id.* at 658. "Financing points and fees may disguise the true cost of credit to the borrower, especially for high interest rate loans." CURBING, *supra* note 38, at 9. "Excessive points and fees are frequently the hallmark of a predatory loan, and they can disguise the real cost of credit when they are financed rather than paid outright at a loan closing." *Promoting Homeownership by Ensuring Liquidity in Subprime Mortgage Market: J. Hearing Before Subcomm. on Financial Institutions and Consumer Credit & Subcomm. on Housing and Community Opportunity*, 108th Cong. 5 (2004) (statement of Michael Calhoun, Gen. Counsel, Ctr. for Responsible Lending), *available at* http://www.responsiblelending.org/pdfs/062304-calhoun-housetestimony.pdf (last visited Mar. 18, 2008). Though borrowers may be able to refinance and escape a high interest rate, homeowners are unable to ever recover excessive fees. "Instead, those fees are financed into the loan amount and are repaid from the homeowners' equity when they refinance. Furthermore, in the subprime market, . . . homeowners may not learn the total fees they are being charged on a loan until the day of closing, if at all." *Id.*

75 Azmy & Reiss, *supra* note 19, at 658.

76 CURBING, *supra* note 38, at 73. *See also* Azmy & Reiss, *supra* note 19, at 660.

77 CURBING, *supra* note 38, at 73. Loan flipping also occurs when borrowers cannot make the scheduled payments. *Id.*

> When a loan is flipped, a borrower refinances on terms that are not economically beneficial to him or her, due to the financing of points, fees and prepayment penalties that accompany such loans. A borrower may receive modest additional funds or a slight reduction in the interest rate, but the points and fees that accompany such transactions in the end make the total transaction more costly to the consumer. For example, reducing a borrower's monthly payment by a small amount, say $30 may cost the borrower thousands of dollars in up-front costs and interest over the life of the loan. The high fees derived from flipping attract unscrupulous originators who deceive borrowers about the true cost of the loan.

CURBING, *supra* note 38, at 74.

78 *Id.* at 74.

79 Azmy & Reiss, *supra* note 19, at 660. It should be noted that "[l]enders who flip loans tend to charge high origination fees with each successive refinancing, and may charge these fees based on the entire amount of the new loan, not on just the incremental amount (if any) added to the loan principal through the refinancing." CURBING, *supra* note 38, at 73.

80 *Id.* at 74.

stripping cycle.[81] If a loan contains prepayment penalties, even more equity is stripped from the borrower's home each time the loan is flipped.[82]

4. Hidden Prepayment Penalties Make it More Expensive for a Borrower to Refinance

Prepayment penalties are fees that a borrower is forced to pay if he or she pays off or refinances the loan before the end of the term.[83] These penalties are designed to decrease refinancing and early payoffs, which both shrink the lender's profits.[84] Prepayment penalties are often included in the amount that is refinanced when a loan is flipped, taking an even bigger slice out of the borrower's equity.[85] It has been estimated that eighty percent of subprime loans carry prepayment penalties, yet less than two percent of prime loans carry these penalties.[86] Even more troubling is the fact that borrowers are often not aware that the terms of their loans include prepayment penalties.[87] Similarly, many borrowers are also misled about the existence of balloon payments in their loans.[88]

5. Balloon Payments can be Used as Leverage to Deplete Borrowers' Equity

The term "balloon payment" refers to a lump sum payment that is due at the end of the loan term. This amount is used to pay off the principal that the borrower has not yet paid.[89] Balloon payments can help borrowers secure an initial lower monthly payment, but in predatory loans the balloon payment may be due only three to five years after the loan's origination.[90] Lenders use upcoming balloon payments as leverage to flip the loan and generate additional income for themselves.[91] Balloon payments are used to begin or continue equity stripping refinancing cycles.[92]

81 Azmy & Reiss, *supra* note 19, at 660–61. "Once a borrower is trapped in this equity-depleting cycle, it becomes increasingly difficult to escape through refinancing with a legitimate lender on favorable terms." *Id.*

82 CURBING, *supra* note 38, at 74.

83 Azmy & Reiss, *supra* note 19, at 658. These penalties are very rare in the prime market, but seventy percent of subprime loans have prepayment penalties of "approximately 5% of the total loan amount." *Id.*

84 *See* Eggert, *supra* note 19, at 518.

85 Azmy & Reiss, *supra* note 19, at 658. "The Center for Responsible Lending (CLR) estimates that 850,000 families lose $2.3 billion each year from their home equity wealth because of prepayment penalties in subprime loans." DEBBIE GOLDSTEIN & STACY STROHAUER SON, CENTER FOR RESPONSIBLE LENDING POLICY PAPER NO. 4, WHY PREPAYMENT PENALTIES ARE ABUSIVE IN SUBPRIME HOME LOANS 3 (2003), *available at* http://www.responsiblelending.org/pdfs/PPP_Policy_Paper2.pdf.

86 GOLDSTEIN & SON, *supra* note 85, at 2; Azmy & Reiss, *supra* note 19, at 658.

87 GOLDSTEIN & SON, *supra* note 85, at 8; Azmy & Reiss, *supra* note 19, at 658.

88 Azmy & Reiss, *supra* note 19, at 661. "Often, these borrowers were either unaware of the balloon or were given misleading oral assurances that the balloon payments could be easily refinanced." Eggert, *supra* note 19, at 519.

89 Azmy & Reiss, *supra* note 19, at 661.

90 *Id.*; *see also* Eggert, *supra* note 19, at 519.

91 Azmy & Reiss, *supra* note 19, at 661; Eggert, *supra* note 19, at 519.

92 *See* Azmy & Reiss, *supra* note 19, at 661–62; Eggert, *supra* note 19, at 519.

6. Negative Amortization Strips Equity Before it is Built

Generally when a borrower makes monthly payments on a loan, that payment is used to pay a portion of the principal and a portion of the interest.[93] "In a negatively amortizing mortgage, a consumer's regularly scheduled payments do not cover the full amount of interest due, causing the outstanding principal balance to increase."[94] In essence, the principal does not decrease over the life of the loan,[95] and as a result equity is lost each month.[96] Negative amortization can occur in conjunction with adjustable rate mortgages that have caps on the monthly payment amounts.[97] As with many of the potentially abusive terms discussed above, "many borrowers report that their lenders did not explain how such a loan structure would work."[98]

C. These Terms are the Most Abusive When Borrowers are "Steered" into Accepting Them

Freddie Mac estimates indicate that ten to thirty-five percent of subprime borrowers could have qualified for prime loans.[99] Many believe that this indicates that many borrowers were "steered" into subprime loans.[100]

93 Azmy & Reiss, *supra* note 19, at 662 ("Most loans amortize over the life of the loan with a resultant diminution of principal.").

94 CURBING, *supra* note 38, at 91.

95 Azmy & Reiss, *supra* note 19, at 662.

96 *Id.*

97 FederalReserve.gov, Consumer Handbook on Adjustable-Rate Mortgages, http://www.federalreserve.gov/pubs/arms/arms_english.htm (last visited Jan. 5, 2008). Many adjustable rate mortgages "limit, or cap, the amount your monthly payment may increase at the time of each adjustment. . . . Any interest you don't pay because of the payment cap will be added to the balance of your loan." *Id.*

98 Azmy & Reiss, *supra* note 19, at 662.

99 FreddieMac.com, Automated Underwriting Report, http://www.freddiemac.com/corporate/reports/moseley/chap5.htm (last visited Jan. 8, 2008). "A recent poll of the 50 most active subprime lenders supports this conclusion. The survey found that up to 50 percent of subprime mortgages could qualify as investment-grade mortgages, although some of these loans would fail to meet certain secondary market criteria." *Id.*

100 GOLDSTEIN & SON, *supra* note 85, at 4. Disturbingly, it is often minorities being steered into these subprime loans. "Nationwide, 50% of all loans in predominately African-American neighborhoods are subprime, compared to only 9% in predominately white neighborhoods." Azmy & Reiss, *supra* note 19, at 654–55. The root of this problem could trace back to when redlining. "Redlining—categorically restricting or precluding residential lending in minority neighborhoods—was openly practiced by banks and government agencies prior to the Fair Housing Act of 1968." WILLIAM H. SIMON, THE COMMUNITY ECONOMIC DEVELOPMENT MOVEMENT 26 (2001). Unfortunately, "[d]espite that statute and the subsequent Equal Credit Opportunity Act of 1975, studies continue to find that people of color, or people who reside in predominately minority neighborhoods, are less likely to have success in applying for credit than white people and people in white neighborhoods in otherwise comparable economic circumstances." *Id* at 26–27. "Subprime lending is geographically concentrated in the same minority neighborhoods once denied access to banks and excluded from federal homeownership programs because of their racial composition." Benjamin Howell, *Exploiting Race and Space: Concentrated Subprime Lending as Housing Discrimination*, 94 CAL. L. REV. 101, 103–04 (2006). "The minority concentration of the neighborhood is also positively associated with a higher probability of receiving a prepayment penalty on a subprime loan." John Farris & Christopher A. Richardson, The Geography of Subprime Mortgage Prepayment Penalty Patterns, Housing Policy Debate, 687, 712 (2004) *available at* http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Farris.pdf. *See*

