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Rules, Standards, and Suitability: Finding the Correct Approach to Predatory Lending

Abraham B. Putney

RULES, STANDARDS, AND SUITABILITY: FINDING THE CORRECT APPROACH TO PREDATORY LENDING

*Abraham B. Putney**

INTRODUCTION

The humorist Dave Barry once wrote:

> [t]he desire to own a home of one's own has been part of human nature ever since that fateful moment, millions of years ago, when our earliest ancestors climbed down out of their trees and moved into their very first caves. It was a major moment in history, and its glory was dimmed only slightly by the fact that their furniture did not arrive for another 250,000 years.[1]

Regarding financing a home, Barry stated: "you are definitely going to need the bank to give you a lot of money in the form of a mortgage. The bank is willing to do this because, the way mortgages are set up, no matter how many payments you make, *you still owe the bank all the money you ever borrowed.*"[2] The frustration with mortgages that Barry points out is common. Mortgages are an expensive,[3] but normal[4] part of owning a home. While Barry's statement is meant as a

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* J.D. Candidate, 2004, Fordham University School of Law. I would like to thank Professor Richard S. Carnell for introducing me to the topic of predatory lending. I would also like to thank my family and friends for their support during the writing of this Note.

1. Dave Barry, Dave Barry's Homes and Other Black Holes, at vii-ix (1988).

2. *Id.* at 41.

3. Expensive is, of course, relative. For example, on an eight percent interest loan of $200,000 (compounded monthly), paid out over thirty years, the total repayment of principal and interest would come out to $528,310.80 (or $1467.53 a month). This is exclusive of any fees that might be applied by a lender in addition to the actual repayment of the loan. It is not unheard of for a predatory lender to charge twenty percent interest. Kathy M. Kristof, *Understanding, Guarding Against Abusive Practices*, L.A. Times, September 10, 2001, at C5. It has even been suggested that, in some cases, with fees added in, the rate has gotten as high as over sixty-six percent. Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. Rev. 473, 564 (2000) (citing congressional testimony).

4. According to U.S. Census Data, of over 72 million owner-occupied American homes, less than 26 million were owned free and clear (i.e. without a mortgage). U.S. Census Bureau, American Housing Survey for the United States: 2001, *available at* http://www.census.gov/hhes/www/housing/ahs/ahs01/tab315.html (Nov. 1, 2002). Also, the number of home purchases and the mortgages associated with them are on the

humorous exaggeration, the shocking thing is, for some borrowers, it can be an accurate description of their loans.[5]

For those Americans who do not have sufficient income or credit to receive a standard mortgage, obtaining funding can be especially frustrating. The funds that can be so essential are often unavailable to those who need them.[6] In response to this dilemma, there has been a tremendous growth in a "subprime" market that gives loans to people who could not otherwise afford them.[7] The development of the subprime market, however, has not been entirely positive because there is another sort of loan, a predatory loan, which at times can be difficult to distinguish from a subprime loan.[8] Although a definition of what constitutes a predatory loan may be elusive, there is a widespread belief that there are certain loan practices and terms that ought to be prohibited.[9] Loans containing such terms, referred to collectively as "predatory loans," have been blamed for a great deal of evil in recent years.[10]

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rise.

> Sixty-eight percent of all American families own homes, the most ever, and a notable increase from 64% just ten years ago. And that market is being held aloft by a wealth of refinancings supported by low interest rates. Today, there are 70% more mortgage transactions than in an average home purchase-driven market and ten times more refinancings than in an average purchase-driven market.

James Peterson, *Mortgage Lending: What to do when the boom is over*, A.B.A. Banking Journal, Jan. 2003, at 26.

5. Or worse, in a process known as "negative amortization," it is possible for a borrower to actually owe *more* after each payment. 12 C.F.R § 226.32(d)(2) (2001) (banning such loans when they fall within a certain class).

6. Ronald K. Schuster, *Lending Discrimination: Is the Secondary Market Helping to Make the "American Dream" a Reality?*, 36 Gonz. L. Rev. 153, 154-55 (2001).

7. Figures indicate that the past decade, in particular, showed a remarkable increase in subprime lending:

> [I]n 1990 subprime home equity loan origination volume was at $7 billion. By contrast, in 1996 subprime loan origination volume was between $100 billion and $150 billion—most of which was home equity lending. By 1997 home equity subprime origination generated around $125 billion. This made up about "11.5% of the total home equity lending market in 1996" and 15.5% of the market in 1997. By another estimate, between 1995 and 1997 "subprime lenders more than tripled their market share of the total mortgage market... originating a full 15% of all mortgages, up from 4% in 1995." By a third estimate, the number of subprime nonpurchase loans increased by 890% between 1993 and 1998. In 1999 subprime loans are expected to make up more than 10% of the mortgage market and account for more than $150 billion in loan originations.

Mansfield, *supra* note 3, at 528-29 (citations omitted); *see also* Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks*, 2002 U. Ill. L. Rev. 215, 392-403 (2002).

8. *See infra* note 31 and accompanying text.

9. This belief is apparently held by many lawmakers on all levels of government, as well as quite a few scholars. *See infra* Part II.

10. *See infra* note 36 and accompanying text.

The purpose of this Note is to analyze some of the specific legislative initiatives that have been suggested, attempted, or enacted, to remedy the problem of predatory lending.[11] Part I provides an introduction to subprime lending and predatory lending. This Part examines the difficulties of legislating against abusive loans and establishes a framework of three categories into which an anti-predatory lending law can fall. Part II provides an overview of the current federal law on the topic, as well as some state and local laws. It also reviews some of the scholarly literature on the topic. With each of the laws or proposed laws, this Note attempts to identify what category or categories the law falls into. Finally, Part III argues that anti-predatory lending legislation should focus on concrete rules and avoid loose standards. This Part suggests that the best way of mitigating the harshness of objective rules is to use gradations within the subprime loan category.

I. AN AMERICAN DREAM DEFERRED

There are few goals as deeply embedded in the American psyche as home ownership. Yet, predatory lending has emerged as a threat to the attainment of this goal. The problem of predatory lending is a complex one, and any solution will have to address many concerns. This part discusses the nature of the problem that predatory lending presents. The first section briefly describes the nature of mortgage borrowing and explains where predatory lending enters the picture. The second section describes the difficulties that arise in attempting to legislate against predatory lending. Finally, the third section establishes categories into which the existing and proposed legislation regarding predatory lending can be grouped.

A. *The Emerging Problem*

Home ownership is a fundamental aspect of American life—a dream to which many aspire.[12] On the other hand, purchasing a home is one of the most complex and expensive transactions that a typical person will be involved in.[13] Practically all homes are purchased with the aid of outside financing, and such financing typically comes in the

11. What this Note will *not* do is state a preference as to how the specific prohibitions should be structured. Often, especially with state and local ordinances, this will depend highly on the particular circumstances. Rather, the Note dedicates itself to analyzing the approaches taken: objective rules, subjective standards, and educational initiatives.

12. *See* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 Tul. L. Rev. 373, 374 (1994); Schuster, *supra* note 6, at 154.

13. *See* Iylce R. Glink, *Home Buying Pitfalls: Common Money Mistakes*, L.A. Times, Feb. 9, 1997, at K1.

form of a mortgage.[14]

1. Mortgages and Subprime Lenders

Mortgages are pledges of property given to secure a loan, particularly one that involves the same property.[15] In the home loan context, a mortgage is often obtained to finance the home or can be obtained to access funds by offering equity in the home as security.

Obtaining a normal mortgage can be a traumatic experience for anyone.[16] All the hopes of owning a home, combined with the fear of rejection, produce a unique borrowing experience. For an unsophisticated consumer, this may be the most complex financing arrangement they ever encounter.[17] Second mortgages on the same property carry with them their own unique emotional issues. A second mortgage is typically a loan of last resort, risking the equity that one has acquired in a home in exchange for much needed money.[18] Considering the value Americans place on their homes, a particular spirit of need,[19] opportunity,[20] or desperation[21] moves one to encumber his or her home with another mortgage.

The above issues make obtaining a mortgage a significant event in the financial life of most Americans. Lenders typically wish only to make loans that they believe will be repaid.[22] They screen consumers' financial information to learn the likelihood of the loan obligation being fulfilled.[23]

Nevertheless, prospective borrowers do not need to have perfect

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14. *See supra* note 4. Moreover, of the approximately 26 million homes that are mentioned as being owned without a mortgage, many of those are so because the mortgage has been paid off.

15. Black's Law Dictionary 1026-27 (7th ed. 1999).

16. *See* Carl Larsen, *Seminars Explain Ins and Outs*, San Diego Union-Tribune, July 28, 2002, at I2.

17. "[E]ven business-school graduates can't read all the disclosure documents that accompany a mortgage today." David Wessel, *Capital: An Inner-City Predator Needs a New Leash*, Wall St. J., Apr. 19, 2001, at A1.

18. *See, e.g.*, Fred R. Bleakley, *A 125% Solution to Card Debt Stirs Worry: Second Mortgage Trend May Signal Economic Trouble*, Wall St. J., Nov. 17, 1997, at A2 (discussing a family that encumbered its home for more than its value to pay off credit card debt).

19. *See, e.g.*, Kaja Whitehouse, *How Do I Raise Cash Quickly?*, Wall St. J., Jan. 28, 2002, at R6 (describing second mortgages as a possible contingency plan in case of financial need).

20. *Cf.* Maggie Jackson, *Entrepreneurship Is Fun. Then There's the Day Job.*, N.Y. Times, May 19, 2002, § 3, at 9 (describing second mortgages as a source of funds one might consider while pursuing a new opportunity).

21. *See* Evelyn Nieves, *Region's Quick-Cash Frauds Snare Desperate Consumers*, N.Y. Times, Feb. 7, 1992, at A1 (describing mortgage lenders who appeal to a borrower's sense of desperation).

22. HUD—Treasury Task Force on Predatory Lending, *Curbing Predatory Home Mortgage Lending*, 29-30 (2000), *available at* http://www.huduser.org/publications/pdf/treasrpt.pdf (n.d.).

23. *Id.*

credit in order to obtain a mortgage.[24] Lenders will take the risk associated with a loan into account when determining how much to charge for the loan.[25] Standard lenders might accept a certain level of risk in exchange for a higher potential profit. For borrowers who do not have sufficient means or credit to secure a loan from a standard lender, there is a class of lenders, known as "subprime" lenders, who provide these loans.[26] Subprime lenders provide loans to higher-risk borrowers and seek a higher profit in exchange for the added risk.[27] Subprime lenders can have a positive impact because they enable some people who otherwise could not have purchased a home to do so.[28]

The danger that has been recognized in this area, however, is the possibility that in making a loan a lender may be too aggressive.[29] Aggressive lending can be accomplished either by using a borrower's ignorance and fear to lend on exploitive terms or by disregarding a borrower's ability to repay entirely and granting a loan intending eventually to foreclose.[30] These practices are commonly referred to collectively as "predatory lending."[31]

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24. *Id.* at 27-28.

25. *Id.* at 28. "Charge" here refers to any method the lender uses to gain a profit on a loan. For example, increased charges might include not only higher interest rates but other fees and expenses as well.

26. *Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 102 (2001) (revised prepared statement of Professor Charles W. Calomiris).

27. *See id.*

28. The subprime lending industry is rather proud of their role in the creation of new home ownership:

> It is imperative to note that subprime lending has been extremely beneficial to thousands of families in the last couple of years. Subprime lending has opened up new markets and helped many consumers that would not have received needed funds but for the special products available in this sector of the market.

Id. at 311 (prepared statement of John A. Courson, President and CEO of Central Pacific Mortgage Company, on behalf of the Mortgage Bankers Association).

29. Anne-Marie Motto, Note, *Skirting the Law: How Predatory Lenders Are Destroying the American Dream*, 18 Ga. St. U. L. Rev. 859, 863-68 (2002).

30. *See* Forrester, *supra* note 12, at 390-92.

