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Feature Article***151 THE HOME OWNERSHIP AND EQUITY PROTECTION ACT OF 1994: EXTENDING
LIABILITY FOR PREDATORY SUBPRIME LOANS TO SECONDARY MORTGAGE MARKET PARTICIPANTS**[Lisa Keyfetz \[FNa1\]](#)

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Introduction

The growth in the subprime mortgage market over the past decade has been accompanied by a widespread epidemic of lending abuses. These "predatory lending" practices entail a variety of manipulative marketing and structuring schemes that strip homeowners of substantial equity in their homes and eventually push them into foreclosure. [FN1] These abusive practices impose substantial costs on families and neighborhoods by leaving families homeless, disintegrating low-income communities, and eroding tax bases. [FN2] In response to evidence of a pattern of abuse in the subprime mortgage market, Congress passed the Home Ownership and Equity Protection Act ("HOEPA" or the "Act") in 1994. [FN3] HOEPA amends the Truth-in-*152 Lending Act ("TILA") by requiring additional disclosures and substantive protections for certain high-interest and high-fee home equity loans. [FN4] Given the dominant role the secondary market plays in demanding and financing subprime mortgages, HOEPA's drafters focused on the need for a mechanism to hold financiers of predatory lending accountable for the misconduct of their counterparts in the primary mortgage origination market. Accordingly, HOEPA's primary enforcement mechanism is an expanded private right of action for borrowers against subsequent purchasers or "assignees" of high cost loans ("assignee liability").

HOEPA's assignee liability provisions can be a powerful vehicle for regulating the home equity lending market and for challenging abusive lending practices through the courts; however, the Act also has its limits. Thus, the legal community must be intimately aware of the statutory provisions and judicial interpretations regarding assignee liability under HOEPA. To this end, this article proceeds as follows: Part I discusses the subprime mortgage market and reviews evidence of the prevalence of abuse in the market. Part II presents HOEPA's general rationale for extending liability to assignees, specifically, as a mechanism to encourage self-policing of the subprime mortgage market. Parts III-V examine the scope, limitations, and future of assignee liability under HOEPA, and Part VI presents state law theories which also impose liability on assignees of predatory loans.

I. Overview of the Subprime Mortgage Market

A. The Problem of Predatory Lending in the Subprime Mortgage Market

The "subprime market" is a broad label used to describe the market for extending credit to borrowers who have impaired or limited credit history or high debt. [FN5] Because of their credit status, subprime borrowers pay higher interest rates and higher upfront fees *153 to borrow money than borrowers in the prime market. [FN6] Most commonly, borrowers obtain subprime mortgage loans from non-depository institutions. [FN7] However, national banks, thrifts, and their affiliates are increasingly taking part in the subprime market. [FN8] The subprime mortgage market has grown tremendously since the deregulation of the lending industry during the 1980s. [FN9] In particular, subprime mortgage originations have skyrocketed over the past decade, increasing ten-fold from \$35 billion in 1994 to \$332 billion in 2003. [FN10]

A joint task force conducted by the Department of Housing and Urban Development ("HUD") and the Department of the Treasury concluded that the subprime residential mortgage market is ripe with "predatory lending" practices in which loan originators use fraud, deception, or other manipulative techniques to extend credit in ways intended to strip borrowers of the equity in their homes. [\[FN11\]](#) Because predatory lending practices can take so many forms, the term is broadly defined as a "mismatch between the needs and capacity of the borrower," which results in a loan with terms so disadvantageous to a particular borrower that there is little likelihood *154 that the borrower can repay the loan. [\[FN12\]](#) Thus, "predatory lending" is most aptly described as lending practices that create an unreasonable risk of foreclosure. [\[FN13\]](#)

To illustrate, consider the case of Ms. "J.," who testified about her experience in the subprime mortgage market before the Joint U.S. Department of Housing and Urban Development--U.S. Department of the Treasury Task Force on Predatory Lending:

Ms. J., who is 71 years old, received a phone call from a mortgage broker, who promised her that he would refinance her two existing mortgages, provide her with \$5,000 in extra cash and lower her monthly payments. Ms. J. needed cash to repair her kitchen, so she agreed to meet. The broker visited Ms. J. at her home. Ms. J. maintains that he gained her trust by claiming that he liked her as a person and he wanted to help senior citizens because his own father had recently died of cancer. Later, the broker returned to Ms. J.'s house to have her sign the mortgage loan papers. Ms. J. said that she could not read the documents carefully because she suffers from vision problems and has a limited education. Ms. J. said she signed the mortgage loan documents based on the broker's *155 promises and representations that the mortgage loan would provide her with cash to repair her kitchen and lower her monthly mortgage payments.

Ms. J. received a \$90,100 mortgage with an APR of 14.819% [about 8% above benchmark Treasury Rate]. The mortgage loan contained a 15-year balloon note that required a final payment of \$79,722.61 (due when she was 86 years old). Ms. J. paid 10% of the loan amount, or \$9,100 as a broker's fee. The monthly payment increased to approximately 80% of her monthly income. Ms. J. did not receive any money from the proceeds of this transaction. [\[FN14\]](#)

Thus, Ms. J.'s contract required payments of approximately \$1,130 per month for 15 years, totaling \$203,000. At the end of 15 years she would have built zero additional equity in her home from the \$203,000 in payments--the \$10,000 loan amortization from \$90,100 to \$79,722 over the fifteen years only paid the \$9,100 broker's fee, which was packed into Ms. J.'s loan upfront, and financed at the 14.819% interest rate.

Ms. J.'s experience highlights several abusive practices that are commonly used in subprime home equity lending, including packing of excessive upfront points and fees, balloon payments that require refinancing (and thus more fees), and loan terms that the borrower cannot afford based on her fixed income. These abusive terms are generally obtained by aggressive and manipulative sales tactics, often amounting to outright fraud; for example, the "bait and switch" strategy used against Ms. J, who expected the refinancing to result in lower monthly payments and extra cash, but ended up increasing her loan payments to 80% of her monthly income. Moreover, the abusive practices are specifically targeted at unsophisticated, elderly, or low-income borrowers. As confessed by a predatory lender in a testimony before the U.S. Senate Special Committee on Aging:

Finance companies try to do business with blue-collar workers, people who haven't gone to college, older people who are on fixed incomes, non English-speaking people and people who have significant equity in their homes. In fact, my perfect customer would be an uneducated widow who is on a fixed income-- hopefully from her deceased *156 husband's pension and social security--who has her house paid off, is living off of credit cards, but having a difficult time keeping up her payments, and who must make a car payment in addition to her credit card payments. [\[FN15\]](#)

Spoken like a true predator.

Ms. J's story represents only a subset of the predatory practices used by mortgage brokers and mortgage bankers to push unnecessary and mismatched loans onto unsuspecting borrowers. For example, the equally rampant predatory practice of "loan flipping" involves repeatedly refinancing mortgages in a short period of time, with high fees and prepayment penalties at each step along the way. [FN16] Ms. Podelco testified before the U.S. Senate Committee on Banking, Housing and Urban Affairs about how Beneficial Finance, United, and Equity One flipped her mortgage seven times between May 1995 and August 1996. [FN17] Over the course of the two years, Ms. Podelco's home equity loan increased from \$11,921 to over \$64,000. She received \$21.70 in cash out of the seven transactions, with the remaining \$52,000 of debt increase going to finance origination fees (as high as \$18,192 for flip number four). As with most victims of predatory lending, the story did not end well for Ms. Podelco either:

By the end of February, I had had five different loans in ten months. I didn't understand that they were adding a lot of charges each time. . . [After two more flips the payments *157 were too much and] I lost my home to foreclosure. . . I now understand that these lenders pushed me into loans I couldn't pay. Adding all of these fees and costs each time caused me to lose my home, a home that I owned free and clear shortly after my husband died.

Like Ms. J., the unsuspecting Ms. Podelco became prey to an industry practice designed to strip her of her most valuable asset, her home.