This is troubling because while the prime market has remained relatively unchanged in recent years, the distinction between the legitimate subprime market and the predatory market has become extremely blurred. Today, more and more subprime loans carry terms that were once primarily associated with predatory loans. As discussed above, eighty percent of subprime loans carry prepayment penalties,[101] a particularly volatile mix considering that there has been a corresponding rise in adjustable rate mortgages.[102] When lenders make adjustable rate subprime mortgages without the borrower's ability to repay at an adjusted rate, most borrowers will inevitably have to refinance to be able to afford their monthly payments and will have to pay the prepayment penalties.[103] This disregard for the borrower's ability to repay also gives lenders increased potential to flip the borrower's loan.

D. Lack of Borrower Knowledge Further Blurs the Distinction Between Predatory and Subprime Loans

Traditionally predatory lenders have targeted borrowers that are not connected to the credit market in order to exploit the borrower's lack of information.[104] The terms discussed above may not independently be predatory, but that caveat quickly disappears when they are imposed on uninformed consumers.[105] Scholars site the asymmetry of information and knowledge between borrowers and lenders as highly problematic.[106] Ex-

also, *Ending Mortgage Abuse*, Calhoun Testimony, *supra* note 65, at 9.

101 GOLDSTEIN & SON, *supra* note 85, at 2.

102 Richard K. Green & Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 J. ECON. PERSP. 93, 99 (2005), *available at* http://repository.upenn.edu/cgi/viewcontent.cgi?article=1000&context=penniur_papers. In 2004, adjustable rate mortgages ("ARMs") accounted for thirty-six percent of the mortgages that year. This has marked the highest percent of adjustable rate mortgages in ten years. *Id.* at 99–100.

103 *Lending Mess*, *supra* note 50. Many "[ARMs] carried prepayment penalties making it prohibitively expensive for borrowers to refinance when their payments got too high. Buyers qualified based on the initial low 'teaser' rate, even though they might not be able to shoulder the higher payments that could come if the rate adjusted upward." *Id.*

104 Engel & McCoy, *supra* note 34, at 1271. "These homeowners tend to be very unsophisticated about mortgage products and largely disconnected from the financial services market." Azmy & Reiss, *supra* note 19, at 656.

105 Stark, *supra* note 9, at 145. Consider:

> [I]f the borrower is planning to move and sell the home in three years, then a loan with a balloon payment due in five years should not be problematic. If the borrower is taking classes at night and working during the day but expects to graduate and has a high-paying job waiting for her in a year, then a loan that accrues interest at a higher rate than it is payable at for a one-year period (causing negative amortization) would not be problematic and may best suit that particular borrower's needs.

Id.

106 *See, e.g.*, Engel & McCoy, *supra* note 34, at 1271; Memorandum from Richard K. Green & Susan M. Wachter, on The Housing Finance Revolution to the Federal Research Bank of Kansas City's 31st Economic Policy Symposium in Jackson Hole, Wyo. 34–35, 38–41 (Aug. 31, 2007), *available at* http://www.kansascityfed.org/publicat/sympos/2007/PDF/2007.08.21.WachterandGreen.pdf. In a recent study published by the Woodstock Institute, an alarming thirty-four percent of borrowers did not know whether their loans carry a fixed or adjustable interest rate. *Many Borrowers Unaware of Mortgage Interest Rate Details; Foreclosures Affect Neighbors, Too*, WOODSTOCK DEV. (Woodstock Inst.,

ploitation of unequal knowledge and information is becoming equally problematic in the subprime industry,[107] and this has caused many subprime loans to have the same ending as their predatory counterparts—foreclosure.[108]

II. CURRENT FEDERAL LEGISLATION HAS NOT BEEN ENOUGH TO PROTECT BORROWERS

A. The Truth in Lending Act

In 1968, the federal government enacted the Truth in Lending Act ("TILA")[109] "as title I of the Consumer Credit Protection Act. . . . TILA, implemented by Regulation Z (12 CFR 226), became effective July 1, 1969."[110] TILA was passed in order to ensure that lenders disclose credit terms to borrowers in a way that allows them to compare the terms of credit that they have been offered.[111] TILA requires that the lender disclose certain terms to the borrower including the amount financed, finance charges, the annual percentage rate ("APR"), a statement whether the payments may "increase or decrease dramatically," and the total number of payments.[112]

Chicago, Ill.), Fall 2007, at 1, *available at* http://www.woodstockinst.org/publications/woodstock-developments-newsletter.

107 Kenneth R. Harney, *Mortgage Forms Sow Confusion*, WASH. POST, June 23, 2007, http:www.washingtonpost.com/wp-dyn/content/article/2007/06/22/AR2007062200867_pf.html). "Many borrowers simply do not understand their mortgages—especially subprime loans that come with complex features and costly penalties." *Id.*

> In a series of intensive interviews . . . researchers also found that 'many borrowers were confused by the current . . . mortgage cost disclosures' . . . .
>
> Many had loans that were significantly more costly than they believed, or contained significant restrictions, such as prepayment penalties, of which they were unaware.

Id.; *see also* FED. TRADE COMM'N, BUREAU OF ECON. STAFF REPORT, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS, EXECUTIVE SUMMARY (2007) *available at* www.ftc.gov/os/2007/06/P025505MortgageDisclosureexecutivesummary.pdf [hereinafter IMPROVING CONSUMER MORTGAGE DISCLOSURES].

108 Keyfetz, *supra* note 55, at 157–58 "There is a strong connection between the growth and concentration of subprime lending and increases in foreclosures—not just in recent weeks, but in recent years." *What We Need is a Meaningful, National Standard for Mortgage Underwriting*, WOODSTOCK DEV. (Woodstock Inst., Chicago, Ill.), Fall 2007, at 3, *available at* http://www.woodstockinst.org/component/option,com_docman/Itemid,260/task,cat_view/gid,98/.

109 15 U.S.C.S. § 1602 (2005).

110 OFFICE OF THE COMPTROLLER OF CURRENCY, TRUTH IN LENDING: COMPTROLLER'S HANDBOOK 1 (2006), *available at* http://www.occ.gov/handbook/til.pdf [hereinafter COMPTROLLER'S HANDBOOK].

111 *Id.* at 4.

112 15 U.S.C.S. § 1638 (2005). It should be noted that TILA does not fully address advertising issues that arise in the subprime loan context. Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. ON LEGIS. 123, 129–30 (2007). McCoy writes:

> Advertisements featuring low introductory rates on variable-rate loans—known as 'teaser rates'—raise other difficulties that TILA fails to fully resolve. Under TILA, an advertisement touting a teaser rate must state how long the teaser rate lasts and advise readers that the APR could rise after consummation. However, nothing in TILA requires an ad to describe the rate increase, its limits, or how it would affect the payment schedule. This allows lenders to entice borrowers with promises of low interest without revealing how high their interest rate could eventually go.

B. Home Ownership Equity Protection Act of 1994

Congress amended TILA to include the Home Ownership Equity Protection Act of 1994 ("HOEPA") in order to help combat predatory lending.[113] HOEPA requires additional disclosures and imposes "substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount."[114] HOEPA provisions are triggered in two cases. First, HOEPA provisions are triggered when the initial APR is 8% higher than the yield on Treasury securities for first-lien mortgages with comparable maturity periods, or that are 10% higher for subordinate-lien mortgages.[115] Second, the provisions are triggered when the points and fees that the consumer will pay at or before the closing are greater than 8% of the entire loan amount or $400.[116]

For mortgages subject to HOEPA, some of the disclosures that lenders must make to borrowers include: the APR; the amount of regular payments and any balloon payments; the total amount borrowed; and for adjustable rate mortgages, a statement that the APR and monthly payments may increase.[117] "HOEPA prohibits negative amortization without exception, balloon payments on loans with terms of less than five years, [and] loan terms that increase the interest rate in the event of a default . . . ."[118] HOEPA, however, does not apply to mortgages used to purchase homes or to home equity credit lines, and has been criticized by many consumer advocates due to the high amounts required to trigger HOEPA's protections.[119] These high trigger amounts allow many lenders to evade compliance with HOEPA by making loans that fall just below the amounts which trigger HOEPA's protections.[120]

As illustrated by the current foreclosure rate, the disclosure requirements mandated by HOEPA and TILA are not enough to protect consumers or to give them enough information to make informed credit decisions.[121]

Id. at 129.