31. "Predatory lending" has never been fully defined, and it is possible that a full definition may not even be a practical goal. Interestingly, one report noted that a survey of nine federal agencies (specifically: the Federal Reserve Board, the OCC, the FDIC, the OTS, the NCUA, HUD, OFHEO, the DOJ, and the FTC) that dealt with issues related to predatory lending failed to yield a single clear response to a request for a definition. Report of the Staff to Chairman Gramm, Committee on Banking, Housing and Urban Affairs, Predatory Lending Practices: Staff Analysis of Regulators' Responses, August 23, 2000 *available at* http://banking.senate.gov/docs/reports/predlend/predlend.htm (Aug. 23, 2002) [hereinafter *Staff Report*]. Although it is common for writers on the subject to compile lists of predatory practices and use the employment of those practices as a kind of working definition of predatory lending, it is notable that these same nine agencies did not have consistent lists of practices either. *Id.* For the purpose of this Note, a predatory loan is simply any loan that contains terms that the law should deem unacceptable. Based on this

2. Predatory Lending

Predatory lending has created a recent flurry of activity in legislatures[32] and in the academy.[33] Moreover, a spate of recent prosecutions and settlements suggests that law enforcement agencies are beginning to take the issue seriously.[34]

Victims of predatory lending tend to be sympathetic groups that are prone to manipulation. Often, predatory lenders target elderly individuals who have accumulated equity in their homes.[35] The literature is replete with stories of individuals who have lost their homes after being swindled by unscrupulous lenders.[36] There tends to

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understanding, a loan need not be subprime to be predatory. *See* Kathleen C. Engel and Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 Tex. L. Rev. 1255, 1261 (2002) [hereinafter Engel & McCoy, *A Tale of Three Markets*]. There is, however, a much greater fear of predatory loans in the subprime market because of the lower sophistication and bargaining power of the borrowers and the fewer financing options available.

32. On the state level alone, in the last three years, forty-one states (plus the District of Columbia) have at least introduced legislation related to predatory lending on some level. *See* Mortgage Bankers Association, *Predatory Lending Resource Center*, *at* http://www.mbaa.org/resources/predlend (last visited Feb. 24, 2003) (listing recent developments in a state-by-state directory); *see also infra* Part II.B.

33. *See infra* Part II.D.

34. For example, Household International Inc. recently proposed a $484 million settlement to end prosecutions from a group of states. Cassell Bryan-Low & Joseph T. Hallinan, *What's Behind the Big Charge? Take a Look at Household*, Wall St. J., Oct. 23, 2002, at C1. Associates First Capital Corp., a subsidiary of Citigroup, had to negotiate with the FTC because of alleged predatory practices and a settlement amount in the $200 million range was discussed. Paul Beckett, *Citigroup May Pay $200 Million in FTC 'Predatory Lending' Case*, Wall St. J., Sept. 6, 2002, at A1. Another recent settlement was in the amount of $60 million. Paul Beckett, *First Alliance Settles Predatory-Loan Charges*, Wall St. J., Mar. 22, 2002, at A6.

35. National Consumer Law Center, Consumer Concerns for Older Americans: Helping Elder Homeowners Victimized by Predatory Mortgage Loans, *at* http://www.nclc.org/initiatives/seniors_initiative/helping_elderly.shtml (last visited Feb. 23, 2003).

36. For a specific example, consider the case of Mrs. Mary Podelco who testified before the Senate Banking Committee. She had fully paid off her mortgage and owned her house freely when she was approached in 1995 by a lender offering a loan of about $12,000. At the time, Mrs. Podelco's sole income was a monthly $458 check from social security. The resulting loan payments came out to more than half her monthly income. Moreover, the lender offered to refinance the loan (usually for a higher total loan), and ended up doing so seven times. By 1997, Mrs. Podelco lost the house which she had previously held with no mortgage. *See Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 18-19 (2001) (statement of Mrs. Mary Ann Podelco of Montgomery, W. Va.). Of course, anecdotal evidence, on its own, would be insufficient to show that a problem existed. Larger scale studies, however, have also confirmed the existence of the problem. One study came to an estimate putting annual cost of predatory lending at $9.1 billion. Eric Stein, *Quantifying the Economic Cost of Predatory Lending, A Report from the Commission for Responsible Lending*, 2-3, July 25, 2001, *available at* http://www.responsiblelending.org/research/Quant10-01.PDF (July 25, 2001, revised Oct. 30, 2001).

be a very strong overlap between those who would normally receive subprime loans and those who receive predatory loans.[37] Individuals who are more desperate for funds have fewer options and are thus more likely to accept the terms offered by a predatory lender. Those who have strong credit histories and higher incomes would not need to resort to this type of financing.[38] Generally speaking, both subprime lenders and predatory lenders deal with populations underserved by the normal loan industry.[39]

The negative social and economic results of inadequately restricted predatory lending can have effects in areas beyond simple overpayment or even home loss. For example, efforts at community development can be quickly hamstrung if the residents of a community are not able to obtain a home loan at fair terms, or are losing their homes due to foreclosures on loans that were made without regard to the borrower's ability to repay.[40] Individuals whose main investment is their home can see their entire net worth stripped away by a second mortgage that they cannot afford to repay, which was pushed on them by a predatory lender looking for a quick profit.[41] Moreover, given the social costs of providing housing to individuals who had homes but lost them because of predatory loans, predatory lending affects the entire economy, not simply the individuals and

37. *See Full Comm. Hearing on Predatory Lending Practices before the House Comm. on Banking and Financial Services*, 106th Cong. (2000) (testimony of Senator Charles E. Schumer), *available at* http://financialservices.house.gov/banking/52400sch.htm (May 24, 2000); Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1261;.

38. Nevertheless, it is at least possible that in a specific case an unscrupulous lender who knew the borrower to be unsophisticated might choose to take advantage of a borrower despite the borrower's strong finances.

39. This can result in, among other things, a disproportionate number of victims of predatory lending that are minorities. *See* Schuster, *supra* note 6, at 155. Because the elderly are often targeted, the most likely candidate for a predatory loan would be an elderly minority borrower who has a significant amount of equity in his or her home. Considering the trend towards gentrification and increased property values in minority neighborhoods, predatory lending could very well become an epidemic if left alone.

40. Community development is premised on being able to develop a small area and allowing it to grow from there. The funds available from the federal government for community development are geared for such a purpose. 42 U.S.C. § 5308 (2000). If the area is losing equity because of predatory lending, however, the effort to grow from a small area may be futile. One method of improving development has been to educate consumers on how to avoid predatory loans. *See* Federal Reserve Board, *Having Faith in Community Economic Development*, Capital Connections, Volume 3, No. 3, Fall 2001, *available at* http://www.federalreserve.gov/dcca/newsletter/2001/fall01/faith.htm (last modified Feb. 14, 2002) [hereinafter Federal Reserve Board, *Having Faith*].

41. For an example of how abusive and destructive this can become, see *Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 14-17 (2001) (statement of Paul Satriano of St. Paul, Minn.).

communities that are directly affected.[42]

B. *The Complications of Predatory Loans*

Predatory loans can have devastating effects, but the problem of predatory lending is compounded by the difficulty in creating proper legislation to prohibit it. Predatory lending presents several issues that prevent a simple solution. This section will identify some of the complicating factors while stressing the need for a solution.

The difficulty in moving against predatory lenders is twofold. First, identifying predatory loans can be tricky. There is no full and comprehensive standard by which loans are defined as either predatory or equitable.[43] The second (and related) problem is that legitimate subprime lenders are apt to be harmed by any attempt to regulate predatory lenders.[44] Drawing overbroad legislation because of a desire to err on the side of creating a comprehensive definition of predatory lending could create a chilling effect on the subprime market.[45] Such legislation would create the ironic result of shutting out credit from the very population that the legislation was seeking to protect.[46]

Balancing the promotion of positive subprime loans and the prevention of predatory loans results in a debate as to whether or not additional laws are needed to prevent predatory lending. Some

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42. The $9.1 billion annual cost is daunting enough. *See* Stein, *supra* note 36. Nevertheless, it quantified only the actual cost in terms of excessive fees and lost equity. If we follow the results of that further, including the fallout costs of maintaining the victims of predatory lending (bearing in mind that it is typically the elderly who are targeted), the costs would be even higher.

43. In fact, it is not even clear what makes a loan predatory in the first place. *See Staff Report*, *supra* note 31.

44. Changes in the law might affect subprime lending dramatically.

> A study of AFSA [American Financial Services Association] member loans originated over the last 5 years suggests that the pending Federal Reserve Board proposal would increase the number of first mortgages covered by HOEPA from 12.4% today to 37.6%, and second mortgages from 49.6% to 81.1%. The effect, if not the goal, of these proposals will likely be to substantially shrink the subprime mortgage market, a point underlined by Freddie Mac's announcement in the Spring of 2000 that it would not purchase any HOEPA loan, a policy now mirrored by Fannie Mae.

Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs, 107th Cong. 378-79 (2001) (prepared statement of George J. Wallace, Counsel for AFSA).

45. *See id.* There is some evidence that this chilling effect has begun already. Lew Sichelman, *Predatory Lending Law Slowed Borrowing, Studies Say*, Chi. Trib., Nov. 3, 2002, at F7.

46. It is true that the very prohibition against predatory lending would shut out some credit. As the Federal Reserve Board has pointed out, however, the lack of credit caused by the shutting out of predatory loans should not be seen as a bad thing. Regulation Z, Truth in Lending, 65 Fed. Reg. 81,438, 81,441 (proposed Dec. 20, 2000) (to be codified at 12 C.F.R. pt. 226). An overly restrictive law, however, might prevent credit from being extended on acceptable terms.

industry leaders have argued that the best way to protect both borrowers and the credit supply is to avoid further legislation and allow prosecutions of violators of current law in combination with market forces to prevent predatory lending.[47] Due to the recent spate of successful litigation against large institutions that may have engaged in predatory practices, the notion that current law will permit prosecution of predatory lenders has gained support.[48]

Some scholars, however, have suggested that large institutions are not the main source of the problem.[49] Rather, they point to a number of small unscrupulous lenders who specially gear themselves towards maximizing profits through abusive loans and who have refined their techniques for lending on these terms.[50] If a smaller group of specialists are causing the problem, large sweeping prosecutions will not be sufficient.[51] In fact, such prosecutions might worsen the problem by sending borrowers away from legitimate institutions who may simply be slightly abusive, and into the hands of lenders whose entire goal is to squeeze the maximum amount of money out of a victim.[52] Therefore, even if present law has proven successful against larger lenders, it is still not clear how useful it will be in combating the problem as a whole.

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47. *Full Comm. Hearing on Predatory Lending Practices Before the House Comm. on Banking and Finance*, 106th Cong. (2000), *at* http://financialservices.house.gov/banking/52400fen.htm (May 24, 2000) (testimony of Neill Fendly, President-Elect, National Association of Mortgage Brokers).

48. *See supra* note 34 and accompanying text. Additionally, some have pointed out that there is apparently an adequate amount of protection in the system for the abuses that have happened. "The regulators' citation of numerous court settlements and decisions with large damage awards demonstrates that the practices they cited as predatory are illegal practices covered by current law. No letter cited any abuses for which there were no legal remedies." *See Staff Report*, *supra* note 31; *Full Comm. Hearing on Predatory Lending Practices Before the House Comm. on Banking and Finance*, 106th Cong. (2000), *at* http://financialservices.house.gov/banking/52400waa.htm (May 24, 2000) (statement of the American Financial Services Association).

49. *See* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1289-96 (explaining why mainstream banks will not be able to provide the necessary competition to bring predatory lenders in line). *But see id.* (mentioning that, occasionally, subsidiaries and affiliates of mainstream banks have been found to engage in predatory practices).

50. *See id.* at 1282-84. Predatory lenders have also learned that such loans may be disposed of as well. Kurt Eggert, *Held Up In Due Course: Predatory Lending, Securitization, and the Holder In Due Course Doctrine*, 35 Creighton L. Rev. 503 (2002). In response, some of the newer legislative movements have been targeted not only at those who make predatory loans, but those who trade in them as well. *See infra* Part II.B. For a general discussion of securitization in the subprime market, see Joseph A. Smith, Jr., *The Federal Banking Agencies' Guidance on Subprime Lending: Regulation With a Divided Mind*, 6 N.C. Banking Inst. 73, 91-105 (2002).

51. Even if prosecuted, a victory against a predatory lender may not be helpful. These lenders are typically not sufficiently capitalized to be able to pay a judgment if one is granted against them. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1290.

52. For example, a borrower might turn to a loan shark who does not even have pretenses of acting within a legal framework.