The predatory practice of "steering" has also been widely documented. [FN18] Steering involves directing borrowers to loans with extraordinarily high interest rates or finance charges relative to their risk. For example, a whistle-blower at First Alliance Mortgage Company, a finance company that was eventually prosecuted for predatory lending violations, admitted that First Alliance's customers with "A" credit ratings would pay the same high fees as customers with "D" ratings. The whistle-blower explained that he wished he could have told his better customers that "every step they took [away] from [his] door to [the conventional branch bank down the street] would save them \$1,000 on their loan." [FN19] Steering is probably the most widespread predatory practice in the subprime mortgage market. In particular, several studies indicate that about 50% of all subprime borrowers could have obtained loans in the prime market based on their credit status, but were steered toward higher interest rate loans by deceptive brokers. [FN20] In large part steering is driven by payment of "yield spread premiums" to brokers, as a reward for originating loans at above-market interest rates and fees relative to the borrower's credit risk. [FN21] Notwithstanding whether subprime *158 lending abuses come in the form of "bait and switch" tactics, steering, or flipping, the outcome of predatory lending is the same for homeowners-- foreclosure.

B. The Costs of Predatory Lending

Predatory practices pervade subprime credit products such as payday loans, tax refund anticipation loans, and rent-to-own contracts. Still, predatory practices within the residential mortgage market are most concerning because of the severe consequences for families who lose their homes. Moreover, the tremendous growth in subprime residential mortgage originations over the past decade, from \$35 billion in 1994 to \$332 billion in 2003, creates the risk that these costs to families and neighborhoods will continue to grow. [FN22]

Predatory lending has resulted in a higher number of foreclosures in a shorter period, [FN23] devastating families and neighborhoods primarily in lower-income, minority, and elderly communities. The foreclosure rate among subprime mortgages is 8% nationally, with some states facing foreclosure rates in excess of 12%. [FN24] By comparison, the foreclosure rate for prime loans is 1%. [FN25] Excluding the costs from foreclosures, which may be too difficult to quantify, the Center for Responsible Lending estimates that predatory lending costs home loan borrowers \$9.1 billion annually as a result of exorbitant fees and penalties (such as those charged to Ms. Podelco), unnecessary products (such as financed credit insurance), and risk-rate disparities resulting from steering (such as those described by the First Alliance whistle-blower). [FN26]

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***159** Borrowers of subprime residential mortgages do not benefit from this extension of credit in the form of increasing access to homeownership. While loan originations have increased nearly ten-fold since 1994, home ownership has only increased 3-4% over the same period. [\[FN27\]](#) This results from the fact that over 80% of subprime loans are refinancings. [\[FN28\]](#) Lenders push borrowers to take on long-term credit secured by the borrowers' home equity to pay for mounting credit card, health care, or other unsecured, short-term consumer debts. Even if the long-term mortgage is financed at a lower interest rate, the extended-maturity trade is not a trade that any informed, intelligent consumer would make. For example, consider a five-year, \$20,000 car loan at 15% that is refinanced into a thirty-year home equity loan at 12%:

- **Five-Year Car Loan with Monthly Installments:** Borrower pays \$476 per month, for payments totaling \$28,548. The borrower's interest expense is \$8,548.

- **Thirty-Year Home Equity Loan with Monthly Mortgage Payments:** Borrower pays \$206 per month for the car, for payments totaling \$74,060. The borrower's interest expense is \$54,060, over six times the interest on the short-term loan. [\[FN29\]](#) Moreover, the car does not last more than ten years, so the borrower will be paying off the car long after he can no longer use it.

While this trade is detrimental for consumers, lenders are clearly aware of the value of the trade to them. As confessed by predatory lender "Jim Dough" in testimony before the Senate, finance companies regularly follow up purchases on retail installment loans to encourage the consumer to make the extended-maturity trade:

Although we would tell customers that we were calling to see if they got their merchandise, the real purpose of the call was to solicit the customer into converting the retail installment loan into a more profitable personal loan or home equity loan. . . . To flip one of these small loans into a ***160** personal or home equity loan, we were trained to sell the monthly "savings," that is, how much less per month the customer would be paying if we flipped the loan. In reality, the "savings" that we were trained to sell to customers were just an illusion. The uneducated customer would jump for the "savings," thinking that he would have more money to buy other things. What the customer wouldn't figure out and what we wouldn't tell him is that he would be paying for a longer period of time and in the end would pay a whole lot more. [\[FN30\]](#)

As illustrated by this testimony, subprime credit is usually something that the lender, not the borrower, needs. The home equity loan market has therefore been described as a "push" or supply-driven market. [\[FN31\]](#) Lenders often encourage brokers, who take advantage of borrowers' susceptibilities, lack of information, lack of market competition and insufficient regulation, to push too much credit onto consumers. [\[FN32\]](#)

C. Securitization: Driving the Market for Subprime Mortgages

Securitization has been the most substantial driving force behind the push to originate subprime home equity loans. [\[FN33\]](#) "Securitization" refers to the pooling of financial assets, such as mortgage loans, and the issuance of securities representing interests in the pool of assets (termed "Mortgaged Backed Securities" or "MBS"). [\[FN34\]](#) Issuance of subprime MBS has risen twenty-fold over the ***161** past decade, from \$10 billion in 1994 to \$203 billion in 2003. [\[FN35\]](#)

In a typical securitization, money is provided by the secondary market first, and a commitment to make loans to individual borrowers follows. [\[FN36\]](#) Specifically, banks and investors create the demand for home equity mortgages by financing the purchase of mortgages for the investment pools. Demand is then filled by finance company employees such as "Jim Dough" who opportunistically seek out victims in whom to "invest" the investors' capital. [\[FN37\]](#) Access to securitization-based financing is a boon to these finance companies. For example, First Alliance Mortgage Co. documented a six-fold in-

crease in originations once it gained access to mortgage market financing. [FN38] Accordingly, securitization has resulted in the creation of an entire industry of mortgage originators whose incentives are to push high-cost, high-fee loans onto consumers regardless of need or compatibility. [FN39]

Borrowers typically interact with a mortgage broker that designs and originates the borrower's mortgage. [FN40] Unbeknownst to the borrower, the loan is actually funded by a larger financial *162 institution, generally an investment bank or large finance company. [FN41] The investment bank underwrites or immediately purchases the newly-originated mortgage as part of an ongoing or pre-arranged relationship with the mortgage broker or finance company. [FN42] The investment bank then aggregates several mortgages from different brokers to create the pool for the securitization. [FN43] To execute the securitization, the financial institution transfers the pool of mortgages into a trust (the "securitization entity"), hires a rating agency to assess the riskiness of the mortgage assets in the trust, and issues debt securities backed by the pool of mortgages. [FN44] The rating agency plays a critical role in analyzing the characteristics of the mortgages in the pool and forecasting expected cash flows from the pool to inform investors regarding the likelihood of repayment on their debt investments. [FN45] The securitization entity then employs a "servicer," responsible for collecting the cash flows due on the mortgages in its trust. [FN46] The purchasers of the mortgage-backed securities (the "investors") become the economic owners of the cash flows due under the loan agreement secured by the mortgage. These investors provide a permanent source of funding for the subprime mortgage. [FN47]

The shift toward securitization-based financing of subprime home loans has resulted in considerable segmentation of the mortgage-lending business. [FN48] The functions of originating, funding, servicing, and evaluating the risks of each mortgage loan are *163 increasingly provided by separate, specialized entities. [FN49] The mortgage industry argues that such segmentation creates benefits for lenders, investors, and borrowers. For lenders, securitization serves as a leveraging tool, allowing the mortgage originator to receive immediate repayment on loan originations from which to originate new loans. [FN50] For investors, securitization of a subprime mortgage creates a new, diverse asset class with varied sensitivity and correlation to changes in interest rates. [FN51] For borrowers, the increased liquidity of mortgages combined with access to a new source of capital arguably allows for more widespread access to credit and lower interest rates. [FN52] However, as discussed in Part II below, the segmentation in the mortgage market resulting from the move toward securitization-based financing has also created a regulatory gap, resulting in destructive incentives for originators of subprime mortgage loans.