113 Press Release, Federal Reserve Board, Home Equity Lending Market; Notice of Hearings [Docket No. OP-1288] (May 29, 2007), http://www.federalreserve.gov/newsevents/press/bcreg/20070529b.htm.

114 COMPTROLLER'S HANDBOOK, *supra* note 110, at 2.

115 12 C.F.R. § 226.32(a)(1)(i) (2007); *see also* Azmy & Reiss, *supra* note 19, at 666.

116 12 C.F.R. § 226.32(a)(1)(ii) (2007); *see also* Azmy & Reiss, *supra* note 19, at 666. Note, the $400, is adjusted annually to reflect inflation. *Id.*

117 12 C.F.R. § 226.32(c)(1)–(5) (2007).

118 Azmy & Reiss, *supra* note 19, at 666.

119 *Id.* at 667; Stark, *supra* note 9, at 144.

120 Stark, *supra* note 9, at 144. Stark is also critical of the main protections that the HOEPA offers overall. She claims that these protections are inadequate, citing required disclosures that borrowers do not understand or read as an example. *Id.*; *see Ending Mortgage Abuse*, Calhoun Testimony , *supra* note 65, at 6–7.

121 Azmy & Reiss, *supra* note 19, at 665–68. "[TILA] fails to include more obvious and less technical disclosures that traditionally unsophisticated victims of predatory lending need. . . . [T]he disclosures that TILA does require need only be made at the loan closing . . . . The disclosures are also too confusing where they come included in a bewildering stack of loan documents." *Id.* at 665–66; *see supra* note 106.

In a recent Federal Trade Commission study of prime and subprime loans that met current federal disclosure requirements, two-thirds of borrowers did not detect the sizeable penalty that would be incurred for refinancing within the first two years.[122] Further, a Consumer Federation of America study from 2004 concluded that borrowers "most likely to purchase complex ARMs were among the least likely to understand these products."[123] Many states have recognized the inadequacies of the current federal protections and mandated disclosures, and have enacted their own laws in order to curb lending abuses and to fill in the gaps left open by federal law.[124]

III. SOME STATES HAVE ENACTED THEIR OWN LAWS THAT REQUIRE CONSUMER EDUCATION IN ORDER TO COMBAT PREDATORY LENDING PRACTICES

In 1999, North Carolina was the first state to try to cure the failures of the federal legislation and passed its own anti-predatory lending statute.[125] Since then, many states have passed some form of legislation intended to curb predatory lending.[126] One of the unique features of North Carolina's law is that it requires consumer education when loans contain certain terms.[127] Only a handful of states have mirrored the requirement of con-

122 Harney, *supra* note 107; *see generally* IMPROVING CONSUMER MORTGAGE DISCLOSURES, *supra* note 107.

123 *The Federal Government's Role in Empowering Americans to Make Informed Financial Decisions Before the Subcomm. on Oversight of Government Management, the Fed. Workforce, and the District of Columbia of the S. Comm. on Homeland Security and Governmental Affairs*; 110th Cong. (2007) (statement of Sheila C. Bair, Chairman, Fed. Deposit Insurance Corporation), *available at* http://www.fdic.gov/news/news/speeches/archives/2007/chairman/spapr3007.html.

124 *See* Christopher R. Childs, Comment, *So You've Been Preempted—What are You Going to Do Now?: Solutions for States Following Federal Preemption of State Predatory Lending Statutes*, 2004 BYU L. REV. 701, 703.

125 Kurt Eggert, *Lashed to the Mast and Crying for Help: How Self-Limitation of Autonomy Can Protect Elders from Predatory Lending*, 36 LOY. L.A. L. REV. 693, 711 (2003).

126 *Id.* at 712–14. It should be noted that there are federalism and preemption issues associated with the states enacting their own anti-predatory lending statutes. "The Office of the Comptroller of the Currency ('OCC') and the Office of Thrift Supervision ('OTS') have, via administrative fiat, aggressively pushed preemption of state laws for national banks and savings associations, especially since 1996." Deanne Loonin & Elizabeth Renuart, *The Life and Debt Cycle: The Growing Debt Burdens of Older Consumers and Related Policy Recommendations*, 44 HARV. J. ON LEGIS. 167, 175 (2007). This had impacted the states' abilities to enforce their own predatory lending laws. "The preemption rights accorded federal depositories by the OTS and the OCC make it very difficult for states to protect their consumers from abusive practices in the credit marketplace. For example, OCC and OTS decisions have trumped state anti-predatory lending laws enacted in recent years." *Id.* at 175–76. This allows "national banks, federal savings associations, and their operating subsidiaries [to] almost completely ignore these state laws." *Id.* at 176. It should be noted that the application of New Jersey's Home Ownership Security Act of 2002 is "preempted by federal law from applying to federal savings associations." Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision, Regarding Preemption of New Jersey Predatory Lending Act (July 22, 2003), *available at* http://www.ots.treas.gov/docs/5/56305.pdf. A full discussion of federalism and preemption issues that accompany individual states' anti-predatory lending would go beyond the scope of this Comment. For discussion regarding preemption issues with regards to North Carolina's predatory lending law, see C. Bailey King, Jr., *Preemption and the North Carolina Predatory Lending Law*, 8 N.C. BANKING INST. 377 (2004). For discussion of preemption issues and state predatory lending statutes, see Childs, *supra* note 124.

127 N.C. GEN. STAT. § 24-1.1E(c) (LexisNexis 2007).

sumer education in their anti-predatory lending statutes.[128] In 2002, New Jersey followed North Carolina's lead and included a consumer education requirement in its Home Ownership Security Act,[129] and in 2006 Illinois began a pilot program requiring credit counseling for some borrowers.[130] The laws of these three states appear to have varying degrees of success, but they all reflect the belief that informed borrowers are important in combating abusive lending practices.[131]

A. North Carolina was the First State to Recognize the Power of an Informed Consumer

One of the main purposes behind North Carolina's anti-predatory lending statute is to promote public awareness by providing "education and counseling about predatory lenders."[132] The North Carolina anti-predatory lending statute prohibits a lender from making a high-cost home loan[133] without first receiving certification that the borrower has received home-ownership counseling.[134] Commentators have celebrated North Carolina's law because it has not impinged on subprime borrowing.[135]

128 Consumer education has not been able to show its strengths in combating predatory lending because subprime lenders have largely been able to avoid the items that trigger the protection of these states' acts. Stark, *supra* note 9, at 146. "Although five states have enacted mortgage counseling requirements for high-cost home loans, because the triggers for this protection are set at such high levels, they have become another reform to avoid rather than comply with." *Id.*

129 N.J. STAT. ANN. § 46:10B-26(g) (West Supp. 2007).

130 765 ILL. COMP. STAT. ANN. 77/70 (West Supp. 2007).

131 *See supra* notes 31, 32, 107, 162.

132 1999 N.C. Sess. Laws 332.

133 A "high-cost home loan" is defined as a loan where: (1) the principal amount of the loan does not exceed the lesser of the conforming loan size limit for a single-family dwelling that is established by Fannie Mae, or $300,000, (2) the borrower is a natural person, (3) the debt the borrower incurs is mainly for personal family, or household purposes, (4) the loan is secured by either a security interest in a manufactured home that the borrower does or will occupy as her principal dwelling, or a mortgage or deed of trust on real estate where there is or will be a structure, or structures, designed for one to four families' occupancy, which is or will be occupied by the borrower as her principal dwelling, and (5) the loan exceeds one or more of the thresholds in section 6. N.C. GEN. STAT. ANN. § 24-1.1E(a)(4) (LexisNexis 2007).