The second part of the criticism against further legislation is that market forces will lead to competitive rates across the board.[53] Scholars have suggested, however, that there has been a market failure in the subprime lending industry that prevents normal market forces from protecting consumers.[54]

Some groups suggest that certain existing legal remedies could be used to punish predatory lenders.[55] Using existing legal remedies would allow a resolution of the issue without encumbering the already highly-regulated lending industry with further regulations—it would simply ensure that they are following laws that they are required to follow anyway. Obviously, in cases of actual fraud, either criminal or civil remedies can be pursued. Even without fraud, certain contractual rules such as unconscionability might invalidate predatory provisions in a loan.[56] These causes of action, however, are often difficult and costly to prove in court. Courts use doctrines such as unconscionability rather sparingly, and the victims of a predatory loan seldom have the financial resources to pursue a protracted litigation.[57] Other suggestions, based on civil rights themes, are novel, but typically are acknowledged stretches from existing jurisprudence on those laws.[58] Moreover, proving every element necessary for a civil rights suit is a rather circuitous and cumbersome method of establishing that a loan was unfair.[59]

53. The Business Council of New York State, Inc., *Council opposes bill that would fundamentally change loans and lending* (Mar. 22, 2002), *at* http://www.bcnys.org/whatsnew/2002/0322lend.htm. (Mar. 22, 2002) [hereinafter Business Council, *Council Opposes*]; *see also* Motto, *supra* note 29, at 897 (referring to a Brookings Institute study finding that local anti-predatory lending ordinances hurt consumers, and that better enforcement would provide a better solution).

54. *See* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1280-98.

55. *See* Business Council, *Council Opposes*, *supra* note 53. Professors Charles W. Calomiris and Robert E. Litan have pointed to studies that imply that current predatory lending legislation can have negative consequences. Charles W. Calomiris & Robert E. Litan, *Homeownership That's Too Important to Risk*, N.Y. Times, Aug. 20, 2001, at A17. Addressing the effects of the recent North Carolina statute, they state that: "subprime mortgage lending by finance companies in the state to borrowers with incomes below $25,000 has dropped by nearly 50 percent. For those with incomes between $25,000 and $50,000, the drop has been one-third." *Id.* Instead they advocate requiring additional disclosures, providing counseling, and increasing activity by enforcement agencies. *Id.*

56. *See* U.C.C. § 2-302 (2002); Restatement (Second) of Contracts § 208 (1981); *see also* Motto, *supra* note 29, at 888-89.

57. *See* Motto, *supra* note 29, at 888-89. For a discussion of the difficulties of bringing an action under laws that were actually geared to preventing predatory lending, see Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly*, 10 B.U. Pub. Int. L.J. 1, 12-27 (2000).

58. *See* Harkness, *supra* note 57 at 28-29 (discussing the applicability of the Civil Rights Act, 42 U.S.C. 1981 (2000), and the Fair Housing Act 42 U.S.C. 3601 (2000), to predatory lending and stating that, under the current law, age is not a basis for a discrimination suit).

59. For example, discriminatory intent or impact must be shown before a fair

Thus, while some feel that predatory lending can be ended without major legislative changes, others disagree and suggest that direct and effective legislation is needed. Not only academics call for changes. Much recent legislative activity seems to take the view that improvement in borrower protection is needed.[60] Moreover, academics who have taken the view that legislation is needed have also made suggestions as to what steps should be taken.[61] All along, however, the goal of protecting consumers, while protecting the credit infrastructure that they depend on, is still at the forefront of the debate.[62] Therefore, when creating legislation to address predatory lending, lawmakers face a particularly thorny problem.

C. *Methods of Reform*

Proposed and existing legislation aimed at curbing predatory lending falls into three major categories: objective rules, subjective[63] standards, and educational initiatives. Most actual legislative packages have included elements from at least two, if not all, of these categories.[64]

Objective rules are specific guidelines about the terms a loan may or may not contain.[65] Typically, these rules are designed to affect loans in the subprime market. This subprime loan market is targeted by means of triggers that will activate the legislation.[66] Triggers can include such things as interest rates over a certain set rate[67] or a defined variable rate over a certain amount.[68] In addition, fees over a

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housing violation will be found. Arlene S. Kanter, *A Home of One's Own: The Fair Housing Amendments Act of 1988 and Housing Discrimination Against People With Mental Disabilities*, 43 Am. U. L. Rev. 925, 980 n. 325 (1994). Discriminatory intent or impact may be present in some instances of predatory lending, but the effort needed to show it goes rather far afield of what should be the basic point of an action—that the loan terms were patently unfair.

60. *See infra* Parts II.A-C.

61. *See infra* Part II.D.

62. Smith, *supra* note 50, at 107-09.

63. The term "subjective" can mean many things. In tort law, for example, a "reasonable person" standard is considered to be an objective one because it relies on the use of a general consensus rather than a particular person's perceptions. *See* Restatement (Second) of Torts § 283 cmt. c. (1965). In this Note, however, "subjective" is taken in the more colloquial sense which includes judgments that have to be made on a case-by-case basis without recourse to an easily ascertainable *per se* rule.

64. *See infra* Parts II.A-B.

65. Typical restrictions on balloon payments in a high cost loan would be an example. *See, e.g.*, 15 U.S.C. § 1639(e) (2000).

66. *See, e.g.*, *id.* § 1639 (referring to mortgages defined in 15 U.S.C. § 1602(aa)(2)(a)(2000)).

67. This is at least theoretically possible. Modern legislation eschews absolute numbers, however, because of concerns that fluctuating interest rates could make such a trigger unrealistically high or low.

68. In fact the federal law on this topic (which is discussed in Part II.A) has a double fluctuation by allowing the Federal Reserve Board to adjust the number of

certain amount are used as triggers.[69] Using fees as triggers prevents a simple displacement of the amount charged for the loan from being in the form of interest payment to fees to avoid the legislation. Using a trigger system allows loans that reach a certain threshold to encounter special restrictions without affecting loans in the prime market, or imposing a blanket usury restriction.[70] Another method lawmakers use is to create a threshold based on the amount of money loaned. Loans for amounts below the set amount are then subject to the legislation.[71] Objective rules have the advantage of being the simplest for lenders to know how to comply with the law, and the easiest for government enforcement agencies to enforce.[72]

Subjective standards are broad directives, used to instruct[73] the lender in what to look for in making a loan. Rather than having specific rules that the lender would have to follow, a subjective standard will point at a goal or result that a legislature wishes to achieve, without necessarily explaining how to get there.[74] The danger

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percentage points over the prime rate that will be used as a trigger. *See id.* § 1602(aa)(2).

69. Again, there is still some room for variation here, with the Federal Reserve Board doing the adjustments on the federal level. *See id.* § 1602(aa)(3).

70. Economists believe that usury laws often are not in the best interest of those who need the money most. By limiting what one can charge for a loan, everyone whose credit risk outweighs the maximum charge will be unable to receive credit. *See* Jonathan R. Macey et al., Banking Law and Regulation 158 (3d. ed. 2001).

71. *See* N.C. Gen. Stat. §§ 24-1.1A (c-c2), (g), 24-1.1E (a)-(e) (2001). The underlying assumption here seems to be that those who are borrowing amounts above the threshold will have sufficient sophistication to protect themselves from predatory lenders.

72. For a discussion of the "argument from efficiency" in favor of objective rules, see Fredrick Schauer, Playing by the Rules: A Philosophical Examination of Rule-Based Decision-Making in Law and in Life 145-49 (Clarendon Press 1991).

73. "Instruct" is, in fact, what the standard does. An instructive role does not mean that a subjective standard does not have teeth. The penalties for violating standards can be every bit as strong. Rather, it means that with a standard, the law will not tell a particular lender what to do in a particular case. Instead, the law will tell the lender the way he or she should approach the question.

74. For a more nuanced description of the distinction between rules and standards, consider the words of Professor Pierre Schlag:

> It is possible to look at positive law (constitutions, statutes, judicial opinions, and administrative orders) as a series of directives. The formula for a legal directive is "if this, then that." A directive thus has two parts: a "trigger" that identifies some phenomenon and a "response" that requires or authorizes a legal consequence when that phenomenon is present. Directives serve a number of *substantive* objectives such as deterrence, allocation of entitlements, and inducement. Directives also have *formal* dimensions. For instance, directives can be general or specific, conditional or absolute, narrow or broad, weak or strong. They can also be rules or standards. Thus, the opposition of rules and standards is one dimension of the form of a legal directive. Corresponding to the two parts of a directive, there are two sets of oppositions that constitute the rules v. standards dichotomy: The trigger can be either empirical or evaluative, and the response can be either determined or guided. The paradigm example of a rule has a hard empirical trigger and a hard determinate response. For instance, the directive that "sounds above 70

with standards is that if left unchecked, a vague standard could run rampant.[75] The reason for the uncertainty is that, in avoiding having to deal with a definition of the problem, the lawmaker has simply passed the buck. Typically, the executive or judicial branch will then have to decide what is, in this case, predatory. In some cases this is an appropriate step. It is not uncommon for a legislature to have a regulatory body review an issue and create rules.[76] In this case, however, it must be admitted that the legislators have not really solved the problem—they have merely asked someone else to do it for them.[77]

Finally, educational initiatives seek to curb predatory lending by improving consumers' knowledge about the loans that they accept.[78] These initiatives attempt to ensure that consumers understand everything they agree to[79]—providing full disclosure regarding the terms of the loan,[80] and increasing the consumer's knowledge about the process of obtaining a loan.[81] The idea behind such educational initiatives is that when consumers have fuller knowledge of what they are signing onto, they can better negotiate equitable terms, or at least understand that they have other options, and can walk away if they perceive the proffered terms to be unfair.[82] Educational initiatives

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> decibels shall be punished by a ten dollar fine," is an example of a rule. A standard, by contrast, has a soft evaluative trigger and a soft modulated response. The directive that "excessive loudness shall be enjoinable upon a showing of irreparable harm," is an example of a standard.

Pierre Schlag, *Rules and Standards*, 33 UCLA L. Rev. 379, 381-83 (1985) (internal citations omitted); *see also* Isaac Erlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. Legal Stud. 257, 258 (1974) (explaining the difference between rules and standards in terms of the number of factors that must be taken into account).

75. *See* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1332, 1345.

76. *See, e.g.*, 15 U.S.C. § 78d(a) (2000) (creating the SEC through § 4(a) of the 1934 Securities Exchange Act).

77. Often, deferring to a regulator or other nonlegislative body is a convenient tool to use in a situation like predatory lending where a definitional problem exists. The advantage of such deference is the ability to create a rule that would, in theory, do away with the problem itself rather than simply the factors that lead to the problem. *See* Erlich & Posner, *supra* note 74, at 261 (arguing that creation of a standard by legislature forces the court to take the role of rule-maker).

78. One way to do this is to require counseling before a high-cost loan is made. *See* Ga. Code Ann. § 7-6A-5(7) (2002). Additionally, direct consumer education is being practiced both by government, *see* Federal Reserve Board, *Having Faith*, *supra* note 40, and by private organizations, *see* AARP, Avoiding Predatory Lenders, *at* http://www.aarp.org/consumerprotect-homeloans/Articles/a2002-09-16-ConsumerAdvocacyHomeLoans (last visited Feb. 24, 2000).

79. For example, the Truth in Lending Act requires various disclosures about the terms and cost of a loan. *See generally* 15 U.S.C. § 1601 (2000).

80. *See, e.g.*, *id.*

81. *See, e.g.*, *id.* § 1639(a)(1)(A) (requiring the disclosure in a high cost loan that "[y]ou are not required to complete this agreement merely because you have received these disclosures or have signed a loan application").

82. *See supra* note 78.

have the advantage of being less intrusive into the actual loan process than rules or standards, and allowing consumers to decide for themselves if the terms offered for a loan are fair on their own.

Having reviewed the problem of predatory lending and established the categories of possible responses, this Note now proceeds to review some of the actual legislation that has been enacted, as well as academic suggestions, in an effort to evaluate how these remedies fit into the categories established above.

II. THE SEARCH FOR A CURE

Predatory lending is a difficult problem, but that does not mean that no one has tried to remedy it. All levels of government, from federal to municipal, have attempted to legislate the issue. Having discussed the problem of predatory lending, the difficulties in finding a solution, and the categories of legislation, this part now turns to some of the actual and proposed laws on the topic. This part reviews federal law, state law, and local law, and then discusses the suggestions of scholars who have examined the problem of predatory lending.