II. Assignee Liability: Restoring Balance to the Subprime Mortgage Market

The destructive incentives in the origination of subprime mortgage loans are encouraged by a legal construct known as the Holder in Due Course ("HDC") doctrine, which allows assignees of mortgage notes to circumvent lending regulations by "laundering" abusive loans. Specifically, the HDC doctrine frees assignees of liability for many claims and defenses which the borrower would have against the original lender. As a result, the HDC doctrine makes the current system "perfect for washing everybody's hands of any responsibility [. . .]. At each step, it gets harder and harder to hold anybody accountable." [FN53] This lack of accountability for lending violations encourages subprime mortgage financiers to supply mortgage brokers with capital with which to push subprime *164 mortgages. As bluntly stated by a spokesman for Lehman Brothers when asked about the investment bank's role in financing the activity of a predatory lender, Lehman Brothers is an "underwriter, not a regulator." [FN54] Given secondary-market players' passive view of their role, Congress recognized the need to subject them to liability for the misconduct of their primary-market counterparts to restore accountability to the subprime mortgage market.

A. Laundering Lending Abuses through the Holder in Due Course Doctrine

It is a general principle of contract law that claims and defenses to a contract survive any transfer of the agreement to a

new party. However, an exception to this general principle, the HDC doctrine, developed as one of commercial law's primary mechanisms for encouraging the flow of credit. [\[FN55\]](#) The doctrine permits assignees of "negotiable instruments" to protect themselves from many claims and defenses to payment that a borrower would have against the original lender, as long as the assignee did not have knowledge of the claims and defenses at the time of transfer of the instrument. [\[FN56\]](#) Without the HDC rule, assignees of negotiable instruments step into the shoes of their seller, and would be liable for any claims or defenses that could have been brought against the seller ("assignee *165 liability"). The HDC rule, therefore, seeks to encourage transferability of negotiable instruments by eliminating assignee liability. [\[FN57\]](#)

Several courts have recognized the applicability of the HDC doctrine to mortgage notes. [\[FN58\]](#) In the context of a securitization, the HDC defense often prevents borrowers from suing or defending against claims brought by the securitization entity. [\[FN59\]](#) In fact, the entities that structure securitizations of residential mortgages are often "coached" in the means to transfer ownership such that the buyer can become a Holder in Due Course. [\[FN60\]](#) While a borrower maintains all claims against the loan originator under the HDC rule, the originator is often an under-capitalized, "fly-by-night" mortgage broker or finance company, against whom the borrower cannot get recourse. [\[FN61\]](#)

The story of George and Marjorie Mox illustrates the unfairness to borrowers that results from application of the HDC doctrine. [\[FN62\]](#) The Mox's case was part of a series of lawsuits arising from the Diamond Mortgage Corporation ("Diamond") mortgage-backed securities fraud. [\[FN63\]](#) Prior to their loan agreement with *166 Diamond, the Mox's had two senior home mortgages totaling \$12,700. [\[FN64\]](#) The Mox's refinanced with a new \$31,000 mortgage with Diamond, which was supposed to pay off the Mox's outstanding mortgages and provide money to the Moxs. [\[FN65\]](#) Immediately upon originating the Mox's loan, Diamond recorded the mortgage and assigned it to an investor who paid good value for the mortgage. [\[FN66\]](#) However, the Mox's existing mortgages were never paid off, nor did they receive a single cent from Diamond, which filed for bankruptcy soon afterwards. [\[FN67\]](#) The Mox's filed a complaint for declaratory relief requesting the court to discharge the Diamond mortgage by declaring the mortgage void for lack of consideration. [\[FN68\]](#) Applying the HDC doctrine, the Michigan appellate court affirmed the trial court's denial of declaratory relief, finding that the mortgage was not void against the defendant-investors because the defendants did not have knowledge of defenses against the mortgage's validity at the time they purchased the mortgage. [\[FN69\]](#) The court's application of the HDC doctrine left the Moxs with the full cost of Diamond's fraud, in the form of \$43,700 in mortgage debt.

The Moxs' unfair outcome resulted from a "perfect storm" combination of the HDC doctrine and Diamond's bankruptcy. Nonetheless, thousands of borrowers are likely to find themselves in a similar situation given the boom-and-bust cycle of subprime lenders. [\[FN70\]](#) According to one author, most of the major subprime mortgage lenders of the 1990s, with total mortgage-backed securities issuances of \$125 billion, have filed for bankruptcy since the subprime liquidity crisis of October 1998. [\[FN71\]](#) Mortgages originated by *167 these lenders were transferred to investors for value long before the originators went bankrupt. Without laws to prevent assignees from claiming the HDC defense, many borrowers of these now bankrupt finance companies would be stripped of potential claims against their abusive mortgages.

B. The Case for Elimination of the Holder in Due Course Doctrine

Throughout much of the twentieth century, the HDC doctrine was widely applied to consumer retail loan transactions. [\[FN72\]](#) However, recognizing the uneven sophistication between borrowers and lenders, the inequitable outcomes resulting from the rule's application and the inefficient incentives created by imposing the costs of abusive lending on borrowers, the Federal Trade Commission (FTC) abrogated the HDC doctrine for buyers of consumer credit contracts by making the buyer liable for claims and defenses against the loan seller (the "FTC Holder Rule"). [\[FN73\]](#) Consumer transactions that did not fall within the definition of a "consumer credit contract," most importantly, residential mortgage transactions, remained subject to

the HDC rule. [\[FN74\]](#) The same rationales that motivated the FTC Holder Rule in 1975 motivated the need for abrogating the HDC rule for assignees of residential mortgages.

The HDC defense is widely recognized to work disastrous results on mortgage debtors. [\[FN75\]](#) As illustrated by the case of Mr. and Mrs. Mox, the rule presents the biggest problem when originating *168 lenders disappear or file bankruptcy. Still, this is not the only context in which the rule works unfairly against consumers. Even if the originating lender remains in business, a consumer facing foreclosure by an assignee will still lose his home without defenses against the assignee. The borrower's ability to separately pursue claims against the original lender does not provide protection against foreclosure by the assignee. For example, even if the Moxs could have pursued their claims for fraud against a non-bankrupt Diamond, the investors could have pursued foreclosure proceedings independently (and probably more quickly) given the reasoning of the Mox court. As plainly stated by William Farris, a lobbyist with AARP, ". . . at the end of the day, if you cannot raise a claim against the person holding the note, you have no defense." [\[FN76\]](#)

Beyond fairness, efficiency similarly demands elimination of the HDC doctrine. First, between the borrower and the investor, the sophisticated investor (through the financial institution that executes the securitization) is the party best able to avoid the harm of a predatory loan. [\[FN77\]](#) For one, financial institutions deal repeatedly with loan originators, giving these institutions the ability to obtain information to distinguish good from bad lenders. Moreover, the costs of gathering information about loan originators can be spread over hundreds of loans purchased from the originating entity. By contrast, an unsophisticated borrower has limited access to information about originator quality. It is not necessarily efficient for each borrower, who will only deal with a mortgage broker or banker a few times in his lifetime, to spend the costs to gather this information. Financial institutions are also the better bearers of the cost of abusive loans because they can contract around liability from bad loans through recourse agreements or third-party insurance. [\[FN78\]](#)

In addition, the HDC doctrine creates a moral hazard by allowing mortgage originators to externalize the cost of their predatory behaviors. [\[FN79\]](#) As illustrated in Mox, the HDC doctrine *169 allows originators to escape liability by transferring the predatory loan. [\[FN80\]](#) The individual borrower fully bears the costs of the abuse. Mortgage brokers already have an incentive to originate high-fee loans, without consideration of the borrowers' needs or ability to pay, because the brokers receive up-front compensation and transfer the loans before they suffer loss from default or liability. The HDC doctrine creates a vicious cycle of incentives for the other players in the lending industry by encouraging investors to keep pushing capital into MBS which pushes investment banks to demand more and more loans from brokers, who can then push more and more loans onto borrowers.