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

135 "Without question, North Carolina has reduced predatory lending. At the same time, evidence shows borrowers in North Carolina continue to have access to a wide variety of competitively priced loans from a wide variety of lenders." CENTER FOR RESPONSIBLE LENDING, CRL POLICY BRIEF NO. 10, SUPPORT H.R. 1182: THE PROHIBIT PREDATORY LENDING ACT 1 (2005), *available at* http://www.responsiblelending.org/pdfs/pb010-MillerWattFrank-0305.pdf (last visited Mar. 22, 2008). The anti-predatory lending statute has not reduced the number of subprime loans made in North Carolina, in fact, "North Carolina had 15% more subprime home loans per capita than the rest of the nation as a whole in 2000." *Id.* at 2. "[T]he subprime market behaved essentially as the law intended: There was a reduction in predatory loans but no change in the cost of subprime credit or reduction in access to credit for high-risk borrowers." Roberto G. Quercia et al., The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment 1 (June 25, 2003) (unpublished manuscript, on file with the Ctr. for Cmty. Capitalism, Univ. of N.C. at Chapel Hill), *available at* http://www.responsiblelending.org/pdfs/PredLendingStudy.pdf (last visited Mar. 22, 2008). It should be noted that North Carolina's statute prohibits high cost home loans from carrying any of the following terms: (1) No call provisions

It should be noted that recent statistics show that North Carolina has not been able to dodge the foreclosure wave that has hit the rest of the nation.[136] The number of foreclosures in North Carolina has not been attributed to the failure of consumer education programs, and may be connected to the thresholds which must be met in order to trigger the statute's provisions.[137] In fact, the North Carolina Justice Center still recommends that "investment . . . in programs designed to promote responsible homeownership, such as housing counseling and financial literacy" be considered in order to fight against the problem of increased foreclosures in North Carolina.[138]

B. New Jersey Included a Consumer Education Requirement in the Home Ownership Security Act of 2002

New Jersey sought to combat the state's high concentration of predatory lending by enacting the Home Ownership Security Act of 2002.[139] The Act "bans numerous additional loan terms when made in connection with High-Cost Home Loans,[[140]] such as balloon payments, negative amortizations, and default interest rates, while also mandating clear disclosures and, in certain cases, loan counseling."[141] New Jersey requires loan counseling[142] when a borrower will be financing points and fees in connec-

that allow the lender to unilaterally to accelerate the borrower's indebtedness, (2) No balloon payments that exceed the sum of two average earlier scheduled payments, (3) No negative amortization, (4) No increased interest rate triggered by default, (5) No advance payments, (6) No modification or deferral fees, (7) No lending without lender's reasonable belief that the borrower will be able to repay the loan, (8) Fees and charges may not be directly or indirectly financed, (9) Lender may not charge additional points and fees when refinancing an existing high-cost home loan held by the same lender. N.C. GEN. STAT. Ann. § 24-1.1E(b)–(c) (LexisNexis 2007).

136 In 2006, there were 46,512 foreclosures filed in North Carolina. "This level represents an increase of over 173 percent from the 16,630 filings in 1998." Al Ripley, *A Good Session Addressing Foreclosure: But More Work Remains*, N.C. JUST. CENTER COMMUNITY NEWS, Fall 2007, at 6, *available at* http://www.ncjustice.org/assets/library/1072_cnfall2007.pdf. Data also shows that the number of foreclosures in 2007 will surpass those of 2006. "Many experts predict that nationwide the height of the crisis will not peak until 2008 or 2009 . . . ." *Id.* The record number of foreclosures has sent North Carolina legislators back to the drawing board to search for a way to combat predatory lending. In 2007, the General Assembly of North Carolina passed House Bill 1817 "to protect North Carolinians from predatory mortgage lending practices that increase foreclosure." *Id.*

137 Stark argues that, like HOEPA, the triggers for the statute's protection are set so high that lenders can avoid compliance with the statute. Stark, *supra* note 9, at 146.

138 *Hearing on Home Foreclosures Before the H. Select Comm. on Rising Home Foreclosurses*, 2005–09 Reg. Sess. (N.C. Feb. 28, 2006) (statement of Carlene McNulty, Staff Attorney, N.C. Just. Ctr.) *available at* http://www.ncjustice.org/assets/library/670_ncjcforeclosepres.pdf.

139 *See* N.J. STAT. ANN. § 46:10B-26(g) (West Supp. 2007); *see also* Azmy & Reiss, *supra* note 19, at 649.

140 The statute defines a "High-cost home loan" as a loan where the principal amount does not exceed $350,000, "which. . . shall be adjusted annually to include the last published increase of the housing component of the national Consumer Price Index, New York-Northeastern New Jersey Region, in which the terms of the loan meet or exceed one or more of the thresholds as defined in this section." N.J. STAT. ANN. § 46:10B-24 (West Supp. 2007).

141 Azmy & Reiss, *supra* note 19, at 671–72; *see also* N.J. STAT. ANN. § 46:10B-26(a)–(g) (West Supp. 2007).

142 It should be noted that there is a difference between consumer education and consumer counseling. "Counseling is specific and is tailored to the particular needs of the individual, while education

tion with a High-Cost Home Loan.[143] While consumer counseling is only required for loans where borrowers will be financing points and fees, creditors can not make any High Cost Home Loan without the borrower first signing a notice that urges the borrower to contact a credit counselor.[144] Scholars projected that the Home Ownership Security Act would curb the "worst abuses of predatory lending while preserving the availability of credit to all New Jersey consumers who need it."[145] Unfortunately, New Jersey has also been unable to avoid a growing number of foreclosures in recent years.[146] Despite the growing number of foreclosures, the New Jersey Department of Banking and Insurance continues to focus on the importance of an educated and informed public.[147]

C. Illinois Enacted Legislation that Requires Mandatory Counseling for Certain Loans

Illinois enacted House Bill 4050[148] in an attempt to "eradicate predatory lending practices. HB 4050 [was] designed to increase homeowner's knowledge about the loans they are considering and to reduce the number of foreclosures resulting from overly expensive homes."[149] The statute provides that brokers or loan originators of mortgages on residential properties within the pilot program area,[150] must submit the information re-

typically is administered in a generic program." HIRAD & ZORN, *supra* note 33, at 5.

143 § 46:10B-26(g). The New Jersey legislature found that "[t]he financing of points and fees in these loans provides immediate income to the originator and encourages the repeated refinancing of home loans." § 46:10B-23(a). Identifying the connection between the financing of points and fees and repeated refinancing, a known predatory term as discussed above, may have motivated the legislature to require consumer counseling with respect to this loan term.

144 "You [the borrower] should consult an attorney-at-law and a qualified independent credit counselor or other experienced financial advisor regarding the rate, fees and provisions of this mortgage loan before you proceed. A list of qualified counselors is available by contacting the New Jersey Department of Banking and Insurance." § 46:10B-26(f) (original in all caps).

145 Azmy & Reiss, *supra* note 19, at 670.

146 Based on the number of homes in the state in May 2007, New Jersey had the fifteenth highest number of foreclosures in the country—approximately "one foreclosure filing for every 843 households . . . ." Kathleen M. Howley, *U.S. Mortgage Foreclosure Filings Rise 90% in May*, BLOOMBERG.COM, June 12, 2007, http://www.bloomberg.com/apps/news?pid=20601087&sid=av3bqU7edFDs&refer=home. This statistic was drawn from information provided by RealtyTrac, Inc. *Id.*

147 The Department of Banking and Finance announced in September 2007 that it would be launching additional education and counseling programs to address and prevent foreclosures. Commissioner Steven M. Goldman stated, "Educating and informing the public is the best defense against business arrangements with potentially catastrophic consequences." Press Release, State of New Jersey Department of Banking and Insurance, DOBI Announces Public Forums, Education Plan to Address Mortgage Lending Issue: Focus on Consumer Education, Foreclosure Prevention (Sept. 26, 2007) http://www.state.nj.us/dobi/pressreleases/pr070926.htm.

148 H.B. 4050, 94th Gen. Assemb., Reg. Sess. (Ill. 2005).

149 HB4050info.com, Homepage, http://www.hb4050info.com/Public_Web/home.aspx (last visited Mar. 25, 2008).

150 The "Pilot Program Area" is defined by statute as "all areas within Cook County designated as such by the Department [of Financial and Professional Regulation] due to the high rate of foreclosure on residential home mortgages that is primarily the result of predatory lending practices." 765 ILL. COMP. STAT. ANN. 77/70(a) (West Supp. 2007). Originally the pilot program area consisted of ten zip codes in Cook County. HB4050info.com, Introduction to the Predatory Lending Database Pilot Pro-

quired by statute[151] to the predatory lending database established and administered by the Secretary of the Department of Financial and Professional Regulation ("DFPR")[152] within ten days of taking a mortgage application.[153] After reviewing the information, the DFPR will issue a ruling within seven days, stating whether the borrower must undergo mandatory credit counseling.[154]

Though foreclosure rates in Illinois and Cook County still remain high,[155] HB 4050 only went into effect on January 1, 2006.[156] Since the statute did not go into effect until then, many of the loans that led to the foreclosures in 2007 were not subject to the statute.[157] Further, it should be

gram, *available at* https://www.hb4050info.com/pdfs/HB4050_intro.pdf. However, after receiving information that suggested that this designation "may be detrimental to the Pilot Program's purpose, namely, to curb predatory lending practices in areas with high rates of foreclosure on residential home mortgages[,]" the Secretary of the Department of Financial and Professional Regulation (the "Secretary") withdrew that designation. Press Release, Illinois Dept. of Fin. & Prof'l Regulation, Re-Designation of Pilot Program Area Pursuant to Public Act 94-280 (HB 4050) (Jan. 19, 2007), https://www.hb4050info.com/pdfs/4050Scan001.pdf. The Secretary withdrew the designation and designated that the Pilot Program Area had no areas or zip codes. *Id.* Some critics had claimed that the originally designated area was a result of racism. *See* Amy Merrick, *Illinois Tries New Tack Against Predatory Loans: Its First Effort Drew Charges of Racism; Mortgage Brokers Revolt*, WALL ST. J., Aug. 21, 2007, at A1. A further examination of this claim goes beyond the scope of this Comment.