A. *Federal Law*

Recently, there has been a great deal of state, and even local, legislation regarding predatory lending.[83] Federal law, however, has been the cornerstone of all predatory lending laws.[84] Efforts beyond this must be seen as variations on, or supplements to, existing federal law.[85]

The primary federal law dealing with predatory lending is the Home Ownership and Equity Protection Act ("HOEPA").[86] Congress passed HOEPA in 1994 as an addendum to the Truth in Lending Act ("TILA").[87] HOEPA's present form is a result of a tightening of the restrictions that occurred at the end of 2002 after the congressional banking committees held hearings about the

83. As mentioned in note 32, *supra*, forty-one states (plus the District of Columbia) have at least introduced predatory lending legislation in the past few years. *See* Mortgage Bankers Association, *Predatory Lending Resource Center* (listing recent developments in a state-by-state directory), *at* http://www.mbaa.org/resources/predlend (last visited Feb. 24, 2003). Many local authorities have done so as well. *See id.*

84. Many of the state statutes are explicitly linked to HOEPA. *See, e.g.*, Ga. Code Ann. § 7-6A-2(19)(a) (2002) (tying Georgia's high cost loan thresholds to HOEPA's).

85. Note that some states have laws that mostly mirror HOEPA. *See* Dennis Hevesi, *New Curbs on Predatory Loans*, N.Y. Times, Nov. 10, 2002, § 11 at 1 (citing advocates who feel that Connecticut's new law is not a substantial improvement over HOEPA).

86. 15 U.S.C. § 1639 (2000).

87. *See generally* Regulation Z, Truth in Lending, 66 Fed. Reg. 65,604 (Dec. 20, 2001) (to be codified at 12 C.F.R. pt.226).

effectiveness of HOEPA as it was then formulated.[88]

HOEPA's main method of operation is to set a system of "triggers" that activate additional scrutiny and restrictions on loans that go beyond certain criteria.[89] The two triggers for "high cost" are the APR of the loan or its associated fee.[90] The Federal Reserve Board has the power to adjust the specific amount that will activiate the triggers.[91] Once the loan has activated the triggers, HOEPA sets out, in fairly specific terms, what the loan may not contain.[92] Among the prohibited terms are certain balloon payments,[93] prepayment penalties,[94] certain payment schedules,[95] and increased rates upon default.[96] Additional disclosures, beyond what would be required by a normal loan, are mandated.[97]

All of the above fit well within the scope of objective rules for predatory lending. HOEPA defines who is included within its protection and, specifically, what those protections are. In addition to the other, more specific prohibitions, HOEPA also prohibits making a HOEPA-covered loan based on the borrower's equity, without regard to the ability to repay the loan:[98]

> Prohibition on extending credit without regard to payment ability of consumer. A creditor shall not engage in a pattern or practice of extending credit to consumers [whose loans are covered by HOEPA] based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment.[99]

This clause creates a restriction that significantly modifies HOEPA by forcing lenders to evaluate the borrower's ability to repay the loan. To comply with HOEPA, a lender need not only remove certain terms from what it will offer to subprime borrowers, but also change the criteria on which the lender approves or disapproves loans. Even though this restriction fits within a subjective frame, it is, however, limited. Requiring that loan approval not be based solely on homeowner equity is vastly different from ensuring that a loan is generally appropriate for a borrower. The former requires that additional reasons beyond equity be found to make the loan, and that

88. *Id.* at 65,607.

89. The definitions that HOEPA uses for the thresholds are found towards the beginning of TILA. *See* 15 U.S.C. § 1602(aa)(1).

90. *Id.*

91. *Id.* § 1602(aa)(2).

92. *See id.* § 1639(c)-(h).

93. *Id.* § 1639(e).

94. *Id.* § 1639(c).

95. *Id.* § 1639(g)-(h).

96. *Id.* § 1639(d).

97. *Id.* § 1639(a).

98. *Id.* § 1639(h).

99. *Id.*

repayment ability cannot be disregarded. The latter requires a full investigation into the financial situation of a borrower, with the result being a guess as to whether or not the borrower will be able to make payments. Additionally, the section requires a "pattern or practice" to establish liability,[100] which would prevent a single instance from being the basis of a lawsuit.

HOEPA has been criticized, essentially, for not going far enough.[101] Although some see the statute as a good first effort,[102] even the supporters of limited reform support lowering HOEPA's triggers and including certain types of mortgages that were excluded from HOEPA (for example, open-ended mortgages).[103] The general thought being that although HOEPA is helpful, a lot of predatory lending activity is still possible without activating its triggers.[104] One of the main trends in local legislation is to make HOEPA-style protections that will apply to loans that do not meet HOEPA's formal requirements.[105]

Whatever HOEPA's shortcomings, it is still the only federal law to address predatory lending head-on. Other statutes may be related in some ways to predatory lending, but either their effect is uncertain or they do not offer specific help for this area. For example, the Community Reinvestment Act ("CRA") seems to have an effect on predatory lending, although it is unclear if it is positive or negative.[106] Although with some modifications the CRA may serve as a deterrent to a large bank, the average predatory lender will probably have little concern about its degree of compliance.[107] Use of consumer protection laws, such as the Real Estate Settlement Procedures Act

100. *Id.*

101. Margot Saunders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. Banking Inst. 111, 129 (2002).

102. *Id.* at 130; *see also* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1307

103. *See* Saunders, *supra* note 101, at 130.

104. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1307.

105. North Carolina was the first state to do so and remains a model of state law that has gone beyond the narrowness of HOEPA to afford greater protection. *See infra* notes 115-21 and accompanying text.

106. For a full discussion of the relationship between predatory lending and the CRA, see Kathleen C. Engel & Patricia A. McCoy, *The Community Reinvestment Act: The Twenty Five Year Anniversary: The CRA Implications of Predatory Lending*, 29 Fordham Urb. L.J. 1571 (2002).

107. CRA credit is generally looked at when a bank wishes to engage in a merger or acquisition, or when it wishes to open a new branch. Keith N. Hylton & Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and the Community Reinvestment Act*, 85 Geo. L.J. 237, 244 (1996). It is also relevant when a bank holding company wishes to become a financial holding company under the Gramm-Leach-Bliley Act. Lissa L. Broome & Jerry W. Markham, *Banking and Insurance: Before and After the Gramm-Leach-Bliley Act*, 25 Iowa J. Corp. L. 723, 757 (2000). There is, however, no direct enforcement of CRA compliance, so a bank that is in substantial noncompliance would not have to worry about its CRA rating unless it wanted to make a change in its structure.

("RESPA")[108] and the non-HOEPA portions of TILA,[109] is difficult because these laws were not geared to preventing predatory lending.[110] There have also been attempts to deal with other more attenuated laws, such as RICO, with little success.[111] Thus, HOEPA remains the best federal law to use in dealing with predatory lenders.

B. *State Law*

A large number of states have either recently passed laws dealing with predatory lending or have bills pending regarding the issue.[112] Although it is beyond the scope of this Note to review all state and local legislation on the issue of predatory lending, certain developments are worth mentioning. As explained above,[113] recent state legislation tends to be structured as a supplement to perceived deficiencies in the federal law on predatory lending. The fact that this legislation is so prevalent may suggest a general dissatisfaction with HOEPA's breadth.[114]

1. North Carolina—The States Get Involved

North Carolina enacted the first state statute specifically focusing on the issue of predatory lending.[115] The act specifically defined general rules for all loans,[116] created a special category of high cost loans,[117] gave additional restrictions for the high cost loans,[118] and then created means of enforcement.[119] North Carolina's rule on predatory lending is mostly objective, but contains a subjective element. Regarding the flipping prohibition, it states:

> "[f]lipping" a consumer loan is the making of a consumer home loan to a borrower which refinances an existing consumer home loan *when the new loan does not have reasonable, tangible net benefit to the borrower considering all of the circumstances*, including the terms

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108. 12 U.S.C. § 2601 (2000).

109. 15 U.S.C. § 1601 (2000).

110. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1306-07 (arguing that the disclosures that TILA requires have not been sufficient to provide adequate information to prevent predatory lending).

111. *See, e.g.*, Emery v. Am. Gen. Fin., 938 F. Supp. 495 (N.D. Ill. 1996).

112. *See supra* note 32. These states are in addition to a large number of local measures.

113. *See supra* notes 83-85 and accompanying text.

114. Even on the Federal level, legislation continues to be proposed. *See, e.g.*, Predatory Lending Consumer Protection Act of 2002, S. 2438, 107th Cong. (2002).

115. Richard R. Daugherty, Note, *Will North Carolina's Predatory Home Lending Act Protect Borrowers From the Vulnerability Caused by the Inadequacy of Federal Law?*, 4 N.C. Banking Inst. 569, 592 (2000).

116. *See generally* N.C. Gen. Stat. § 24-1.1A (2001) (creating primarily disclosure-based protections); *id.* § 24-10.2 (creating substantive protections).

117. *Id.* § 24-1.1E(a)(4)-(7).

118. *Id.* § 24-1.1E(b)-(d).

119. *Id.* § 24-1.1E(e).

> of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances. This provision shall apply regardless of whether the interest rate, points, fees, and charges paid or payable by the borrower in connection with the refinancing exceed those thresholds specified in G.S. 24-1.1E(a)(6).[120]

The flipping prohibition forces the lender to evaluate the borrower's need for the refinancing and decide if the refinancing is to the borrower's benefit. While subjective, the limitation of the prohibition to refinancing loans, instead of a general rule for all loans, prevents it from requiring too deep an analysis by the lender of the borrower's needs.

Because it was first, North Carolina's law can be seen as a model for other state statutes, and it is frequently monitored to evaluate the effects of state predatory lending laws.[121]

2. Georgia—Subjectivity, but with Safeguards

Georgia's recent law against predatory lending—effective as of October 1, 2002[122]—enacts a fairly straightforward and direct set of rules dealing with predatory lending. The act includes prohibitions that apply to all home loans,[123] as well as prohibitions applicable only to high cost loans.[124] This structure allows the state to rule out activities it considers generally harmful while still allowing protections against other activities that are sometimes beneficial (but other times harmful) by limiting those prohibitions to what could be considered the subprime market.[125]

The activities that are prohibited in all home loans generally do not apply to the main loan terms themselves but, rather, to activities and

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120. *Id.* § 24-10.2 (c) (emphasis added). Although refinancing is often a legitimate method of restructuring one's debt, flipping tends to happen so quickly and so often that the benefit to the borrower is lost and the only beneficiary is the lender who adds transaction fees with each refinancing.

121. *See, e.g.*, Sichelman, *supra* note 45.

122. H.B. 1361 § 2, 2002 Gen. Assem. (Ga. 2002). However, OTS had announced an intention to preempt much of Georgia's law for federal thrifts, in response to complaints that the law was overly strict. Rob Blackwell & Erick Bergquist, *OTS Blocks Most of Ga. Predator Statute*, Am. Banker, Jan. 23, 2003, at 1. One implication is that the balancing act between protection of borrowers and promotion of loans is still at work, and that, at least in the OTS's view, the Georgia statute goes too far toward the protection side. The OCC has considered similar action. *See* 68 Fed. Reg. 8,959 (Office of the Comptroller of the Currency Feb. 26, 2003) (seeking comments on a request to preempt the Georgia law).

123. *See* Ga. Code Ann. § 7-6A-3 (2002).

124. *See id.* § 7-6A-5.

125. For example, some restrictions on the use of funds obtained from a high cost loan might be seen as cumbersome and intrusive were it not for predatory lending concerns. *See, e.g.*, *id.* § 7-6A-5(9) (requiring that, when the loan is used to pay a contractor, an affidavit be signed that work was done, and requiring that payment not be made by the bank directly to the contractor).

terms that sometimes come along with the loan.[126] One of these is inserting the financing for some types of insurance within the loan.[127] Another prohibited act is "flipping" the loan.[128] Also included are restrictions on late fees,[129] fees for providing certain information about loan balances,[130] and encouraging default.[131]

The Georgia law affects the terms of subprime loans more directly. For these loans, it prohibits some kinds of prepayment penalties and certain payment and interest schedules.[132] Additionally, it requires counseling before a high cost loan is created.[133] Other rules include certain jurisdictional rules that are advantageous to a borrower,[134] and special procedures for foreclosure of high cost loans.[135] The law also makes third parties who have purchased or been assigned such a loan liable for violations of the law to the same extent as the original lender,[136] and requires notice of this to be written on any affected loan.[137]

All of these requirements seem to fall within the category of objective standards. They are all specific rules that either prevent or require various terms and activities. Nevertheless, the Georgia statute contains a term that may be seen as leaning toward the subjective side:

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126. This may be because, if it is not a covered loan, the terms of the loan are considered acceptable. If, however, there are activities that are generally harmful, they might as well be prohibited for everyone. *See id.* § 7-6A-3.