Assignee liability eliminates the inefficient incentives created by the HDC doctrine because it links the parties involved in the mortgage production process through shared liability. Specifically, assignee liability forces the party who feeds capital to predatory mortgage originators to internalize the costs imposed on consumers by the predatory lender. To avoid the cost, prudent assignees should engage in due diligence of loan originators and should refuse to purchase loans from predatory originators, thus eliminating the ability of predatory lenders to stay in business. As predatory lenders are cut out of the mortgage origination business, the costs of assignee liability should be offset by a decreased risk of default, which benefits borrowers in the form of lower interest rates. [\[FN81\]](#) At the same time, the threat of liability should also push back on Wall Street's demand for subprime mortgages. Thus, to flip the blunt response of Lehman Brothers' spokesman regarding the role of investment banks in the subprime market, [\[FN82\]](#) assignee liability ensures that financiers such as Lehman Brothers act as both underwriters and regulators to correct current failures in the pricing and supply of subprime credit.

*170 C. Market Adaptations to Assignee Liability

Opponents of assignee liability rally around the HDC doctrine as a necessary condition to preserve access to capital for subprime borrowers. [\[FN83\]](#) To be sure, this assumes that access to the type of credit financed by the secondary market is a benefit to borrowers. [\[FN84\]](#) Specifically, lenders argue that the complex process of securitization, which provides more than two-thirds of the capital funding for the subprime market, requires predictable and quantifiable risks. The uncertainty imposed by the risk of liability deters rating agencies from rating MBS. [\[FN85\]](#) Accordingly, investors refuse to purchase MBS, closing access to the subprime market for millions of borrowers in need.

Lenders point to Georgia's "failed" experiment with expanded assignee liability as the "poster child" for their case. In October, 2002, Georgia passed a state anti-predatory lending law, the Georgia Fair Lending Act (GFLA), which expanded upon federal anti-predatory lending law. [\[FN86\]](#) Because the GFLA went so much further in protecting consumers than any existing federal or state law, by subjecting assignees to potentially unlimited liability, the market overreacted. [\[FN87\]](#) Lenders refused to originate new loans to Georgia *171 borrowers and rating agencies refused to rate securitizations that included certain loans originated in Georgia. [\[FN88\]](#) As a result, some Georgia residents were unable to obtain subprime mortgages. Georgia legislators immediately modified the legislation to respond to the rating agencies concerns, bringing GFLA's provision for assignee liability in line with existing federal assignee liability law. [\[FN89\]](#) Lenders and rating agencies immediately "re-opened shop" in Georgia. [\[FN90\]](#)

States have since learned from Georgia's "failure," and have worked more closely with rating agency representatives to define the standard under which, and the extent to which, assignees should also be held liable for predatory practices of mortgage originators. [\[FN91\]](#) As a result, rating agencies have been clear about their continued ability to rate loans that impose assignee liability. [\[FN92\]](#) Thus, the mortgage industry needs a better "poster child" to continue to make the case against assignee liability. The collective evidence is even more telling than these particular states' success stories. By the end of 2003, nineteen states and cities had already passed their own assignee liability laws. [\[FN93\]](#) Yet the mortgage industry raved about 2003 as "one of its best years ever for both originations growth and profits" in the subprime mortgage business. [\[FN94\]](#) Likewise, federal assignee liability *172 under HOEPA existed for a ten year period during which subprime mortgage volume grew nearly ten-fold, and subprime mortgage-backed securities volume grew twenty-fold. [\[FN95\]](#)

The lending industry's doomsday scenario for the subprime mortgage market has been proved wrong for a simple reason: securitization entities have access to several structuring tools, or "credit enhancements," to adapt to assignee liability. A simple credit enhancement already used in most securitizations involves a recourse agreement between the securitization entity, which holds the mortgages for the benefit of investors, and the seller of the mortgages. [\[FN96\]](#) Practically, this simple recourse agreement should force buyers to engage in initial due diligence of the seller with whom they contract to ensure minimum capital requirements, bonding, or other guarantees of payment should the securitization entity need to sell a predatory loan back to the buyer. Securitization entities can also create more complicated trust structures in which the seller retains the equity, or first-loss tranche of the pool of securities. [\[FN97\]](#) Similar to the recourse agreement, the seller will first bear the cost of "bad loans", and thus have an incentive to ensure that bad loans do not end up in the securitization entity's mortgage pool. Thus, credit enhancements provide sellers with the needed incentive to police the flow of their capital to honest lenders.

Rating agencies have already successfully turned to credit enhancements as an adaptation to assignee liability laws. [\[FN98\]](#) For example, Standard & Poor's require the seller of loans to provide the securitization entity with a representation and warranty that the loans in the pool are not subject to assignee liability, and that the seller has effective procedures for identifying liability-carrying loans. [\[FN99\]](#) *173 Standard & Poor's require the representation be provided by a creditworthy entity, with sufficient capital to repurchase loans that are in breach of the warranty. [\[FN100\]](#) Tellingly, Congress had this simple credit enhancement in mind when it passed the first assignee liability provision under federal law. [\[FN101\]](#)

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III. Federal Regulation of Predatory Lending

A. The Home Ownership and Equity Protection Act of 1994 (HOEPA)

Congress enacted TILA in 1968 to promote informed use of consumer credit. [\[FN102\]](#) The statute requires creditors to provide borrowers with standard disclosures regarding the costs of credit. [\[FN103\]](#) However, TILA was not created to respond to the deceptive and abusive practices which developed specifically in the home-equity market. [\[FN104\]](#) Accordingly, TILA does not impose any substantive limitations on the provision of home equity credit or correct any of the market failures that encourage abusive lending practices. Recognizing the need to directly address the mounting evidence of abuses in the home equity lending market, Congress enacted the Home Ownership Equity Protection Act ("HOEPA") in 1994. [\[FN105\]](#)

*174 HOEPA prohibits loans from including certain abusive terms, and also expands TILA's disclosure requirements. [\[FN106\]](#) Unlike TILA, which applies to every residential mortgage loan, HOEPA applies only to a certain class of "High Cost Mortgages." [\[FN107\]](#) HOEPA provides that a mortgage is High Cost when the mortgage reaches either an interest rate or a points and fees trigger. [\[FN108\]](#) Specifically, the loan is a "HOEPA loan" or "High Cost Mortgage" if it is:

(1) a consumer credit transaction (2) with a creditor (3) that is secured by the consumer's principal dwelling and (4) is a second or subordinate residential mortgage, not a residential mortgage transaction, a reverse mortgage transaction, or a transaction under an open credit plan and (5) that satisfies either of the following two tests:

a) APR Test: the annual percentage rate (APR) of interest for the loan transaction exceeds the rate for Treasury securities of a comparable maturity by more than 8%; or,

b) Points and Fees Test: the total "points and fees" payable by the borrower at or before closing will exceed the greater of (i) 8% of the total loan amount; or (ii) \$400.00. [\[FN109\]](#)

To illustrate how "high cost" a HOEPA loan is, consider the payments on a \$100,000 thirty-year mortgage at a prime interest rate versus the same mortgage at HOEPA's threshold interest rate, currently about 6.0% versus 13.5%, respectively. [\[FN110\]](#) The borrower's *175 monthly payments would be \$600 versus \$1,145, respectively, with total interest payments over the thirty-year term of \$115,838 versus \$312,348, which constitutes a cost difference of about 200% for the same buying power today!