151 765 ILL. COMP. STAT. ANN. 77/72 (West Supp. 2007). The information required includes information about the borrower, such as name, address, social security number, the mortgage's interest rate and related material terms, information about the loan originator or employer including license number and fees being charged to the borrower as well as "[a]ll information indicated on the Good Faith Estimate and Truth in Lending statement disclosures given to the borrower by the broker or originator." *Id.* § 77/72(6).

152 § 77/70(b).

153 § 77/70(c).

154 *Id.* The law requires that the Department create a database for the loan applications that it receives. The database would collect information from all of the loans issued in the Pilot Areas. "Under the program, mortgage companies and brokers must enter information about the borrower and the borrower's loan into the Internet-based database. This database will be able to automatically analyze the details of each loan and determine if the loan agreement meets credit counseling standards set by the Department." Press Release, Governor's Office, Gov. Blagojevich Signs Law to Protect Homebuyers in At-Risk Communities From Predatory Lenders (July 21, 2005), http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=3&RecNum=4166 [hereinafter Press Release, Law to Protect Homebuyers]. The determination shall be based on the Department's comparison of the information provided and the Department's credit counseling standards. *Id.* If the Department determines that the borrower must undergo counseling, this requirement may not be waived by the borrower. *Id.*

155 From January to June of 2007, there were 42,998 foreclosures filed in Illinois, one for every 120 households. Press Release, RealtyTrac.com, Foreclosure Activity up Over 55 Percent in the First Half of 2007 (July 30, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=2932&accnt=64847. "Cook County reported 3,721 foreclosure filings in May [2007], a 27 percent decrease from the previous month but still the most of any county in the [Chicago] metro area." Press Release, RealtyTrac.com, Chicago Foreclosure Activity Decreases 20 Percent in May (June 30, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3011&accnt=64847. "The county's foreclosure rate of one foreclosure filing for every 563 households was sixth highest among metro counties and 1.2 times the national average." *Id.*

156 *See* 765 ILL. COMP. STAT. ANN. 77/70 (West Supp. 2007).

157 Many of the foreclosures that are occurring now are due to the interest rates of ARMs being reset. *See supra* notes 12, 17 and accompanying text; SCHLOEMER, *supra* note 14, at 5. Until recently, 2/28 ARMs were the most common type of subprime loan. Holden Lewis, *Popular 2/28 Mortgages are No More*, BANKRATE.COM, July 26, 2007, http://biz.yahoo.com/brn/070726/22748.html?.v=1. "A 2/28 subprime ARM has a low initial rate that lasts two years. After that, the loan resets, which means that

noted that HB 4050 was enacted after, and in response to, the large number of foreclosures in Cook County.[158] In fact, HB 4050 was an attempt to curb the number of foreclosures and help families harmed by loans that they did not understand.[159]

D. These Laws Strive to Give Borrowers the Knowledge Necessary to Avoid Abusive Loan Terms

Though foreclosure statistics since the enactment of North Carolina, New Jersey, and Illinois' respective anti-predatory lending statutes may not initially indicate success, these states are definitely on the right track.[160] In the Center for Responsible Lending's 2006 report assessing state predatory lending laws, New Jersey and North Carolina were listed among the states with the strongest predatory lending laws.[161] Consumer counseling and education is aimed at curing the problems caused by unequal information and knowledge possessed by borrowers and lenders.[162] These states aim to provide borrowers with the knowledge they need to avoid abusive loan terms while still allowing borrowers to make the ultimate decision about how to invest.[163]

Eleven HUD certified counseling agencies participated in the HB 4050 Predatory Lending Database Pilot Program during the twenty-week period between September 1, 2006 and January 19, 2007.[164] In the Pilot Program's twenty weeks, about 1,200 borrowers received credit counseling, or a "File Review," from a HUD-certified counseling agency.[165] "The overwhelming majority of borrowers who were receiving adjustable-rate

the rate is adjusted upward or downward. At the first jump, the rate can conceivably climb 2 to 6 percentage points, causing monthly payments to skyrocket." *Id.*

158 In 2003 Cook County had more foreclosures than any other U.S. county. Sarah Max, *The Next Big Trend: Foreclosure*, CNNMONEY.COM, Feb. 5, 2004, http://money.cnn.com/2004/02/04/pf/yourhome/foreclosures/index.htm.

159 Press Release, Law to Protect Homebuyers, *supra* note 154. "A recent analysis by The Chicago Reporter, an investigative newsmagazine, found that the Chicago area ranks first among United States metropolitan areas in the number of subprime loans issued to homeowners from 2004 through 2006." Morgenson, *supra* note 1.

160 *See supra* notes 137, 155–159 and accompanying text (discussing potential reasons why North Carolina and Illinois' statutes may have failed to produce a decrease in the numbers of recent foreclosures).

161 Wei Li & Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, CRL REPORT (Ctr. Resp. Lending, Durham, N.C.), Feb. 23, 2006, at 7, *available at* http://www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf. States were evaluated using HOEPA's protections as a baseline and then by considering six aspects of a "typical subprime loan: (1) types of loans covered, (2) treatment of points and fees, including covered charges and amount of charges that activate high-cost protections, (3) prepayment penalties, (4) anti-flipping rules, (5) substantive protections applicable to high-cost loans, and (6) remedies available to borrowers." *Id.* at 6.

162 *See supra* note 106 and accompanying text.

163 "Nothing in this Article is intended to prevent a borrower from making his or her own decision as to whether to proceed with a transaction." 765 ILL. COMP. STAT. ANN. 77/70(i) (West Supp. 2007).

164 *Findings From the HB 4050 Predatory Lending Database Pilot Program*, HOUSING ACTION ILL. (Housing Action Illinois, Chicago, Ill.), Apr. 4, 2007, at 1, *available at* http://www.housingactionil.org/downloads/HB4050Findings.pdf [hereinafter *Findings HB 4050*].

165 *Id.*

loans were surprised when the HUD-certified Counseling Agency informed them that they were receiving an adjustable-rate loan and not a loan with a fixed rate for the entire term of the loan."[166] The counseling agencies' research indicates that borrowers who received counseling were better able to "understand the costs and terms of their loans, leading to better-informed decision-making."[167] These findings correspond with those in a 2001 study, which found that pre-purchase mortgage counseling is effective in reducing the number of delinquent mortgage payments.[168]

IV. THE FEDERAL GOVERNMENT SHOULD ENACT FEDERAL LEGISLATION REQUIRING CONSUMER EDUCATION WHEN A MORTGAGE CONTAINS CERTAIN TERMS

The federal government should enact legislation requiring borrowers to participate in a consumer education program before borrowers can commit to a loan that contains an adjustable interest rate, prepayment penalties, or balloon payment(s); a loan that does, or has the potential to, negatively amortize; or a loan in which points and fees will be financed along with the principal.[169] Requiring borrowers to complete a consumer education program will give borrowers the tools necessary to understand the meaning of each of these terms, as well as their potential benefits and dangers. At the completion of all consumer education programs, extra one-on-one counseling should be made available to all borrowers who desire additional assistance in understanding the terms of their loans. The federal government forces subprime lenders to face an educated consumer by requiring consumer education when these terms are present.[170] Giving borrowers information and education will help to eliminate the asymmetry of knowledge between borrowers and lenders, which has been cited as one of

166 *Id.* at 3. It appears that when lenders told borrowers that the term of the mortgage was fixed they did not reveal that the term was only fixed for a short amount of time. "Truth in Lending Act (TILA) disclosures do not adequately disclose this to the unsophisticated borrower. . . . Most borrowers also did not understand that they were being charged substantial fees/costs for the loan." *Id.* at 4.