127. *See id.* Within predatory lending discussions this is often termed "packing."

128. *Id.* § 7-6A-4. The Georgia statute, which has a slightly more objective definition of flipping than North Carolina's statute, reads:

> Flipping occurs when a creditor makes a covered home loan to a borrower that refinances an existing home loan that was consummated within the prior five years when the new loan does not provide reasonable, tangible net benefit to the borrower considering all of the circumstances, including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances. In addition, the home loan refinancing transaction shall be presumed to be a flipping where a covered home loan refinances an existing home loan that was consummated within the prior five years and that is a special mortgage originated, subsidized, or guaranteed by or through a state, tribal, or local government or a nonprofit organization, which either bears a below-market interest rate at the time the loan was originated or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income, are limited to a percentage of income, or where no payments are required under specified conditions and where, as a result of the refinancing, the borrower will lose one or more of the benefits of the special mortgage.

Id. Note that in this case the statute goes as far as directly labeling the practice of flipping as "unfair."

129. *Id.* § 7-6A-3(3).

130. *Id.* § 7-6A-3(4).

131. *Id.* § 7-6A-3(2).

132. *Id.* § 7-6A-5(1)-(5).

133. *Id.* § 7-6A-5(7).

134. *Id.* § 7-6A-5(6).

135. *Id.* § 7-6A-5(11)-(15).

136. *Id.* § 7-6A-6.

137. *Id.* § 7-6A-5(15).

> A creditor shall not make a high-cost home loan unless a reasonable creditor would believe at the time the loan is consummated that the borrower residing in the home will be able to make the scheduled payments associated with the loan based upon a consideration of his or her current and expected income, current obligations, employment status, and other financial resources, other than the borrower's equity in the collateral that secures repayment of the loan. There is a rebuttable presumption that the borrower residing in the home is able to make the scheduled payments to repay the obligation if, at the time the loan is consummated, said borrower's total monthly debts, including amounts under the loan, do not exceed 50 percent of said borrower's monthly gross income as verified by tax returns, payroll receipts, and other third-party income verification.[138]

While it is true that such a term seems to require a lender to decide whether the loan is appropriate, it avoids creating a truly subjective standard. The use of the rebuttable presumption and the listing of the specific elements to be considered would suggest that the subjective range of even this part of the act is limited.[139]

The result is that Georgia has created an objective set of rules that are aimed at predatory lending without resorting to heavily subjective determinations. These rules eliminate the worst elements of predatory practices and provide a clear but manageable framework for making loans to subprime borrowers.

3. Florida—Subjectivity Without Safeguards

Florida's recent efforts to control predatory lending are also noteworthy. Florida's Fair Lending Act sets out a category of "high-cost home loan[s]"[140] and makes them subject to various restrictions.[141] The statute contains typical elements such as: controlling prepayment fees,[142] no increased interest rates in the event of a default,[143] balloon payment restrictions,[144] no negative amortization,[145] no including the first payments in the loan,[146] no encouraging default,[147] an anti-flipping provision,[148] and so on.

138. *Id.* § 7-6A-5(8).

139. The rebuttable presumption is a feature not found in HOEPA, and can be seen as a means of balancing the subjectiveness of the rule with some objectifiable criteria.

140. Fla. Stat. § 494.0079(6) (Supp. 2003). Actually, the law simply borrows from the federal definition.

141. *Id.* § 494.00791.

142. *Id.* § 494.00791(1).

143. *Id.* § 494.00791(2).

144. *Id.* § 494.00791(3).

145. *Id.* § 494.00791(4).

146. *Id.* § 494.00791(5).

147. *Id.* § 494.00791(11).

148. *Id.* § 494.00791(9).

There are two provisions of particular interest in the Florida statute. The first of these is the subjective part of the statute which says:

> Extending credit without regard to the payment ability of the borrower.—A lender making a high-cost home loan shall not engage in any pattern or practice of extending high-cost home loans to borrowers based upon the borrowers' collateral without regard to the borrowers' ability to repay the loan, including the borrowers' current and expected income, current obligations, and employment.[149]

While the requirement of evaluating the borrower's ability to repay the loan is familiar, the rebuttable presumptions found elsewhere[150] are absent. Instead, lenders are left to wonder, if they take a chance on a borrower, whether a court will think that the loan was made "without regard" to repayment ability. The law does at least offer some protection to a well-intentioned lender by requiring a "pattern or practice" before imposing liability.[151]

An unusual provision in the Florida law is a restraint on the marketing of high cost loans. The statute states:

> Prohibited door-to-door loans.—A high-cost home loan may not be made as a direct result of a potential or future lender or its representative offering or selling a high-cost home loan at the residence of a potential borrower without a prearranged appointment with the potential borrower or the expressed invitation of the potential borrower. This subsection does not apply to mail solicitations that may be received by the potential borrower.[152]

This restriction is useful because it focuses on activities particular to predatory lenders. Often, predatory lenders find likely targets by identifying homes which seem to need repair, knocking on the door, and proposing a loan to cover the cost.[153]

4. New York—Further Presumptions

New York[154] generally follows established patterns for objective[155] and educational[156] components of its law. Regarding the repayment ability clause, however, New York's rule follows the opposite pattern

149. *Id.* § 494.00791(6).
150. *See, e.g.*, *supra* notes 138-39 and accompanying text; *infra* notes 157-60 and accompanying text.
151. Fla. Stat. § 494.00791(6).
152. *Id.* § 494.00791(12).
153. *See* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1282-83.
154. Apparently, as in Georgia, *see supra* note 122, the OTS found New York's rule too strict and decided to preempt it for federal thrifts. *See* Preemption of New York Predatory Lending Law, Office of Thrift Supervision, P-2003-2 (Jan. 30, 2003), http://www.ots.treas.gov/docs/56209.pdf (Jan. 30, 2003).
155. N.Y. Banking Law § 6-l(2)(a)-(j), (m)-(q) (Consol. 2002), *available at* http://assembly.state.ny.us/leg/?cl=9&a=2.
156. *Id.* § 6-*l*(2)(*l*).

from Florida. The statute makes reasonableness a judgment to be made on each loan.[157] To compensate, the statute allows the use of a rebuttable presumption.[158] New York seems, however, to have a higher standard of proof for ability to repay before gaining the rebuttable presumption. California, for example, allows "any... reasonable means,"[159] whereas New York permits reliance only on use of information "as verified by detailed documentation of all sources of income and corroborated by independent verification."[160]

State governments strike a balance between creating the objective rules, while still putting some subjective standards into place. This is, of course, not true everywhere.[161] Where subjectivity exists, it is typically tempered by boundaries. On the whole, states apparently endorse the HOEPA model, providing triggers that set off a variety of protections.

C. Local Law

In addition to federal and state efforts to curb predatory lending, attempts have been made on a local level to control the problem. In late 2002, the New York City Council passed, over the mayor's veto,[162] an ordinance that is aimed at reducing predatory lending by prohibiting the city from having business dealings with predatory lenders.[163] For example, companies which seek to obtain contracts with the city must be in compliance with the policies set forth in the law. Similar legislation has been put into effect in Cleveland, Ohio.[164] While this type of legislation is standard in its formulation of predatory lending,[165] the use of the government's spending power is unique to the local level. The effectiveness of such an approach may be limited. A small, specialized predatory lender is unlikely to be harmed by the loss of such business.[166] In other municipalities, the anti-predatory lending laws resemble standard state legislation. Among these are Los Angeles[167] and Toledo.[168]

157. *See id.* § 6-*l*(2)(k).
158. *Id.*
159. Cal. Fin. Code § 4973(f)(1) (2002).
160. N.Y. Banking Law § 6-*l*(2)(k), *available at* http://assembly.state.ny.us/leg/?cl=9&a=2 (last visited Feb. 24, 2003).
161. Virginia, for example, recently passed two bills to prevent predatory lending, but these do not contain a subjective element. *See* H.B. 2708, 2787, 2001 Gen. Assem (Va. 2001).
162. Kyriaki Venetis, *NYC Council Overrides Veto on Ordinance*, Nat'l Mortgage News, Nov. 25, 2002, at 17.
163. *See generally* Proposed Int. No. 67-A, *available at* http://www.council.nyc.ny.us/textfiles/Int%200067-2002A.htm (last visited Aug. 27, 2002).
164. Cleveland, Ohio, Ordinance 737-02 (Apr. 23, 2002). The Cleveland ordinance makes extending such loans a misdemeanor. *Id.* § 659.99.
165. *See, e.g., id.* § 659.01 (f)(2).
166. *See supra* notes 49-52.
167. City of Los Angeles, Cal., Ordinance 01-1476 (Nov. 18, 2002).

Washington, D.C., has a colorful history in its attempts to regulate predatory lending.[169] In its enthusiasm to control predatory lending, the Washington, D.C., City Council unanimously passed an aggressive anti-predatory lending ordinance.[170] This may have been slightly overzealous, as the original ordinance passed was so enormous, confusing, and strict[171] that it was suspended before it went into effect.[172] New forms of the ordinance are now being considered.[173]

Because of different amounts of power and varied political climates, local governments show an unsurprising lack of any uniformity in handling predatory lending.[174] Consistently, however, local approaches to defining when a loan is predatory are similar to the state and federal approaches.

D. *Scholarly Approaches*

A number of articles have outlined the problems that predatory lending presents and have suggested methods to correct them. In predatory lending scholarship, writers typically identify specific objective rules they believe should be enacted. The exception to this is the recommendation of a duty of suitability.

1. Proposals Geared to Objectivity

Donna S. Harkness has concluded that the federal and state remedies existing at the time she wrote her article[175] were insufficient to solve the problem.[176] She has suggested that the best solution is to provide counseling to subprime borrowers.[177]

168. City of Toledo, Ohio, Ordinance No. 291-02 (Oct. 4, 2002).

169. Sewell Chan & Sandra Fleishman, *D.C. Council Suspends New Lending Law: Moratorium Imposed After Industry's Outcry*, Wash. Post, Nov. 7, 2001, at E1.

170. *Id.*

171. *Id.*

172. *Id.*

173. See Rob Blackwell, *D.C. Council Mulls Anti-Predator Bills*, Am. Banker, Jan. 23, 2002, at 4.

174. Robert E. Litan, A Prudent Approach to Preventing "Predatory" Lending, at 12, *available at* http://www.aba.com/NR/rdonlyres/00003594asmhksfkzepaxsef/LitanReport93.pdf (Feb. 2001) (prepared on behalf of the American Bankers Association) [hereinafter Litan, *Prudent Approach*] (featuring a chart of local ordinances that ranged in penalties from a municipality not doing business with a predatory lender to possible fines and imprisonment).

175. Predatory lending has generated much legislative and regulatory activity recently. Therefore, any scholarship on the subject must be viewed in its own time. It is not possible to say what new developments, if any, a given author would have believed to be sufficient.

176. Harkness, *supra* note 57, at 43-45.

177. *Id.* at 45. A student Note, focusing on the state of the law in Ohio, has found that there were inadequate remedies available for predatory lending victims in that state. Anna Beth Ferguson, Note, *Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers*, 48 Clev. St. L. Rev. 607, 636 (2000). In reviewing possible solutions, she has recommended further regulation of the industry

Kurt Eggert was particularly troubled by the possibility of evading enforcement of predatory lending laws by selling the loans to third parties.[178] This, however, is also an issue he believes should be resolved by what amounts to objective legislation.[179]

In a review of HOEPA and its results, Margaret Saunders has found that predatory lending continues to flourish[180] and that industry controls are unlikely to correct the problem.[181] She has advocated a solution based on further legislation which would include strengthening HOEPA through proposed legislation[182] and changes to other Federal laws such as taxes,[183] regulation of foreclosures,[184] changes in the CRA,[185] and increased disclosure requirements.[186]

In a similar study,[187] which also embraced some of the nascent state laws, Cathy Mansfield has suggested that the appropriate solution would involve increased disclosure requirements,[188] the education and counseling of borrowers,[189] and basic rate limits.[190] Mansfield, however, feels that the changes might work on either the state or federal level.[191]

On the other side, Robert E. Litan of the Brookings Institute has taken the position that HOEPA is adequate for resolving predatory lending.[192] Moreover, he has asserted that improvement will occur soon without any further government action, because of the public release of Fair Isaac credit scores.[193]

The above scholars consider the central issue to be finding the correct limitations and regulations that could be put into place to curb the predatory practices of certain lenders.[194] The proposals are mainly geared to finding proper *objective* rules that would prevent predatory

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and practices. *Id.* at 633-36. The changes that she has endorsed are primarily in the objective class, with some mention of counseling as well. *Id.* In particular, the author referred to the New York and North Carolina forms of legislation which were the first two state laws aimed specifically at predatory lending.