In limiting HOEPA's scope to high-cost home equity loans, Congress sought to target the most abusive sector of the subprime market. [\[FN111\]](#) Unfortunately, Congress was influenced by industry lobbyists who argued that additional regulation would unnecessarily close the subprime market to several borrowers. However, the Board of Governors of the Federal Reserve System (the "Board") expanded HOEPA's coverage somewhat in 2001, recognizing the limited effectiveness of the 1994 Act's initial scope. [\[FN112\]](#) Current bills in Congress, such as the bill proposed by Congressmen Brad Miller, Mel Watt, and Barney Frank, continue to push for additional protections for borrowers of high cost loans. [\[FN113\]](#)

It is illegal for HOEPA loans to contain certain terms, because these terms create an unreasonable risk of foreclosure when combined with an already high-cost, high-fee loan. Prohibited terms include points on loan amounts refinanced, default interest rates above the pre-default rate, balloon payments, negative amortization, prepayment penalties, "loan flipping," and extension of credit without consideration of the borrowers' ability to repay. [\[FN114\]](#) In addition, the creditor of a HOEPA loan must provide the borrower with a special disclosure warning the borrower that he can lose his home if he does *176 not meet his obligations under the loan. [\[FN115\]](#) This warning, along with the standard TILA disclosures, must be provided to the borrower three days before loan settlement to allow the borrower a "cooling off" period to evaluate the loan. [\[FN116\]](#)

B. A Dual Scheme for Assignee Liability: Strict Liability or Negligence

(Cite as: 18 Loy. Consumer L. Rev. 151)

Congress focused on assignee liability as HOEPA's major enforcement mechanism. The negative effects of the HDC doctrine on the subprime mortgage market were well recognized at the time of HOEPA's passage:

[In the past,] [u]nscrupulous lenders were limited . . . by their own capital resources. Today, however, with loans sold on a regular basis, one unscrupulous player can create havoc in a community by selling loans as fast as they are originated. [\[FN117\]](#)

Thus, HOEPA's drafters intended assignee liability to encourage the secondary market to provide the needed "policing" of unscrupulous mortgage originators in the primary market. [\[FN118\]](#) Accordingly, HOEPA's drafters used broad language that makes an assignee liable for "all claims and defenses" that the consumer could assert against the "creditor." [\[FN119\]](#) However, this broad cause of action *177 against assignees is limited by a "safe harbor" for diligent assignees and a cap on damages for all assignees. As a result, HOEPA's assignee liability provisions come together to create a dual scheme for seeking remedies from assignees, based alternatively on negligence or strict liability.

Under HOEPA, an assignee of a predatory loan may be liable either on a theory of negligence or strict liability. Specifically, section 1641(d) combined with section 1639(j) / 1635(b) create this dual remedial scheme. First, section 1641(d) imposes capped monetary damages on negligent assignees. Assignees who meet HOEPA's required showing of reasonable due diligence are protected by the statute's safe harbor. Second, HOEPA imposes strict liability for certain violations and gives borrowers the right to rescind their predatory loan under section 1639(j) / section 1635(b).

1) Negligence [section 1641(d)]:

HOEPA gives borrowers a private right of action for damages against assignees of predatory High Cost Mortgages. [\[FN120\]](#) However, an assignee can protect itself from liability for damages by "exercising ordinary due diligence" to avoid the purchase of a High Cost Mortgage ("HOEPA's Safe Harbor"). [\[FN121\]](#) For a violation of one of section 1639's disclosure or substantive requirements, the borrower is entitled to collect actual damages, attorneys fees, and all finance charges paid by the consumer from the assignee. [\[FN122\]](#) For a violation of any other cause of action against the assignee, HOEPA limits the borrower's damages to the sum of the borrower's remaining indebtedness plus the total amount paid by the borrower in connection with the transaction. [\[FN123\]](#)

2) Strict Liability [section 1639(j) / section 1635(b)]:

Alternatively, HOEPA gives borrowers a right to rescind a predatory High Cost Mortgage against an assignee if the loan violates *178 HOEPA. [\[FN124\]](#) Under the rescission remedy the borrower cancels the loan agreement and is "not liable for any finance or other charge" associated with the loan. [\[FN125\]](#) The lender is forced to terminate its security interest in the borrower's home upon repayment of the outstanding principal balance by the borrower. [\[FN126\]](#) While the main purpose behind the damage remedy under negligence is to enforce HOEPA's disclosure and substantive provisions, the rescission remedy was codified for an additional purpose, to give homeowners a means to "unburden themselves of security interests exacted by [unscrupulous sales] tactics." [\[FN127\]](#) Accordingly, a borrower's right to rescission is completely unaffected by transfer of the High Cost Mortgage to an assignee, even where the assignee exercises the requisite due diligence. [\[FN128\]](#) The borrower's right to rescind against the *179 creditor or assignee extends three years from the date of loan origination. [\[FN129\]](#)

Rescission can be a powerful remedy for borrowers who have access to refinancing. [\[FN130\]](#) To illustrate, consider a borrower who rescinds after two years a \$100,000 High Cost Mortgage at a 14.0% interest rate, which included \$5,000 in origination and other fees. Upon rescission, the borrower's total monthly payments of \$28,436, plus the \$5,000 in upfront fees are offset against the original \$100,000 loan. The borrower is then obligated to the lender for \$71,563. Since the rescission

remedy entitles the borrower to full credit against the loan principal for all payments made to the lender up to the date of rescission, the borrower effectively gets the benefit of two years worth of no-interest financing. Moreover, the borrower is freed from any prepayment penalties or other costs from refinancing into a more suitable mortgage.

IV. HOEPA's Expansion of the Borrower's Right of Action Against Assignees

A. Comprehensive Market-Based Mechanism for Policing the High Cost Mortgage Market

HOEPA was the first statutory provision to create a comprehensive right of action against assignees of residential mortgages. A very limited provision for assignee liability existed within section 1641(a) of TILA prior to HOEPA's passage. However, the provision was expanded in significant ways under HOEPA to fashion assignee liability as a substantial enforcement mechanism for anti-predatory lending laws against High Cost Mortgages. [\[FN131\]](#)

First, HOEPA expands the universe of predatory lending ***180** violations for which assignees are derivatively liable. Under TILA, an assignee is only liable for a creditor's violations of TILA itself; the assignee is not liable for a creditor's violations of other federal or state laws. [\[FN132\]](#) In contrast, assignees of High Cost Mortgages are "subject to all claims and defenses, whether under Truth in Lending law or other law that could be raised against the original lender." [\[FN133\]](#)

Second, section 1641(d)(1) imposes a higher duty of due diligence on assignees who seek exemption from liability in the form of a "safe harbor." [\[FN134\]](#) Under section 1641(a) of TILA, assignees are only liable for lending violations "apparent on the face of the [TILA] disclosure statement" (the "TILA Safe Harbor"). [\[FN135\]](#) Congress narrowed the safe harbor for High Cost Mortgages by requiring that an assignee demonstrate, "by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by this subchapter, the itemization of the amount financed, and other disclosure of disbursements that the mortgage was a [High Cost Mortgage] (the 'HOEPA Safe Harbor.')" [\[FN136\]](#)

Thus, HOEPA arguably places a greater burden on assignees to review not just the particular loan documents in a given High Cost Mortgage transaction, but to scrutinize the parties who played a role in originating the mortgage to ensure that these parties did not engage in any abusive practices. [\[FN137\]](#)

***181** Third, HOEPA expands an assignee's "regulatory" role by imposing liability for the predatory practices of both lenders and brokers. [\[FN138\]](#) Like TILA, HOEPA imposes liability on assignees for the claims and defenses that the borrower could assert against the "creditor." However, HOEPA defines "creditor" more broadly than TILA. A HOEPA "creditor" includes any person who originates two or more High Cost Mortgages in a twelve month period, or any person who originates one or more High Cost Mortgages through a mortgage broker. [\[FN139\]](#) By contrast, TILA applies only to a person who "regularly" extends credit, and to whom the debt is initially payable. [\[FN140\]](#) Therefore, while TILA only regulates the actual providers of credit, [\[FN141\]](#) HOEPA also regulates entities that originate and/or solicit High Cost Mortgages. When combined with the assignee liability provision, HOEPA's new definition of "creditor" means that assignees of High Cost Mortgages are liable for lending abuses of mortgage brokers and finance companies, even if these entities do not extend credit to the borrower. This result is critical to HOEPA's enforcement scheme because of the substantial, and often abusive, role that mortgage brokers play in marketing and originating subprime loans. [\[FN142\]](#)

B. Liability Against Assignees for "All Claims and Defenses"

HOEPA's most substantial expansion of assignee liability is the Act's applicability to claims or defenses arising under any source of law. HOEPA's plain language explicitly entitles borrowers to sue assignees for "all claims or defenses" that the assignee could raise against the original creditor, regardless of the source of the claim ***182** against the original creditor.