167 *Id.* at 1.

168 HIRAD & ZORN, *supra* note 33, at 3.

169 It has been argued that, "it is important to emphasize that prevention, including counseling and education, is never a substitute for strong regulation. Education is not a panacea as long as creditors are allowed to push dangerous, unaffordable credit on the most vulnerable." Loonin & Renuart, *supra* note 126, at 197; *see also Ending Mortgage Abuse*, Calhoun Testimony, *supra* note 65, at 7. It should be noted that this Comment does not contend that only consumer education should be used to prevent predatory and abusive loan terms, but merely that its potential for success and inherent strengths should not be overlooked.

170 State and federal laws have been criticized because the triggers that evoke the laws' protections are set too high. Stark, *supra* note 9, at 144–46. Triggers further encourage lenders to simply avoid the triggers rather than comply with the laws. *Id.* at 146. As Malcolm Bush, President of the Woodstock Institute, notes, in calling for national underwriting standards: "Previous laws failed to prevent the problems we are now seeing for a very straightforward reason. The nature of predatory lending is such that any attempt to regulate specific products or practices simply serves as an impetus for unscrupulous lenders to develop new methods for preying on vulnerable home owners." Malcolm Bush, *What We Need is a Meaningful, National Standard for Mortgage Underwriting*, WOODSTOCK DEV. (Woodstock Inst., Chicago, Ill.), Fall 2007, at 3, *available at* http://www.woodstockinst.org/component/option.com_docman/Itemid,260/task,cat_view/gid,98/.

the largest driving forces behind predatory lending practices.[171] Moreover, having the consumer education requirement tied to specific loan terms rather than interest rate or fee triggers, helps to ensure that lenders cannot avoid compliance.[172]

Some have criticized consumer education and counseling because it puts the "burden of the problem on the victim . . . ."[173] This Comment's proposal should not be viewed as forcing borrowers to shoulder additional burdens when taking out loans with certain terms; it should be viewed as empowering borrowers by giving them the tools necessary to assess risk[174] and make informed financial decisions. Exotic mortgages[175] should be available to consumers who decide to enter into them with full knowledge of their potential consequences.[176] Federal implementation of a basic consumer education requirement would be most efficient and ensure that all states have a basic education requirement.[177] This would allow lenders to still offer exotic mortgages, but would assist borrowers in making more informed decisions.[178] Despite the criticism that has been directed at the consumer education requirement in the bankruptcy system, a consumer education requirement for home mortgages would have advantages[179] and has been shown to help reduce mortgage delinquencies.[180] One of the easiest ways to ensure compliance with a consumer education requirement would be to require that lenders show proof that borrowers have completed the re-

171 Engel and McCoy argue "that today's home-mortgage market is replete with information asymmetries that predatory lenders have exploited to the detriment of borrowers who are disconnected from the credit market." Engel & McCoy, *supra* note 34, at 1271. A twenty-week study of Illinois HB 4050 conducted by eleven HUD-Certified Counseling Agencies revealed that "[b]orrowers tend to trust what they are told by their loan originator and do not understand what is written in the voluminous disclosures given to them." *Findings HB 4050*, *supra* note 164, at 3. "Additionally, borrowers often operate under the mistaken presumption that their loan originator has an obligation to obtain the best loan and interest rate for them." *Id.* at 4. "Buying or refinancing a home is the biggest investment that most families ever make, and particularly in the subprime market, this transaction is often decisive in determining a family's future financial security. The broker has specialized market knowledge that the borrower lacks and relies on." *Ending Mortgage Abuse*, Calhoun Testimony, *supra* note 65, at 8.

172 *See supra* note 170 and accompanying text.

173 Stark, *supra* note 9, at 131. "A solution founded on education or counseling puts the onus on potential victims to avoid predatory-loan terms, rather than on the perpetrators. Such reliance is nothing more than caveat emptor served up with an informational brochure or loan counseling." Engel & McCoy, *supra* note 34, at 1310–11.

174 "[R]isk means the chance that something *different* than expected will happen." ERIC A. CHIAPPINELLI, CASES AND MATERIALS ON BUSINESS ENTITIES 44 (2006). For borrowers, foreclosure should be something different than what is expected to happen when they take out a mortgage.

175 Exotic mortgages are mortgages with non-traditional terms, such as adjustable interest rates, prepayment penalties, balloon payment(s), negative amortization, or financed points and fees.

176 *Maxed Out*, a documentary on debt in America, begins with a realtor in Las Vegas discussing how she had taken out a "loan to value" mortgage to build a large custom home. She admits that, if the "interest rate goes up by the time we move-in in April, I might not be able to afford the house anymore." MAXED OUT (Magnolia Home Entertainment 2006). This is a markedly different situation from a borrower who has entered into a loan, not even knowing that his/her loan carries an adjustable interest rate.

177 *See infra* notes 182–186 and accompanying text.

178 *See supra* note 105 and accompanying text.

179 *See infra* Part IV.B.

180 *See* HIRAD & ZORN, *supra* note 33, at 3.

quired consumer education before they are allowed to securitize their loans and sell them on the secondary market.[181]

A. Federal Legislation Should Establish a Baseline for the Consumer Education Requirement

The consumer education requirement proposed in this Comment should be federally enacted, but it should only be viewed as a baseline for the states to follow. Though this approach may not be favored by multi-state lenders due to potential variances between states,[182] it is favorable to purely federal legislation and to legislation that is left solely to the states for a number of reasons. Implementing the consumer education requirement in this manner ensures that all states will have an efficient consumer education requirement.[183] Further, because the federal legislation provides only a baseline, states will be allowed to pass stricter legislation if they believe it is necessary. For example, states may add additional terms which would also require consumer education. This allows the states some level of freedom to experiment and gives each state the ability to account for its individual needs.[184] This proposal may be workable as an amendment to existing federal law, such as the TILA,[185] or it may require an entirely new piece of legislation. In addition to federal implementation of the consumer education requirement, the federal government should provide the states with federal funds to implement the consumer education requirement.[186]

Some of the main concerns of requiring a consumer education requirement are how to fund this education, and how to find and train enough educators.[187] This Comment proposes that the federal government bear the costs of the consumer education programs, since the requirement will be federally mandated and cannot be waived by borrowers whose loans contain certain terms.[188] One possible way for the government to fund and implement this requirement would be for the federal government to allot an additional budget to the Department of Housing and Urban Development ("HUD") for consumer education programs.[189]

181 The ease of securitization of loans has led to the boom in the subprime market and the growth of predatory lending practices. *See supra* Part I.A.

182 "Lenders would prefer a uniform approach . . . because with a uniform law, multi-state lenders will have only one set of rules to comply with, making compliance with the law easier and cheaper to administer." Stark, *supra* note 9, at 150.

183 Stark argues for a uniform federally enacted mortgage counseling intervention requirement, noting that it is preferable to the state-by-state approach, because "consumer advocates fear that in light of the current holders of national office, it is unlikely that as effective a law will be enacted as might be enacted by certain states." *Id.*

184 *Cf. id.* at 150–51 (arguing that a uniform federal requirement would be preferable to a state-by-state approach).

185 Stark's article proposes consumer counseling as an amendment to the TILA. *Id.* at 150.

186 *Id.* at 141.

187 *Id.*

188 *Id.* at 141–42.

189 *Id.*

Currently, HUD has already approved housing counseling agencies across the country.[190] Having HUD develop uniform counseling criteria—to be adjusted to suit stricter state laws if necessary[191]—for these already approved counseling agencies to adopt, may be one of the easiest and most efficient ways for a consumer education requirement to be implemented. Though additional educators may still need to be trained,[192] the existence of an already established network of counselors would cure some of the initial burden during the implementation stage of the consumer education requirement.[193] This pre-existing network of government-approved housing counselors would put a consumer education requirement for mortgages steps ahead of the consumer education and counseling requirements in the bankruptcy system.[194]

B. Though Consumer Education has not been Successful in Bankruptcy, it can Succeed in Protecting Borrowers

In 2005, Congress reformed the bankruptcy system.[195] The new law,

190 For a listing of HUD-approved housing counseling agencies, see HUD.gov, HUD Approved Housing Counseling Agencies, http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm (last visited Mar. 15, 2008). There are over 125 approved housing counseling agencies in California alone. *See id.*

191 Should states enact stricter legislation in addition to the federal legislation, the states should be expected to make budgetary contributions to account for the additional counseling that will have to be given in that state.