178. *See generally* Eggert, *supra* note 50.
179. *Id.* at 636-38.
180. *See* Saunders, *supra* note 101, at 112-19.
181. *Id.* at 138-42.
182. *Id.* at 130.
183. *Id.* at 142.
184. *Id.* at 143.
185. *Id.* at 144-45.
186. *Id.* at 146.
187. Mansfield, *supra* note 3.
188. *Id.* at 570-72.
189. *Id.* at 572-73.
190. *Id.* at 573-75. This essentially entails a usury prohibition, a once popular concept that has fallen out of favor. *See supra* note 70.
191. Mansfield, *supra* note 3, at 575. As the author noted, however, certain federal preemptions would have to be removed before it could function as state law. *Id.* at 574.
192. Litan, *Prudent Approach*, *supra* note 174, at 7-9.
193. *Id.* at 15.
194. *See supra* notes 175-93 and accompanying text.

loans from happening. There are, of course, some suggestions that further information-gathering and education are also needed. Essentially, though, the trend is toward an increase in HOEPA-type protections for borrowers.

2. The "Duty of Suitability"

In contrast to the prevalent practice of recommending specific improvements, Professors Kathleen C. Engel and Patricia A. McCoy have suggested an entirely new and different approach to resolving the problem of predatory lending.[195] They contend that the best resolution will not be found in specifying exactly what can and cannot be done. Rather, they believe that the solution lies in creating an adaptable and strong protection for borrowers in the form of a "Duty of Suitability."[196]

In their article, Engel and McCoy review the factors that have made predatory lending the major problem that it is.[197] The article includes a review of the trends in the mortgage industry,[198] economic factors in predatory lending,[199] and the business practices of predatory lenders.[200] In doing so, they identify three markets: the prime market, the subprime market, and the predatory lending market.[201] Further, in reviewing the economics of the situation, Engel and McCoy assert that, for various reasons, there has been a market failure preventing subprime lenders from competing in a manner that will eliminate predatory lending.[202]

The authors conclude that what is needed is a duty of suitability—such as exists in the securities industry.[203] In the securities context, suitability is a duty on a broker to investigate a client's circumstances and recommend only those securities that the broker believes are appropriate for that client.[204] To make this evaluation, the broker must take the "financial situation, risk threshold, investment sophistication, investment objectives, and other securities holdings . . . into account."[205] In recommending a duty of suitability for lenders,

195. *See* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31.

196. *See generally id.* at 1317-66. The authors point out that suitability requirements exist to some degree in current lending laws, *id.* at 1319-20, but the extent of the use of this "duty of suitability" is wider and more comprehensive than has been seen elsewhere.

197. *See generally id.* at 1270-98.

198. *Id.* at 1273-80.

199. *Id.* at 1280-98.

200. *Id.* at 1259-70.

201. *Id.* at 1258-59.

202. *Id.* at 1299.

203. *Id.* at 1318. The authors also note that a similar duty is found in other fields, such as commodities, certain derivatives transactions, and insurance. *Id.* at 1319.

204. Norman S. Poser, *Liability of Broker-Dealers for Unsuitable Recommendations to Institutional Investors*, 2001 BYU L. Rev. 1493, 1494 (2001).

205. *Id.* at 1495.

Engel and McCoy propose a series of new federal laws and an accompanying regulatory scheme, analogous to the one found in the securities field, which would include federal regulation, state regulation, and industry self-regulation.[206]

They suggest that suitability is appropriate for various reasons.[207] The main rationale is that predatory lenders ought to internalize the damage that they cause.[208] Additionally, the authors propose that the problems of predatory lending resemble problems in the securities industry. In both cases disclosure alone is not sufficient to prevent harm[209] because there is too much reliance on the person providing the loan not to have a suitability standard, and the lender is best situated to evaluate whether the loan is appropriate for the borrower.[210]

Although the authors acknowledge that suitability left purely as a common-law standard would likely cause a decrease in legitimate subprime lending,[211] they contend that if the lines could be drawn a little more clearly by a regulatory agency with rule-making authority, this danger could be averted.[212] The authors feel that excessive litigation is unlikely if the general standards could be shaped by the wise hands of a federal regulatory agency.[213]

The element that makes the suitability approach radically different from current law and other proposed resolutions is the tenor of the legislative scheme. Until now, scholars have been content to identify exactly what it is they consider unfair practices and to outlaw such practices.[214] This arrangement leaves the borrower and lender to contract freely as long as neither violates the law. Although subjective elements are present in current predatory lending laws, they are used more as stopgap measures—essentially to include what would have been too difficult to define in precise terms.[215]

What Engel and McCoy advocate is a shift from a system that has been primarily objective with occasional subjective features, to a system with a subjective approach, but in which objective guidance is

206. *See generally* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1337-57.
207. *Id.* at 1336.
208. *Id.* at 1360-61.
209. *Id.* at 1335-36.
210. *Id.* at 1336, 1358-59.
211. *Id.* at 1343.
212. *Id.* at 1345.
213. *Id.*
214. *See supra* notes 175-94 and accompanying text.
215. *Cf. supra* note 130. Had the legislators who drafted the current anti-predatory lending laws wanted the subjective part to be relied upon entirely, they would have had no need for objectified terms as well. Moreover, in these cases, the laws often have a rebuttable presumption in the lenders' favor—a feature which the proposed suitability standard does not seem to embrace.

provided by a rulemaking process.[216] The framework of suitability is ultimately subjective: it asks for a case-by-case determination of appropriateness. Thus, a rulemaking system exists primarily to rein in the potential breadth of such a standard. This is not to suggest that Engel and McCoy advocate a purely subjective approach.[217] They hope to achieve a system that provides clear rules but still forces a lender to take a borrower's welfare into account.

Legislation against predatory lending[218] takes a fairly consistent pattern. With some variation in determining which loans are affected, most legislation contains: a list of features that a subprime loan may not contain; prohibitions against certain activities by the lender; disclosure requirements; and a requirement that lender believe that the borrower can afford the loan. Most of the prohibitions against predatory lending take the form of objective rules. The exception to this is the common requirement of evaluating repayment ability. Normally, this requirement comes with a range of protective devices, but it is essentially a subjective standard. Most scholars believe that improvements are needed, but they still endorse, either explicitly or implicitly, the model that lawmakers adopted. One notable dissention is by Engel and McCoy who argue for the imposition of a duty of suitability.

III. A CALL FOR CLARITY

The current laws designed to combat predatory lending have been attacked as inadequate. For a solution to be effective, it will have to be one that reduces predatory lending without having too great an impact on the subprime lending market.

This Part first argues that suitability is not an appropriate method of combating predatory lending. Second, this Part rejects both educational initiatives and subjective standards as remedies. Third, this Part endorses objective rules as the best solution and suggests that some of the problems with objective rules might be resolved by

216. Engel & McCoy, *A Tale of Three Markets*, supra note 31, at 1345-46. If Engel and McCoy had simply wished that the present law be toughened, it would have been easy to say so directly. The move to "suitability" implies a change in the attitude one takes in viewing the relationship between the borrower and lender. In the present scheme, the responsibility for the borrower's welfare ultimately rests upon the borrower. Engel and McCoy explicitly reject such an arrangement as inequitable—as they put it: "predatory lending is not about free choice; it is about the suppression of free choice." *Id.* at 1358. They argue that "[w]hen predatory lenders target vulnerable homeowners who do not understand what they are signing, and then deny these borrowers access to vital information about their loans and hurry them into signing, free choice is nowhere to be found." *Id.*

217. *See id.* at 1362. In fact the authors went so far as to add an appendix in which they reviewed various legislative proposals and endorsed the versions of the rules that they liked. *Id.* at 1367 app. Interestingly, the "repayment ability" clause was not commented on.

218. *See supra* Parts II.A-C.

creating more sophisticated triggers for activating restrictions on loans.

A. *Why Suitability Isn't Suitable*

This section attempts to show that, despite suitability's intuitive appeal, it is the wrong tool to fix the problem of predatory lending. Suitability has been touted as a way of achieving the goals of a standard while still keeping the specificity of a rule. Nevertheless, suitability is an inappropriate approach for the lending context.

Engel and McCoy present a case for an approach that is, on the surface, appealingly simple and straightforward. It attempts to bridge the difference between objective rules and subjective standards by creating a set of clear rules that require a lender to consider the welfare of the borrower. Nevertheless, the suitability approach is flawed. The flaws in using a suitability standard come from two areas. First, suitability is not conceptually consistent with the roles of a lender and borrower. Second, many of the dangers associated with predatory lending may be resolved in a manner that is threatening to the continuation of beneficial subprime lending.

1. Suitability and the Roles of Lender and Borrower

Suitability, when used in the securities context, is ultimately just a method of ensuring that brokers are doing their job correctly when offering a security to a client. A stockbroker assumes the role of an agent and thereby assumes a fiduciary duty to act in the client's best interest.[219] Therefore, the duty of suitability properly becomes part of the broker-investor relationship.[220] Thus, the conceptual framework easily supports the duty of suitability.

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219. A professor discussing the duty of suitability that a broker carries explained:

> There is a substantial body of law that states that a broker who recommends an unsuitable security breaches its fiduciary duty to his customer. The source of this duty is the common law of agency, which holds that an agent, by virtue of his relationship to his principal, is considered a fiduciary with respect to all matters within the scope of his agency. A fiduciary is subject to duties that "go beyond mere fairness and honesty; they oblige him to act to further the beneficiary's best interests." The Supreme Court of Colorado, for example, has held that if a broker makes a recommendation, or merely brings a possible investment to the attention of the customer, the broker may be in breach of its fiduciary duty to the customer if the broker ignores the unsuitability of the investment, even if the customer assents to the transaction.

Poser, *supra* note 204, at 1554-55 (internal citations omitted). Professor Poser points to other jurisdictions where the fiduciary duty is not present. *Id.* at 1555. Even in these states, the point remains valid because the nature of the relationship remains one in which the broker is working for the client—in which case suitability can at least be consistent with the broker's functions.

220. *Id.* at 1557.

Lenders, however, are not the agents of the borrower.[221] Lenders are the party at the other side of the table who exist primarily to further their own interests. As such, a lender should have the right to exist as an arm's length party who tries to maximize his or her own benefit. To remove the right of the lender to act as a counterparty distorts the necessary dynamic through which efficient transactions can occur.

Attempting to bring the suitability obligation into the context of home mortgages creates some difficulties. These difficulties are due to context, not intent. Obligations to deal fairly in business and to provide appropriate disclosures can hardly be criticized.[222] Many laws exist to respond to concerns that a more powerful party might impose onerous terms on a weaker one; it is for just this sort of concern that principles like unconscionability were developed.[223] The difficulty arises when, instead of enacting rules to ensure fair play, government tries to reinvent the rules of the game entirely.[224]

The oppositional nature of a lending transaction does not mean that the law must take a callous attitude, but it does mean that it should respect the positions of the various parties. The presence of counterparties is not an accidental arrangement. Capitalism and free market economics rest upon the assumption that everyone will attempt to maximize their own benefit.[225] To do so, each party should at least have the freedom to act in its own self-interest. To remake the role of a lender into a position of quasi-agent for the borrower, who

221. *See* Scott v. Dime Sav. Bank, 886 F. Supp. 1073, 1078 (S.D.N.Y. 1995) (holding that "the legal relationship between a borrower and a bank is a debtor-creditor relationship that in and of itself does not create a fiduciary relationship"); *see also* A. Brooke Overby, *Bondage, Domination, and the Art of the Deal: An Assessment of Judicial Strategies in Lender Liability Good Faith Litigation*, 61 Fordham L. Rev. 963 (1993) (questioning whether courts were even applying a good faith test to lenders). There is an industry of mortgage brokers who could possibly be considered agents of the borrower and, at least conceptually, it would be consistent to consider a duty of suitability for these brokers. Creating a duty of suitability for mortgage brokers would, however, probably be more trouble than it is worth, because the net result would simply be the cessation of predatory lenders using brokers.