[FN143] HOEPA's unambiguous language distinguishes section 1641(d) from the already-existing section 1641(a) under TILA, which only imposes assignee liability for a "civil action for a violation of this title." [FN144] Thus, in contrast to claims pursuant to the pre-1994 statute, claims under the 1994 statute may be brought against an assignee based on any violation of TILA, other federal lending laws, or even state lending laws.

The legislative history surrounding HOEPA's passage clearly supports a broad scope of assignee liability. The Senate Report on HOEPA expressly states that section 1641(d) will impose liability on assignees for all of the original lender's violations of federal and state lending laws. [FN145] Drawing on products liability law, the Senate Report reflects the understanding that all parties involved in placing a "defective" mortgage into the stream of commerce must be held liable as a mechanism for ensuring that the mortgage is "safe" for consumer borrowers. In addition, the Senate Report explains that HOEPA's assignee liability provision is intended to "mirror" the FTC Holder Rule. [FN146] As explained in well-reasoned dicta by the court in *Pulphus v. Sullivan*, Congress' intent in mirroring the Holder Rule was to expand assignee liability to cover all claims and defenses independent of their source of law:

The plain language of the statute and its legislative history, however, suggest that [section 1641(d)(1)] makes assignees liable for the original lender's violations of state law . . . The Senate Report says that the provision. . . "mirrors a rule promulgated by the Federal Trade Commission for 'consumer installment' loans." That FTC rule, called the holder rule, subjects holders of consumer credit contracts "to all claims and defenses which the debtor could assert against the seller of [the] goods or services." The holder rule, the FTC explained, applies "to all claims or defenses connected with the transaction, whether in tort or contract. When, under state law, a consumer would have a tort claim against the seller that would defeat a seller's right to further payments or allow *183 the consumer to recover affirmatively, this claim is preserved against the holder." [FN147]

While only a few courts have considered this same question, the Northern District of Georgia reached a similar conclusion to the *Pulphus* Court, holding that section 1641(d) resulted in joint and several liability for all parties involved in originating and financing a High Cost Mortgage. [FN148]

Notwithstanding, some courts have limited an assignee's liability under HOEPA's section 1641(d) by holding that the section does not apply to a creditor's violations of federal and state laws aside from HOEPA itself. [FN149] These courts rely on the argument that HOEPA "merely abrogates" the HDC defense and thus does not *184 create a cause of action that did not exist in the underlying law. [FN150] Since the underlying laws generally apply only to violations by the originating creditor, these courts reason that section 1641(d) cannot be used to hold the assignee liable.

There are several problems with the "mere abrogation" interpretation of section 1641(d). Most obviously, the plain language of section 1641(d) does not make any reference to abrogation of the HDC doctrine. Rather, it contains broad language giving borrowers a right against assignees for "all claims and defenses" that could have been brought against the creditor. [FN151] The "mere abrogation" interpretation of section 1641(d) also contradicts the structure of the provision, which sets up a two-prong system for measuring damages against assignees. In particular, section 1641(d)(2) provides one formula for calculating damages with respect to a violation of HOEPA, and a separate calculation for damages with respect to "all other causes of action." [FN152] Thus, section 1641(d)'s structure presumes that liability would be imposed by section 1641(d) on assignees for non-HOEPA causes of action. [FN153] Finally, the "mere abrogation" *185 interpretation also disregards Congress' specific purpose in expanding assignee liability under HOEPA: to encourage self-policing of the High Cost Mortgage market. [FN154]

Section 1641(d)'s drafters were attuned to failings in the existing lending laws because the laws were easily circumvented by the HDC defense. [FN155] For this reason, HOEPA's drafters used broad, unqualified language in section 1641(d). An

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interpretation that qualifies section 1641(d) by giving borrowers "all claims and defenses [arising under HOEPA]" limits the provision beyond its plain language, its legislative intent, and its underlying policy.

C. A Narrower Safe Harbor: The Assignee's Duty of Due Diligence

HOEPA expands assignee liability in a second significant way by imposing a higher duty of due diligence on assignees who seek exemption from liability through the statute's safe harbor. [\[FN156\]](#) In particular, HOEPA only exempts assignees of High Cost Mortgages from liability when the assignee engages in ordinary due diligence of all documentation surrounding the mortgage's origination, and based on this due diligence, concludes that the mortgage is not High Cost. To the extent the assignee knowingly, or negligently, purchases a High Cost Mortgage, the assignee remains liable for predatory ***186** lending violations associated with the mortgage. [\[FN157\]](#) Thus, the expanded due diligence requirement creates an incentive for buyers to more fully investigate the seller's origination practices to ensure that the mortgage was originated in accordance with all lending laws. Alternatively, the safe harbor encourages assignees to completely abstain from purchasing High Cost Mortgages.

There is limited case law interpreting or applying the stricter safe harbor under HOEPA. A prevailing interpretation of HOEPA's ordinary due diligence standard was provided in *Cooper*, which held on a motion for summary judgment that ordinary due diligence under HOEPA requires: (1) review of documentation required by Truth-in-Lending Act, itemization of amount financed, and other disclosure of disbursements; (2) analysis of these items; and (3) whatever further inquiry is objectively reasonable given the results of the analysis. [\[FN158\]](#) In *Cooper*, the assignee moved for summary judgment under section 1641(d)'s safe harbor, arguing that the loan's HOEPA status was not determinable based on reasonable due diligence. [\[FN159\]](#) The court denied the assignee's motion because the assignee's corporate designee had a poor understanding of HOEPA. The court reasoned that it could not have reasonably evaluated and analyzed the borrower's loan documents for HOEPA status. [\[FN160\]](#) Still, *Cooper* was only a decision to allow the borrower to proceed against the assignee at the summary judgment stage. Thus, it remains unsettled how future courts will apply this broader test announced in *Cooper*, or some alternative standard of due diligence.

At least one other court has implied that HOEPA's due diligence standard is much narrower than the three-part standard pronounced in *Cooper*. [\[FN161\]](#) Specifically, in *Jenkins v. Mercantile Mortgage Company*, the court exempted the assignee of a High Cost Mortgage from liability based solely on the information in the fraudulent loan documents provided to the assignee by the seller. [\[FN162\]](#) ***187** Ms. Jenkins sued Provident Bank, the assignee of her mortgage, claiming violations under federal and state predatory lending laws. [\[FN163\]](#) Ms. Jenkins' \$92,000 home-improvement loan included over \$9,200 of pre-paid finance charges, which clearly placed the loan within HOEPA's scope. [\[FN164\]](#) However, in assigning the loan to Provident Bank, the original lender materially altered the documents disclosing Ms. Jenkins' finance charges, such that Ms. Jenkins' loan did not appear to meet HOEPA's points and fees trigger. [\[FN165\]](#) Without discussion of HOEPA's ordinary due diligence requirement, the *Jenkins* court held that Provident Bank could not be liable on these facts because Provident Bank could not determine that Ms. Jenkins loan was High Cost on the face of the documents that it had received. [\[FN166\]](#) Moreover, the court rejected Ms. Jenkins' argument that Provident Bank should have been placed on notice that further due diligence was necessary based on discrepancies between the documents Provident Bank received and those that Ms. Jenkins received. [\[FN167\]](#)

Clearly, the *Jenkins* court's interpretation of ordinary due diligence cannot be correct. Such a reading creates a strong incentive for originators to disguise loans. Not surprising in the face of decisions like *Jenkins*, disguising of High Cost loans has recently been recognized as a problem in the secondary market. [\[FN168\]](#) At the same time, the *Jenkins* decision encourages assignees to know as little as possible about the parties with whom they contract. Accordingly, industry lawyers have

already recognized the benefit to their lending clients, which can be achieved by distancing themselves from originators. For example, in a 1997 *Banking Law Journal* on "Dealing with Mortgage Brokers," the author advises:

an extremely cautious lender may wish to establish as many barriers as possible between itself and its brokers. It can avoid closing loans in its own name; it can exercise less control over the origination process whether in ***188** underwriting, pricing, or documentation; it can avoid pricing schemes that encourage or allow "overages" for its broker's salespeople; it can establish its own internal monitoring program for broker originated loans; it can avoid table funding relationships altogether. [\[FN169\]](#)

The latter part of this advice, altered pricing schemes and monitoring programs, is a desirable and intended response to section 1641(d)'s expanded due diligence requirement. However, decisions such as *Jenkins* are more likely to encourage assignees to follow the former advice as well, establishing as many barriers as possible between themselves and their originators, thus encouraging abusive behavior to occur below the lender's radar.