192 Since the education requirement cannot be waived, additional counselors who speak languages other than English will need to be trained in some locations. Some of the approved housing counseling agencies in the current HUD network offer services in languages other than English, and some do not. *See* HUD.gov, Find a Housing Counselor, http://www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm (last visited Mar. 15, 2008). Being able to provide services in languages other than English is of vital importance in some regions in the United States, particularly considering evidence which shows a correlation between a borrower's inability to read or speak English and his/her vulnerability to predatory lending practices. *See*, *e.g.*, C. Lincoln Combs, Comment, *Banking Law and Regulation: Predatory Lending in Arizona*, 38 ARIZ. ST. L.J. 617, 623 (2006). Combs' article notes the trend in Arizona, where the state's immigrants from Latin America and Mexico have become targets of predatory lending. One of the main reasons that these people have been targeted by predatory lenders is because "they are often not able to read the documents in English that are presented to them to sign . . . ." *Id.*

193 During the twenty-week study of Illinois HB 4050 conducted by eleven HUD-Certified Counseling Agencies, there were forty-one counselors trained to provide the Bill's required File Review. "All borrowers referred for File Review were able to schedule and complete the File Review with a participating HUD-certified Counseling Agency within the 10-day statutory time frame." *Findings HB 4050*, *supra* note 164, at 2. Moreover, "[t]here were no documented delays in the closing of loans because of a lack of counselors or delays in providing the File Review." *Id.*

194 *See infra* notes 206–09 (discussing criticism of the lack of direction given to US trustees regarding training and qualification of bankruptcy counselors).

195 Loonin & Renuart, *supra* note 126, at 186. *See also* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.). "BAPCPA . . . [is] the most substantial revision of bankruptcy law since the 1978 Bankruptcy Code. BAPCPA generally became effective as to cases filed on or after October 17, 2005." Eugene R. Wedoff, *Major Consumer Bankruptcy Effects of BAPCPA*, 2007 U. ILL. L. REV. 31, 31. "By the early 2000s, more people filed for bankruptcy each year than suffered a heart attack. More filed bankruptcy than were diagnosed with cancer. More filed bankruptcy than graduated from college. . . . Americans filed more petitions for bankruptcy than for divorce." Elizabeth Warren, *A New Conversation About the Middle Class*, 44 HARV. J. ON LEGIS. 119, 120 (2007). Due to the overwhelming number of Americans filing for bankruptcy each year, BAPCPA was enacted in order to prevent abuse of the bankruptcy system and its protections and to make affordable credit more accessible. Press Release, The White House, President Signs Bankruptcy Abuse Prevention, Consumer Protection Act

the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), made many significant changes to American bankruptcy law.[196] One of the major changes BAPCPA made to the Bankruptcy Code was the addition of consumer counseling and consumer education requirements.[197] First, to be able to qualify as a debtor under BAPCPA, individuals must now receive consumer counseling, in the form of a briefing, within 180 days of filing for bankruptcy.[198] This briefing can take place in a one-on-one or group setting, and can be done over the phone or the internet.[199] "Specifically, the credit briefing must outline opportunities for credit counseling, provide a budget analysis, and provide an analysis of financial conditions, factors that caused such financial conditions, and how the debtor can develop a plan of action for dealing with the debt without incurring negative amortization of debt."[200] Second, in order to be able to qualify for discharge, debtors must also complete a personal financial management course.[201]

Congress enacted the consumer education and counseling requirements of BAPCPA in response to concerns that consumers were filing bankruptcy in cases when it was not their only option.[202] BAPCPA's con-

(Apr. 20, 2005), *available at* http://www.whitehouse.gov./news/releases/2005/04/20050420-5.html. Scholars and practitioners have expressed doubt that these goals can be achieved through BAPCPA and have sharply criticized the law. "BAPCPA likely prevents bankruptcy abuse if only because it limits the number of people eligible to file for bankruptcy protection. By reducing the number of overall bankruptcy filings, BAPCPA likely curbs abusive bankruptcy filings. Of course, . . . BAPCPA also prohibits good faith filers from obtaining bankruptcy relief, leaving them at the mercy of their creditors and state exemption laws." Alan D. Eisler, *The BAPCPA's Chilling Effect on Debtor's Counsel*, 55 AM. U. L. REV. 1333, 1334 (2006). *See generally* David K. Stein, Comment, *Wrong Problem, Wrong Solution: How Congress Failed the American Consumer*, 23 EMORY BANKR. DEV. J. 619 (2007).

196 Wedoff, *supra* note 195, at 31.

197 11 U.S.C.A. §§ 109(h), 111 (West 2007).

198 § 109(h); *see also* Wedoff, *supra* note 195, at 36; Martin & Tama y Sweet, *supra* note 20, at 518; Karen Gross and Susan Block-Lieb, *Empty Mandate or Opportunity for Innovation? Pre-Petition Credit Counseling and Post-Petition Financial Management Education*, 13 AM. BANKR. INST. L. REV. 549, 550 (2005). "Under new § 109(h), individuals are ineligible for relief under any chapter of the Code unless, within 180 days of their bankruptcy filing, they received 'an individual or group briefing' from a nonprofit budget and credit counseling agency approved by the U.S. trustee or bankruptcy administrator . . . ." Wedoff, *supra* note 195, at 36 (quoting 11 U.S.C.A. § 109(h)(1) (West 2007)). There are some narrow exceptions for this requirement set forth in 11 U.S.C.A. § 109(h)(4).

199 11 U.S.C.A. § 109(h)(1) (2007); Wedoff, *supra* note 195, at 36.

200 Martin & Tama y Sweet, *supra* note 20, at 518. *See* 11 U.S.C.A. § 109(h)(1)(a) (2007).

201 11 U.S.C.A. § 111 (2007); Wedoff, *supra* note 195, at 37; Gross & Block-Lieb, *supra* note 198, at 551. Some narrow exceptions for this requirement are also set forth in 11 U.S.C.A. §109(h)(4) (2007). "According to the instructions distributed by The Executive Office of the United States Trustee ('EOUST') and memorialized in the Code of Federal Register, the entity charged with administering this requirement, the course must cover at least three areas of instruction: budget development, money management, and the wise use of credit." Martin & Tama y Sweet, *supra* note 20, at 519.

202 Michael Newman, *BAPCPA's New Section 109(h) Credit Counseling Requirement: Is It Having the Effect Congress Intended?*, 2007 UTAH L. REV. 489, 489–92. "Congress's intent in enacting the new credit counseling provisions of BAPCPA was thus to encourage individual consumer debtors to consider bankruptcy a 'remedy of last resort,' by forcing debtors to learn about the consequences of filing bankruptcy and the available non-bankruptcy alternatives." *Id.* at 490–91. "[BAPCPA] contains several provisions that seek to improve consumers' financial literacy in an attempt to decrease the total number of future bankruptcy filings." *Id.* at 489 (quoting 151 CONG. REC. E685, E704 (2005) (statement of Rep. Moore)).

sumer education and counseling requirements have received a great deal of criticism for a variety of reasons. Considering that the debtor is already on her way to file her bankruptcy petition, one of the main concerns is whether the required briefing[203] to obtain debtor status will be effective.[204] Further, it is argued that this requirement prevents people who would otherwise qualify for bankruptcy from being able to file for relief.[205]

Another large concern is the lack of direction given to the Executive Office of the United States Trustee regarding how to approve the private non-profit organizations that have been charged with the task of implementing the mandatory pre-bankruptcy counseling.[206] In the past, the credit counseling industry was funded by the consumer finance industry, but this has ended and, as a result, more aggressive consumer counseling agencies have emerged.[207] This has led to a litany of potential dangers for consumers who seek the help of these agencies, including "deceptive marketing, high pressure sales efforts, high fees and practices inconsistent with the best interests of their consumer customers."[208] Congress, aware of these problems in the credit counseling industry, still decided to require that everyone seeking to file bankruptcy receive counseling from an approved agency.[209]

Though the consumer education and counseling requirements of BAPCPA have been widely criticized, requiring consumer education or counseling for mortgages that carry certain specified terms could avoid many of these criticisms. First, and probably most importantly, the counseling will take place before the borrower enters into the mortgage agreement.[210] The timing of pre-purchase counseling distinguishes it from pre-bankruptcy consumer counseling for debtors. Pre-purchase counseling for borrowers takes place when borrowers still have the ability to decide not to enter into a mortgage, which is dramatically different from pre-bankruptcy counseling which takes place after consumers have already made credit decisions that have led them to the brink of bankruptcy.[211] More importantly,

203 11 U.S.C.A. §109(h) (2007).