222. No one has suggested that fraudulent and deceptive lending practices ought to be allowed. A lender who actively lies to a borrower is subject to existing laws and can be punished accordingly. *See, e.g.*, Truth in Lending Act, 15 U.S.C. § 1601 (2000).

223. *See, e.g.*, Robert A. Hillman, *An Analysis of the Cessation of Contractual Relations*, 68 Cornell L. Rev. 617, 621 (1983).

224. *Cf.* Nicholas W. Allard, *Reinventing Rate Regulation*, 46 Fed. Comm. L.J. 63, 81-88 (1993) (describing how, after deregulation, cable rates actually *rose* at a rate three times that of inflation).

225. Maximizing one's self-interest can be described as the cornerstone of the American economy. "Indeed, the entire premise of our largely capitalistic economic system is the belief that reliance on self-interest will maximize societal welfare. The central assumption of capitalism, of course, is that the individual's incentive to maximize profits will lead to the creation of improvements in products and services." Martin H. Redish, *First Amendment Theory and the Demise of the Commercial Speech Distinction: The Case of the Smoking Controversy*, 24 N. Ky. L. Rev. 553, 573 (1997).

must constantly ensure that the results of the transaction will be in the borrower's best interest, puts a lender into a schizophrenic state. This obligation would create a perplexing situation where the lender would always wonder who exactly they are lending to benefit.[226]

The difference in relationships is not the only issue that separates a lender from a broker. There is a significant difference between the position of someone looking to invest and someone looking to obtain money to either purchase a home or make use of the equity in their home. A prospective borrower might be more vulnerable in the sense that they may simply receive a "take it or leave it" offer.[227] When this occurs, however, they are in that position for a reason—they have less to offer. Many kinds of securities are available to a prospective investor and anyone purchasing securities ought to have the right to find one that is appropriate for them. In making an investment, it is the investor who is taking the risk. In making a loan, it is the lender who takes the risk. If the borrower does not qualify for a loan on the terms that he or she would like, then the lender may simply turn them away. Often, when a legitimate subprime lender takes a chance on a loan, the lender does so with the intention of benefiting the borrower.[228] Nevertheless, if the loan was a borderline one, there is

226. A lender with an obligation to look out for the borrower's benefit would have a hard time knowing how to proceed. In securities, this is not a problem because the profit gained by the broker is separate from the nature of the product being sold. In the lending market, however, lenders make their profits by charging the borrower more than the loan costs them. If a lender had to be constantly thinking of what might be most suitable for the borrower, then a point would be needed to decide when the lender could start being concerned with its own profits. Should lenders always be concerned that they could get the borrower a better rate merely by lowering their profits? Is there some margin of profit that the proposed regulatory process would allow? If so, would suitability merely be a sophisticated method of the government setting prices? Engel and McCoy attempt to address this by appealing to objective rules that would ultimately be set by an agency. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1344-45. Unfortunately, relegating the problem to an agency does not solve it. If suitability means that a lender must have concern for a borrower's situation, then the problem will not be solved by rulemaking. If suitability merely means stricter rules, then the whole label is unnecessary and lawmakers' efforts would probably be better spent refining current laws than creating an entirely new regulatory scheme. A self-regulatory organization ("SRO"), as Engel & McCoy endorse, *id.* at 1337-39, would have a similar problem. If there is no way to disconnect the lender from the profit of the loan, there is no way to set objective loan terms without creating some form of price fixing.

227. If, in fact, they receive any offer at all.

228. This is not to say that the subprime lender's motives are purely altruistic. The subprime lender may be looking for a profit as well. Nevertheless, a subprime lender might take the view that they are "doing well by doing good." *See Full Comm. Hearing on Predatory Lending Practices Before the House Comm. on Banking and Financial Services*, 106th Cong. (2000), *at* http://financialservices.house.gov/banking/52400bar.htm (May, 24, 2000) (testimony of Steve Bartlett, President of The Financial Services Roundtable). In fact, non-profit organizations, such as credit unions, do make subprime loans with the specific intention of helping the borrower. *See Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 384-

little to prevent a defaulting borrower from turning around a few years later and suing a lender, who believed in the borrower's ability to repay,[229] by calling the loan "unsuitable."[230] Loan making is very much a numbers-oriented field.[231] This does not mean, however, that discretion is, or ever should be, entirely absent.

Imposing a suitability standard would also impinge upon the freedom of contract. Each new loan created is, in essence, a new contract made between two parties. There is nothing contrary to traditions of contract law in establishing rules by which parties must operate in formulating their respective obligations. There is, however, a departure from the tradition when the obligation becomes to assume the position of the other party and to decide if the contract meets the other's needs.

2. Suitability Is Too Great a Risk for the Subprime Market

Even if the duty of suitability were consistent with the role of a lender, it would be inadvisable if other, less invasive, remedies were adequate. Because lending has always existed without such a duty, the imposition of a duty of suitability could create radical changes in the way lenders do business.

Before discussing why suitability would be harmful to the subprime market, it must be reiterated that the growth of the subprime market is both very recent and has overall been very positive.[232] A solution to predatory lending that causes a large drop in subprime lending would harm many potential homeowners. Because the subprime market is so new and so important, changes to this market should be handled with extreme care. This subsection addresses some potential impacts that a duty of suitability could have on the subprime market. The effects that a suitability standard would have are not limited to those discussed here. The results of radical change in the underlying rules of a nascent industry are not predictable.

In evaluating suitability, one must remember that the mere creation

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87 (2001) (prepared statement of Lee Williams on behalf of the Credit Union National Association).

229. This raises the question of whether negligence in an assessment would ever lead to liability on the lender's part. The laws cited in Parts II.A-B. all revolve around whether the loan was made "without regard" for repayment. It is not clear at this point just how intensive the "regard" would have to be to escape liability.

230. Engel and McCoy attempt to counter this argument by suggesting that the "bright-line suitability rules in lieu of fuzzy standards, plus adequate documentation by lenders of compliance, should keep frivolous lawsuits to a minimum." Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1362. While it is true that clear rules are the best way to provide protection for both the borrower and lender, the issue is whether suitability is the correct notion to base rules upon. Rules based on suitability would still give a borrower a large advantage in a lawsuit.

231. *See* Wilmarth, *supra* note 7, at 264-67.

232. *See supra* notes 7, 28.

of a duty would not, in itself, accomplish anything. To decide what suitability means, interpretations would have to develop. These interpretations could be extremely liberal, which would leave almost no loan as unsuitable and, therefore, do nothing to resolve the problem. Alternatively, these interpretations could be extremely strict, which would effectively eliminate all subprime loans, and possibly impact prime loans as well.[233] Engel and McCoy recognize this issue.[234] To counter it, they suggest a regulatory scheme where a regulator would create a system of *per se* rules to define the parameters of suitability in lending.[235] As explained above,[236] however, this merely shifts the focus to a new group of people, but does not resolve the problem of actually determining the rules. If creating a set of objective rules that adequately protect both borrowers and lenders is impossible, then assigning regulators to do the job will not make it otherwise. If, however, rules can be made that would prevent predatory lending, then there would be no need for a duty of suitability.[237] If the area of predatory lending is so complex that Congress cannot simply codify the rules needed to end it, Congress could extend the Federal Reserve's authority under HOEPA.[238] But at no point does it seem that a subjective answer will work. Even as Engel and McCoy advocate it, they back away—leaving no real change in the search for answers.[239]

Although it is not likely that education alone will yield the ultimate

233. *See supra* notes 44, 53, 55.

234. *See* Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1345 (discussing the possible impact on the subprime market).

235. *Id.* at 1344; *see also supra* notes 211-13 and accompanying text.

236. *See supra* note 77 and accompanying text.

237. Of course, the same argument could be made for the securities area as well. Securities, however, are still well-suited for the suitability standard because, as mentioned above, *supra* note 219, the duty of suitability reinforces the correct relationship between a broker and investor. Therefore, a duty of suitability provides a good frame of reference for a broker to use in approaching his or her client.

238. Currently the Federal Reserve Board has authority to regulate three areas that relate to predatory lending. *See* 66 Fed. Reg. 65,604, 65,605-06 (Dec. 20, 2001). The first of these is setting, within a set range, the triggers for HOEPA. 15 U.S.C. § 1602(aa) (2000). The second is the ability to exclude mortgages from HOEPA that are in the public's best interest, to include ones designed to evade HOEPA, and to limit refinancings that are not in the public's best interest. *Id.* § 1639(*l*). Third, the Federal Reserve Board has general authority to create regulations that encourage compliance with, or prevent evasion of TILA (of which HOEPA is a part). *Id.* § 1604(a).

239. The extension of the Federal Reserve Board's (or anyone else's for that matter) power to regulate predatory loans can be accomplished without adding the element of suitability. It may very well be that Congress lacks either the time or expertise to enact a comprehensive system to address all of the necessary issues. The point is that suitability is not needed in this context. More than anything else, suitability addresses itself to the relative duties and responsibilities of the parties. A change to a regulatory system would not need to embrace this perspective to be effective.

answer to predatory lending,[240] it is true that if an "information asymmetry"[241] exists, the best way to correct the asymmetry would be to increase education.[242] A look at the incentives created by suitability, however, shows that education would likely become less valuable to a borrower operating in a suitability framework. When the borrower is responsible for ensuring that they are receiving a loan that is appropriate for them, there will be a strong incentive to make the effort to understand the loan's terms and to decide whether or not to accept it. When the responsibility for the loan's appropriateness falls upon the lender, a borrower will have little incentive to put any effort into determining if the loan is beneficial. The risk of an inappropriate loan would be borne by the lender. This "moral hazard"[243] would likely increase costs associated with providing loans to the subprime market.[244]

Engel and McCoy also assert that their solution is a good one because it puts the cost of avoiding predatory loans on the predatory lenders themselves.[245] As appealing as the solution may sound, it ignores the very issue of identifying predatory lenders.[246] If there is a great deal of gray area that makes it difficult to distinguish predatory lenders from legitimate subprime lenders, then subprime lenders will bear a great deal of the cost of avoiding predatory lending.[247] Lawsuits alleging predatory lending could occur any time a subprime lender felt the need to foreclose. Subprime lenders' transaction costs would increase, just as the need to gather and document more information about each borrower to prevent the possibility of losing in court would increase. Such costs would not only harm the lenders, but

240. *See infra* notes 256-58 and accompanying text.

241. "[P]redatory lenders need to identify people who are disconnected from the credit economy and therefore unlikely or unable to engage in comparison shopping." Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1281.

242. If the people who are "unlikely or unable to do comparison shopping," *id.*, were to gain sufficient knowledge to identify when they are being exploited, it would go a long way to ensure that these exploitive loans never happen.

243. "Moral hazard refers to the tendency of third party insurance to lessen risk aversion among insured entities." Helen A. Garten, *A Political Analysis of Bank Failure Resolution*, 74 B.U. L. Rev. 429, 429 n.1 (1994). By analogy, in the case of a suitability standard, a borrower will be less risk averse if they know that there might be an opportunity to escape responsibility in the event of default.

244. Increased costs to subprime lenders can result in one of two outcomes: either the lender will abandon the subprime market, or the lender will stay and increase its rates to borrowers. Neither of these results benefit those who need the subprime lenders.

245. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1335-36; *see also supra* notes 216-17.

246. *See supra* note 31.

247. The subprime lenders will also be carrying the costs of any general regulatory compliance that is imposed on them. Incorporation of externalities makes a great deal of sense when the party that is benefiting from the externality can be identified. Where the party benefiting from the externality cannot be identified, the benefits of redistribution are lost.

would likely increase the costs to the borrower to whom they would be passed on. In such a case, the cost of the new regulatory compliance would be paid by subprime borrowers, a group ill-equipped to bear it.