Interpretations of HOEPA's safe harbor that focus only on due diligence of the actual documentation provided to the assignee, as in *Jenkins*, are insufficient because they allow the sneakiest violators off the hook. [\[FN170\]](#) These interpretations do not capture HOEPA's suggested intent "to encourage investors in the secondary market for HOEPA loans to more carefully scrutinize the backgrounds and qualifications of those with whom they choose to do business." [\[FN171\]](#) Thus, given Congress' clear intent to create a stricter due diligence standard than existed under TILA, the three-part standard announced in *Cooper* is arguably more appropriate. In applying the standard, due diligence under HOEPA should require a reasonable inquiry into the background and qualifications of the mortgage seller, such that it is reasonable for the assignee to rely on the documentation provided in making the HOEPA determination.

V. Limitations to Assignee Liability Under HOEPA

A. Limitations to Under the Current Statute

HOEPA was the first attempt by any federal or state legislature to implement assignee liability for subprime home equity loans. As such, the statute's drafters sought to balance the competing ***189** needs of borrowers and the demands of lenders. Thus, although HOEPA expands assignee liability, the Act has several limitations that result from the drafters' balancing of competing interests.

HOEPA has received some criticism from consumer advocates for not going far enough to fight predatory lending. [\[FN172\]](#) Foremost, this is a criticism of HOEPA's triggers, which are either set far above market interest rates, [\[FN173\]](#) or are incredibly difficult to calculate, [\[FN174\]](#) and therefore only capture a small percentage of the subprime home equity loan market. [\[FN175\]](#) More specifically with regard to assignee liability, the statute contains several significant limitations:

(1) A one-year statute of limitations for damages and three-year statute of limitations for rescission; [\[FN176\]](#)

(2) HOEPA's strict liability rescission remedy only applies to violations of HOEPA, rather than to "all claims and defenses" for the damages remedy; [\[FN177\]](#) and

***190** (3) HOEPA's augmented due diligence requirement is ambiguous. [\[FN178\]](#)

In part, these limitations resulted unintentionally from sloppily drafting HOEPA within TILA's existing structural and remedial scheme. At the same time, the limitations were intentional compromises between advocates for borrowers and lenders. Either way, these limitations, along with HOEPA's very high triggers, have combined to leave few borrowers with the ability to take advantage of the rights created by HOEPA's assignee liability provisions. [\[FN179\]](#)

VI. Alternative Bases of Assignee Liability Under State Law

Newly-enacted state anti-predatory lending statutes and recent decisions under state common law provide alternatives for holding assignees liable for the predatory practices of loan originators. However, state law bases for assignee liability claims may also be limited because of federal preemption.

*191 A. Assignee Liability for High Cost Loans Under State Statutory Law

HOEPA has been expanded by more recent anti-predatory legislation at the state level. [\[FN180\]](#) State statutes generally model HOEPA by carving out a category of high cost mortgages, and then enhance or supplement HOEPA's regulatory scheme for mortgages covered by the statute. [\[FN181\]](#) At least twenty-three states and localities have introduced anti-predatory lending legislation that includes a provision for assignee liability. [\[FN182\]](#) Most notably, New Jersey, New Mexico and Illinois have passed legislation that provides more expansive rights for borrowers against assignees. [\[FN183\]](#) These more debtor-protective state statutes provide one alternative for establishing liability against assignees of predatory loans. However, like HOEPA, the state statutes apply only to a subcategory of high-cost subprime mortgages.

The New Jersey Home Ownership Security Act of 2002 (the "New Jersey Act"), provides an example of one of the more carefully-crafted state assignee liability laws. [\[FN184\]](#) First, section 46:10B-27 provides for full assignee liability unless the purchaser shows that it exercised reasonable due diligence in determining whether the loan was high cost. [\[FN185\]](#) This forces negligent *192 assignees to fully internalize the cost of their misbehavior, and therefore creates an optimal incentive for self-policing. By contrast, HOEPA's capped damages for negligent assignees arguably encourages insufficient due diligence. In addition, [New Jersey Statute section 46:10B-27](#) defines "ordinary due diligence" more expansively than section 1641(d) of HOEPA, by requiring purchasers to implement policies and practices to avoid purchasing predatory high cost loans. [\[FN186\]](#) Even if assignees meet this higher due diligence duty, they are still liable for limited damages equal to the amount of debt remaining in the borrower's account plus reasonable attorney's fees. [\[FN187\]](#) This strict liability provision provides broader protection to *193 borrowers, such as Ms. Jenkins, who face court decisions finding that the assignee exercised the statutorily-required level of due diligence. [\[FN188\]](#) Unlike rescission under § 1635, which a borrower can only take advantage of if he is able to secure a source of refinancing, the New Jersey Act's strict liability provision insures that all victims of predatory lending will have recourse against their predatory loans. In addition, extending the statute of limitations to six years insures that the New Jersey Act provides greater enforceability of its protections, particularly in foreclosure actions where even the six year statute of limitations does not apply." [\[FN189\]](#)

B. Assignee Liability for All Loans Under Common Law

The landmark decision of *In re First Alliance Mortgage Co.* presented the first instance where a financier was held accountable for the predatory practices of a mortgage originator under common law fraud. [\[FN190\]](#) In *First Alliance*, a class of *First Alliance* mortgagors sued the investment bank Lehman Brothers. The class claim arose under the California common law theory of aiding and abetting fraud. Specifically, class plaintiffs alleged that Lehman Brothers financed *First Alliance Mortgage Company* through a warehouse line of credit, purchased the company's loan production, and securitized portfolios of the company's loans as mortgage-backed securities, even though Lehman Brothers knew about the company's fraudulent conduct. [\[FN191\]](#) The *First Alliance* court held that Lehman Brothers could be liable for *First Alliance's* lending violations because "Lehman's credit facility made *First Alliance's* fraudulent practices possible." [\[FN192\]](#) The *194 jury proceeded to award *First Alliance* borrowers damages totaling \$51 million, with Lehman's responsibility allocated at 10%. [\[FN193\]](#)

California is not unique in recognizing that financiers of illegal activity can be held liable for the illegal conduct that they finance. [\[FN194\]](#) Thus, *First Alliance* creates a powerful precedent for using state law to pursue claims against assignees that

knowingly finance the activities of predatory lenders. Accordingly, consumer advocates have recently focused attention on state common law as an alternative source of assignee liability. [FN195] Still, unlike HOEPA, which imposes the burden on assignees to show reasonable due diligence, aiding and abetting fraud requires plaintiffs to prove that the assignee had knowledge of the originator's wrongful conduct. [FN196] The First Alliance plaintiffs succeeded in proving knowledge because of the widespread fraud litigation already pending against First Alliance at the time Lehman Brothers extended the warehouse credit facility. [FN197] Proving knowledge of the wrongful conduct in future cases will be the difficult battle for most plaintiffs and their attorneys.