204 Martin & Tama y Sweet, *supra* note 20, at 540. "[I]t is highly questionable whether *any* debtor education on the way into bankruptcy will be effective. . . . It is simply too late, at that point, to meaningfully affect any decision a debtor could make." *Id.*

205 "Given the timing and the stress levels of a person facing financial crisis, the first course serves no useful function. Importantly, this requirement also keeps deserving people out of bankruptcy." *Id.* at 519.

206 *See* Gross & Block-Lieb, *supra* note 198, at 553–58.

207 *Id.* at 554.

208 *Id.* Even though these are non-profit agencies, some "function as virtual for-profit businesses, aggressively advertising and selling DMPs [(debt management programs)] and a range of related services, maintaining close ties to for-profit firms, [and] reaping high revenues . . . ." *Id.* at 555.

209 *Id.* at 558.

210 Timing plays a large role in borrower education and counseling. Pre-purchase counseling and education tends to be "designed to better prepare families for the responsibilities of homeownership by explaining the home buying and financing process, encouraging financial planning and money management, and going over home maintenance and repair issues and concerns." HIRAD & ZORN, *supra* note 33, at 5.

211

it has been shown that pre-purchase consumer counseling and education does have a significant impact on mortgage delinquency rates.[212] Promoting lender compliance is also an integral component to ensuring that consumers are receiving the knowledge necessary to navigate the complicated terms in today's subprime mortgage market. One way to prompt lenders to adhere to this requirement would be to require proof that the borrower has completed the required consumer education program before lenders are allowed to securitize the loan.

C. Precluding Lenders from Securitizing Loans where Borrowers did not Participate in the Required Consumer Education will Promote Compliance

As discussed above, the boom in the subprime market is largely attributable to the rise in securitization of mortgages.[213] One of the biggest criticisms of subprime lending is that, due to securitization, loan originators do not have a reason to closely scrutinize the loans' anticipated future performance.[214] Since lenders are able to quickly sell their loans on the secondary market, lenders have become less concerned with borrowers' potential future defaults.[215] As a result, securitization has led to relaxed underwriting standards.[216] To prevent abusive lending practices there has been a call for

> [I]t is likely that some—perhaps many—debtors' financial situations will have so deteriorated before they seek prebankruptcy credit counseling that bankruptcy is their only recourse. A recent U.S. Government Accountability Office (GAO) study reports that anecdotal evidence suggests just that: By the time debtors seek prebankruptcy credit counseling, their financial situation is dire enough to allow few alternatives to bankruptcy . . . .

NOREEN CLANCY & STEPHEN J. CARROLL, PREBANKRUPTCY CREDIT COUNSELING 2 (2007), *available at* http://www.usdoj.gov/ust/eo/public_affairs/reports_studies/docs/Pre-Bankruptcy_Credit_Counseling_Report_Rand.pdf.

212 "Borrowers receiving individual counseling experience a 34 percent reduction in [90-day] delinquency rates. . . . [C]lassroom and home study counseling [reduce these delinquency rates by] 26 percent and 21 percent . . . respectively." HIRAD & ZORN, *supra* note 33, at 2. It should be noted that the data for this study came from loans originated from 1993 to 1998, and the authors note that, since counseling and education techniques have progressed since then, "[i]t is likely that these changes have improved counseling's effectiveness, and therefore our analysis likely underestimates the benefits of current counseling programs." *Id.* at 18–19. Further, unlike BAPCPA, it should be noted that this Comment's proposal does not allow for telephone or internet education. Telephone counseling and education have not been shown to effectively reduce delinquency rates. *Id.* at 18.

213 *See supra notes* 19, 51, 181; *see infra* notes 214, 216.

214 SCHLOEMER, *supra* note 14, at 5. "Lenders shield themselves from the full potential cost of foreclosures by selling their loans to investors through the secondary mortgage market. Together, third-party originations and the risk dispersion made possible through the secondary market help distance loan originators from seriously adverse consequences of foreclosures." *Id.* Securitization also helps lenders to avoid legal responsibility for predatory loans. "A legal doctrine called the 'holder in due course' rule shields [the] loan assignee and ultimately the investors against liability for the predatory nature of the loans." Loonin & Renuart, *supra* note 126, at 178–79.

215 Eggert, *supra* note 19, at 550.

216 *Id.* at 550–51. "[S]ecuritization has encouraged the decline of stringent underwriting." *Id.* at 550. The effect that securitization would have on the underwriting standards has been around for some time. In a 1989 article, Edward Pittman wrote, "Today, approximately half of the private whole loan pass-through market is comprised of limited documentation loans. The increasing use of such loans, among other things, has been cited by some commentators as evidence of deterioration in the quality of securities that are being created." Edward L. Pittman, *Economic and Regulatory Developments Affect-*

more strictly enforced underwriting standards[217] and greater investor accountability.[218] Requiring lenders to show proof that a borrower has participated in the federally mandated consumer education program before the lender is able to securitize the loan would help serve these goals.

If a borrower has completed the consumer education courses, she should be in a position to assess the risks of her proposed investment, and will have been given the ability to contact an additional counselor if she has questions or concerns regarding her loan. These tools will enable the borrower to make an informed decision as to whether she should enter into a particular loan. If borrowers have undergone this process, then investors would be able to invest in mortgage-backed securities knowing that borrowers have assessed the risks of the loan,[219] therefore giving investors increased confidence that their investments are not furthering predatory lending practices.

If a borrower has not participated in consumer education, the lender will be precluded from securitizing the loan. This will force the lender to endure the consequences if the borrower should default on her mortgage in the future. Since it would not be in the lender's best interest for the borrower to default on the loan while the lender was still holding it in his portfolio due to the time and expense related to foreclosure proceedings, lenders would most likely reform underwriting standards or ensure that borrowers participate in the required consumer education courses to help them understand the terms of their loans.

ing Mortgage Related Securities, 64 NOTRE DAME L. REV. 497, 546 (1989). Today, scholars are still critical of the effects of securitization on underwriting standards. "Lax underwriting standards magnify the risk of loans that already include high-risk features. Subprime lenders who market exploding ARMs and other high-risk loans often do not adequately consider whether the homeowner will be able to pay when the loan's interest rate resets, even if rates stay constant." SCHLOEMER, *supra* note 14, at 5.

217 Bush, *supra* note 170, at 3.

218 "Investors should take reasonable steps to avoid supporting unsound lending, including refusing to purchase mortgages from lenders who make abusive loans and requiring that subprime lenders use appropriate underwriting standards to ensure that borrowers can repay the loan." SCHLOEMER, *supra* note 14, at 31.

219 Moral hazards should be considered. "In general, a moral hazard is the risk that a party with discretion to act will choose an action that decreases the expected value of the transaction to the other party in a way that the other party cannot effectively prohibit." CHIAPPINELLI, *supra* note 174, at 86. A full discussion of moral hazards and subprime loans would go beyond the scope of this Comment. But, briefly, one might claim that one of the main moral hazards to the lender is that a borrower may not care that there is a high probability of foreclosure associated with the mortgage and go through with the transaction anyway. A response to this argument could be that lenders can control this moral hazard by tightening their underwriting standards.

CONCLUSION

Consumer education can work. Illinois' law, HB 4050,[220] made Mr. Alvaro Cortez a believer.[221] In December of 2006, Mr. Cortez found his dream house and went through the counseling sessions mandated by HB 4050.[222] A loan counselor worked with Mr. Cortez and taught "him how to verify his mortgage's terms."[223] Mr. Cortez believes that his counseling "helped him stand up for himself when he went to his closing. There. . .the paperwork showed that he had an adjustable-rate loan, instead of the fixed-rate one he had been promised. The interest rate also was higher than he agreed to pay. Mr. Cortez refused to sign."[224] On Mr. Cortez' second closing date, the loan documents still did not reflect the loan he had been promised and he refused to sign once again.[225] At the third closing, Mr. Cortez finally signed loan documents reflecting the loan that he was promised.[226]

A federally mandated consumer education requirement would curtail abusive lending practices since lenders would not be as easily able to exploit borrowers' lack of knowledge of mortgage terms. To increase lender accountability and ensure their compliance with the consumer education requirement, lenders should be required to prove that borrowers have completed the mandatory education in order to securitize their loans. If the federal government were to implement a consumer education requirement for mortgages containing certain terms that have been commonly associated with predatory lending and are now prevalent in subprime loans, like Mr. Cortez, many borrowers would learn the skills necessary to protect themselves.

220 Codified as 765 ILL. COMP. STAT. ANN. 77/1, et seq. (West 2007); *see also* Merrick, *supra* note 150.

221 Merrick, *supra* note 150.

222 *Id.*

223 *Id.*

224 *Id.*

225 *Id.*

226 *Id.*