Comparing a predatory-lending suit under an objective regime to a suit under a subjective regime illustrates this point. First, take a case of a legitimate lender who believed that the loan it made was in the borrower's best interest. If the borrower falls on hard times and the lender wishes to recover the money it lent, the lender must contend with the possibility that the borrower will argue that the loan was improper on the hope that a jury will be sympathetic. The lender must then worry every time it makes a loan that there could be a jury somewhere who will disagree with them about what makes a loan appropriate. In other words, it will have a chilling effect, causing legitimate subprime lenders to err on the side of caution. Lending money to someone in need is not necessarily a cut and dry decision. If lenders do not take reasonable chances, fewer loans will be made.[248] Under an objective scheme, all that would need to be shown is that lenders followed the law and they would be protected from such litigation.[249]

Consider, now, the opposite case—where a borrower really has been victimized. In a subjective scheme, the borrower would have to prove that the loan was not fair. In some cases this may be clear, while in others it might be murky. Jurors might decide that the borrower should have known better and no relief should be granted. By contrast, in an objective case, the rule would simply be applied to determine whether the loan was acceptable or not. Even if not every abuse can be legislated against, the presence of legislation, if well crafted, would serve to reduce the prevalence of predatory loans and the degree to which loans could be abusive, even if they did not prevent it completely.

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248. Fewer loans mean that fewer people with imperfect credit would become homeowners. Engel and McCoy anticipate this objection and respond that the problem is unlikely to develop because homeowners would be unlikely to risk their homes by taking out loans they cannot afford in the hopes of winning in a suitability suit. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1359. Their response misses the real objection. The problem is not likely to arise in cases of borrowers intentionally defaulting on loans. Rather, the problem will arise when someone has received a legitimate subprime loan but has failed to make the appropriate payments (it must be remembered that these loans are high-cost for a reason—the borrowers are a greater risk). In such a case, a subprime lender must face the possibility that a subprime borrower will cry "suitability."

249. To reiterate, Engel and McCoy's suggestion of creating a rule-based regulatory scheme simply distances itself from the aim of having a suitability standard and moves toward an objective system. *See supra* notes 234-39 and accompanying text. As a result, the suggested advantage of suitability over the current standard of simple compliance with the law is one that will become moot as these concerns are addressed.

Suitability is not likely to produce a situation that creates adequate protection for a borrower while protecting the legitimate (and important) subprime market. Subprime lending has increased in recent years because the lending industry has reached a greater number of customers and a greater amount of profits by extending credit to those who did not have an opportunity to borrow in the past.[250] If a new duty were required of these lenders in a manner that would dramatically reduce their profitability, lenders would lose the incentive to target subprime borrowers, thereby reducing the number of Americans who could hope to own their own home.[251]

It is easy to point out a major problem and demand a resolution. Difficulties arise, however, in attempting to decide *ex ante* exactly how much action is needed before the problem will be resolved. Recently-passed laws,[252] and laws that are still being passed,[253] go further than prior protections. HOEPA's new and stronger form is also very recent.[254] Before radical change is considered, it might be worth seeing if these remedies work. Impatience in observing a new law's effects may have negative long-term consequences.[255]

B. *Education—Too Weak; Subjectivity—Too Risky*

Education, though helpful, is not sufficient to end predatory lending. First, there is too much knowledge that needs to be imparted to allow a borrower to take a loan with assurance that no predatory terms are in it. Second, as Engel and McCoy point out,[256] there is too much difficulty in reaching victims to educate them adequately.[257]

250. *See supra* notes 7, 28.

251. Further regulation of any sort may do at least some harm to the subprime market. *See supra* note 44. There is some evidence that this has already begun to happen. *See supra* note 55. If the regulation is done in a manner that makes a lender fear tremendous exposure to liability, the effects can only be worsened.

252. *See, e.g., supra* Part II.B.

253. *See, e.g.*, 2003 Ky. H.B. 240 (An Act relating to home loan protection); 2003 Tenn. H.B. 21 (Tennessee Predatory Lending Prevention Act); 2002 N.J. A.B. 75 (New Jersey Home Ownership Security Act of 2002).

254. The strengthened HOEPA regulations by the Federal Reserve System went into effect on October 1, 2002. Regulation Z, Truth in Lending, 66 Fed. Reg. 65,604 (Dec. 20, 2001) (to be codified at 12 C.F.R. pt. 226).

255. *See, e.g.*, John Cornyn, *The Roots of the Texas Constitution: Settlement to Statehood*, 26 Tex. Tech L. Rev. 1089, 1140 (1995) (Justice John Cornyn of the Texas Supreme Court citing Thomas Jefferson Rusk, President of the Texas Constitutional Convention, explaining that the purpose of the veto power was to prevent the ills of hasty legislation); Ian McCallister, *Modern Reproductive Technology and the Law: Surrogacy Contracts in the United States and England*, 20 Suffolk Transnat'l L. Rev. 303, 316-17 (1996) (criticizing England's hasty passage of surrogacy agreements).

256. Engel & McCoy, *A Tale of Three Markets*, *supra* note 31, at 1309-11.

257. "Reaching the potential victims of predatory lending is the biggest challenge for any educational campaign.... [T]here is no guarantee that the individuals will understand the information.... Until this country comes to grips with low literacy rates, financial literacy efforts are not likely to succeed." *Id.* at 1309-10.

Although Engel and McCoy object to educational programs because they put the "onus on potential victims,"[258] it seems that if a borrower really had full understanding of the terms and still wanted to consent to them, it would become difficult to say why the transaction should not be allowed.

The best way to protect both subprime borrowers and subprime lenders is to create a system of clear and comprehensible rules that also afford significant protections. Ambiguous standards are of little help to a subprime lender who is making a sincere and honest attempt to comply with the law.[259] Rather, objective guidelines that define exactly what methods can and cannot be used best protect the legitimate lenders.[260] Recent laws passed to prevent predatory lending illustrate that such rules are possible, and have primarily been objective.[261] If there is a need for a policy that simply prohibits loans a borrower cannot afford, it should be done on a "pattern or practice"[262] basis that will avoid isolated incidents being used against a lender, and should contain a rebuttable presumption that protects a lender—assuming certain specified criteria are met.[263] Such a policy has the benefit of a "catchall" provision that prevents a lender from skirting around the rules while still providing a clear method of compliance to a lender who is merely looking to follow the law.[264] Laws that require evaluation of the borrower's ability to pay without providing protection are dangerous and unpredictable.[265]

Ultimately, the problem with broad, subjective standards in this context is that they are unnecessary. If predatory lending can be stopped, or at least limited, through specific laws, then taking the risks that a subjective standard entails would not be worthwhile.

258. *Id.* at 1310.

259. Gradually, a standard might be sufficiently fleshed out through case law to give a lender a reasonable sense of what is required to avoid liability. At best, this result would be equivalent to a strong set of objective rules. At worst, it might do either too little or too much. Either way, in the interim, subprime lenders would have no guidance as to what exactly was required of them. During this time, a sharp reduction in subprime credit could be expected because lenders would fear the possible liability if the law were eventually interpreted strictly.

260. For all the concerns of what methods a predatory lender might use to circumvent legislation, in the end a mortgage is a fairly straightforward transaction with a finite number of variations. In this respect it is a perfect candidate for straightforward legislation.

261. *See supra* Parts II.A-B.

262. *See, e.g., supra* note 99 and accompanying text.

263. *See, e.g., supra* notes 138-39 and accompanying text.

264. Stated differently, including objective features into the subjective portion of a law moves it away from being a standard and closer to being a rule.

265. The laws reviewed in Part II.B all contained at least one protective feature of "pattern or practice" or a rebuttable presumption. To ensure that this provision does not get out of hand, future lawmakers would be wise to include both provisions.

C. *Suggestions for the Future*

Because suitability is not appropriate for loans, and subjective measures may backfire, objective rules are best suited for preventing predatory lending. This section discusses ways of improving the current system of objective rules to mitigate the sometimes harsh results of inflexibility.

Rule-based predatory lending legislation can be criticized on the basis that it is either too harsh or too lenient, depending on the individual borrower. Subprime status, as addressed in current laws, is an all-or-nothing prospect. A trigger is now set by a given interest rate or fee amount. Those who are affected by the trigger are affected by the legislation. Those who are not affected by the trigger are generally unaffected by the legislation. By definition, if there is only one cut-off there will be no ability to make distinctions within the group.[266] If being a member of the subprime group makes one vulnerable to subprime lending, then the degree to which one is out of the prime category should determine just how vulnerable one is to a predatory lender. This variation means that some borrowers are just barely within the subprime category and are therefore being unduly restricted by present law. Other borrowers are heavily within the subprime category and may need additional protection.

Both HOEPA and state laws have done a good job of identifying those characteristics of a loan which are most problematic. Certain practices, while acceptable for some borrowers, can be devastating to others. An example of this is flipping. While refinancing can be very sensible in certain situations, when it is abused the results can be catastrophic.[267] The use of triggers is meant to prevent those in the subprime category of loans from being at risk from these practices, while leaving the practices available for others who are at less risk of being abused.[268] The result might sometimes be harsh in borderline cases.

The best way to bring flexibility to predatory lending law is to create a more sophisticated trigger system. To improve the triggers, a system should be set up in gradations.[269] Instead of having one all-or-nothing trigger, several triggers could define different levels of restriction. Then, the restrictions on the loans could be better balanced according to how prone to abuse the particular practice is, or the practice itself could be subject to gradations.[270]

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266. In the subprime market, gradations already exist and are used by lenders, albeit on an informal and lender-specific level. *See* Mansfield, *supra* note 3, at 532-35.

267. *See supra* note 36.

268. *See supra* notes 66-72 and accompanying text.

269. For example, a loan at 6 points over the prime rate might be a Category 1 loan, whereas a loan 10 points over the prime rate could be a Category 2 loan, and so on.

270. In this case, for example, a person might be able to refinance a loan *X* times

Such a trigger system would encourage lending to those who are just barely within the subprime group by having fairly liberal restrictions on loans to them. Moreover, it would also allow law enforcement to focus on a smaller and more isolated group of heavily subprime borrowers. If lenders withheld credit from the more extreme group, the problem would be smaller than if the entire category of subprime loans was suffering for lack of credit.

On the surface, this system may seem more complicated than presently-existing laws. Such a system, however, is clear enough that a simple chart could be made to decide what category a given borrower is in and what the restrictions imposed on them are. This solution avoids the dangers that a subjective standard poses, while mitigating the harshness of a sharp division between prime and subprime loans. Moreover, if this plan were adopted on a national level, with preemption in effect, the rules would be overall a great deal simpler than having fifty different state laws and innumerable local ordinances.

Although predatory lending is still a major problem, there is reason for optimism. The recent flurry of legislation on the state level suggests that state legislatures are willing to take action to address predatory lending.[271] The recent strengthening of HOEPA by the Federal Reserve[272] indicates a willingness on the part of regulators to address predatory lending when necessary. Recent settlements[273] indicate a willingness to prosecute lenders who make predatory loans, and an apparent ability to do so successfully. If the resources of these groups are geared towards eliminating predatory lending, then it is likely that some improvement will be seen. Large changes do not always happen overnight, but if the change is given adequate time the results may be quite positive.

Abusive practices in lending are a problem that will probably never disappear entirely. It may simply be an inherent part of human nature to try and maximize one's benefit when lending to another. It is likely for this reason that the first usury laws were developed.[274] What can change, however, is our sophistication and effectiveness in dealing with abusive loans. If a method can be developed that gives adequate protection to a borrower, without becoming so onerous that no one wants to lend at a subprime level, it is a goal well worth achieving. If, in the future, laws must be amended to deal with unforeseen issues,

for a Category 1 loan, but only *Y* times for a Category 2 loan. Additionally, rebuttable presumptions might be set up according to gradations, with the presumption in favor of the lenders getting weaker as the categories progressed.

271. *See supra* note 32.

272. *See supra* note 88 and accompanying text.

273. *See supra* note 34.

274. *See* Robert C. Ellickson & Charles Dia. Thorland, *Ancient Land Law: Mesopotamia, Egypt, Israel*, 71 Chi.-Kent. L. Rev. 321, 399 n.440 (1995) (citing early usury laws).

the changes can be seen as further progress of the law. At all times, however, the law should be clear, comprehensible, and cause as little harm as possible to those it tries to protect.

CONCLUSION

Predatory lending is a problem that affects many of the most vulnerable Americans and costs billions of dollars a year. Direct legislation is difficult because it threatens to cut off an important source of credit to underserved populations. Recently, many attempts to combat predatory lending have been made. Use of a duty of "suitability," similar to one found in securities law, is appealing but ultimately unhelpful because of the differences between the securities industry and lending industry. Because of the need for clarity and the need to limit the exposure of subprime lenders to opportunistic lawsuits, preference should be shown to objective rules rather than subjective standards. Improvement in current law could best be achieved by creating a more sophisticated system of triggers to identify which loans require the most scrutiny.

Notes & Observations