Common law includes several other theories which may also be used to challenge the assignee's ability to hide behind the protections of the HDC doctrine. [FN198] For example, borrowers may challenge the assignee's status as an HDC by showing that the assignee had knowledge of defenses against the loan when the assignee bought the predatory mortgages. [FN199] Alternatively, borrowers *195 may argue that the originating creditor and its assignee are so interconnected that the agreement by which the assignee "buys" loans from the lender is really a pretense, and thus that the assignee should not be able to take advantage of the protections of the HDC doctrine. [FN200] To the extent that statutory assignee liability is limited in the future, common law theories will continue to present a unique opportunity for all borrowers to pursue claims against assignees for violations by lenders; unlike statutory claims, the common law claims are not limited to a subcategory of high cost subprime mortgages.

C. Preemption Challenges to Assignee Liability Under State Law

Several states have supplemented HOEPA's assignee liability scheme with a more expansive system to police the secondary market and to protect consumers. As illustrated with the example of the New Jersey Act, many of these provisions are more protective than HOEPA. Likewise, state common law may also broaden the basis for claims against assignees. However, borrowers litigating assignee liability under state laws will likely step into the minefield of preemption debates which challenge the constitutionality of state anti-predatory lending laws. Specifically, the Office of Thrift Supervision ("OTS"), the Office of the Comptroller of the Currency ("OCC"), and the National Credit Union Administration ("NCUA") have all issued opinions substantially preempting several state anti-predatory lending laws. [FN201] For example, the OCC's Final Rule regarding the applicability of state laws to national banks provides *196 that "state laws that obstruct, impair, or condition a national bank's ability to fully exercise its federally authorized real estate lending powers" do not apply to national banks. [FN202] While these preemption decisions focus on attacks on state statutes, the agencies' broad claim to preempt "state laws" may be extended to state common law as well. There is still some uncertainty regarding the regulation of non-national bank assignees that purchase high cost loans originated by institutions regulated by these federal agencies. [FN203] However, the OTS has already made clear that its rationale for preemption extends to regulation of purchasers of mortgage loans originated by covered institutions. [FN204] Thus, the legal community must also keep a close watch on the preemption debates to determine the viability of assignee liability claims under state law.

Conclusion

The lack of accountability in the subprime mortgage market creates incentives for brokers to push subprime mortgages onto too many consumers, at too high a cost, for purposes unrelated to home ownership. [FN205] As a result of these equity-stripping mortgages, thousands of consumers are forced into foreclosure each year. [FN206] HOEPA was Congress' initial response to this widespread and devastating problem. Despite its limitations, HOEPA's expanded provisions for assignee liability can be a powerful mechanism for restoring accountability to the subprime mortgage market.

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[FN1]. See Margot Saunders, The [Increase in Predatory Lending and Appropriate Remedial Actions](#), 6 *N.C. Banking Inst.* 111, 114 (2002). The number of home foreclosures rose 338% between 1980 and 1999. *Id.* Subprime loan originations increased over 400% during the same time period. See *infra* Part II.B.

[FN2]. Saunders, *supra* note 1, at 141.

[FN3]. See Riegle Community Development and Regulatory Improvement Act of 1994, [Pub. L. No. 103-325, §151-58](#), 108 Stat. 2190-98 (1994) (enacted as a part of the federal Truth in Lending Act (TILA), [15 U.S.C. §§1601-1649](#); 12 C.F.R. §226, Reg. Z). See also [S. Rep. No. 103-69, at 22-23 \(1994\), reprinted in 1994 U.S.C.C.A.N. 1881, 1993 WL 444316](#) (describing the pattern of abuse that emerged from testimony in Senate hearings).

[FN4]. See [15 U.S.C. §§1601-1649](#); 12 C.F.R. §226, Reg. Z. See also [S. Rep. No. 103-69](#), at 22-23.

[FN5]. Joint U.S. Dep't of Housing and Urban Dev.--U.S. Dep't of the Treasury Task Force on Predatory Lending, Curbing Predatory Home Mortgage Lending, at 13 (June 2000), <http://www.huduser.org/publications/hsgfin/curbing.html> [hereinafter Curbing Predatory Home Mortgage Lending].

[FN6]. *Id.*

[FN7]. Board of Governors of the Federal Reserve System, Regulation Z, 12 C.F.R. Part 226, Final Rule at 7, <http://www.federalreserve.gov/boarddocs/press/boardacts/2001/200112142/attachment.pdf> (last visited Jan. 6, 2005) [hereinafter "Regulation Z, Final Rule (Dec. 21, 2001)"].

[FN8]. National banks, thrifts, and their affiliates accounted for about twenty percent of subprime loan originations in 2002. See Edward M. Gramlich, Fed. Reserve Sys. Governor, Subprime Mortgage Lending: Benefits, Costs, and Challenges, Remarks at the Financial Services Roundtable Annual Housing Policy Meeting, Chicago, Illinois (May 21, 2004), <http://www.federalreserve.gov/boarddocs/speeches/2004/20040521/default.htm> [hereinafter Remarks by Governor Edward Gramlich].

[FN9]. See Saunders, *supra* note 1, at 115-16.

[FN10]. See Curbing Predatory Home Mortgage Lending, *supra* note 5, at 24; Promoting Homeownership by Ensuring Liquidity in Subprime Mortgage Market: Joint Hearing Before Subcomm. on Fin. Inst. and Consumer Credit--Subcomm. on Hous. and Cmty. Opportunity, 108th Cong. 4 (2004) (statement of Michael Calhoun, Gen. Counsel, Ctr. For Responsible Lending), available at <http://www.responsiblelending.org/pdfs/062304-calhoun-housetestimony.pdf> [hereinafter Statement of Michael Calhoun].

[FN11]. See Curbing Predatory Home Mortgage Lending, *supra* note 5, at 1; Regulation Z, Final Rule (Dec. 21, 2001), *supra* note 7, at 1-2.

[FN12]. Kurt Eggert, [Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine](#), 35 *Creighton L. Rev.* 503, 511 (2002) (citing Daniel S. Ehrenberg, If the Loan Don't Fit, Don't Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending, 10 *J. Affordable Hous. & Cmty. Dev. L.* 117, 119-20

(2001)).

[FN13]. Cf. Baher Azmy & David Reiss, [Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002](#), 35 Rutgers L. J. 645, 650 (Winter 2002). In *The Two-Income Trap: Why Middle Class Mothers and Fathers Are Going Broke* (2003), Elizabeth Warren and Amelia Warren Tyagi point out that it would never be acceptable to sell consumers a toaster that had a one in twelve chance of blowing up. See *Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit: Joint Hearing Before the House Subcomm. on Hous. and Cmty. Opportunity and the House Subcomm. on Fin. Inst. and Consumer Credit, 108th Cong. 7-8 (2003)* (statement of Margot Saunders, Managing Attorney, Nat'l Consumer L. Ctr.), available at http://www.nclc.org/initiatives/predatory_mortgage/content/AccessToCredit.pdf [hereinafter Statement of Margot Saunders] (citing Elizabeth Warren & Amelia Warren Tyagi, *The Two-Income Trap: Why Middle Class Mothers and Fathers Are Going Broke*, Chapter 6, (2003)). To the extent the manufacturer knowingly sold consumers a toaster that posed such a risk, the manufacturer's conduct would be even more objectionable and punished more severely. *Id.* Similarly, it cannot be acceptable to originate mortgage loans where one in twelve loans end up in foreclosure. Knowingly originating loans with such a high risk is predatory. *Id.*

[FN14]. *Curbing Predatory Home Mortgage Lending*, supra note 5, at 21-22.

[FN15]. *Equity Predators: Stripping, Flipping and Packing Their Way to Profits: Hearing Before the Special Committee on Aging, 105th Cong. (1998)* (statement of "Jim Dough," finance industry employee), available at <http://aging.senate.gov/public/events/hr14jd.htm> [hereinafter Statement of "Jim Dough"].

[FN16]. "Loan flipping" is analogous to "churning" in the securities brokerage industry. Loan flipping is one of the most common means used by lenders or brokers to strip equity from a consumer's home. See [S. Rep. No. 103-69, at 25 \(1994\), reprinted in 1994 U.S.C.C.A.N. 1881, 1993 WL 444316](#). As confessed by a predatory lender in testimony before the U.S. Senate, "[w]e were instructed and expected to flip as many loans as possible. One of my supervisors imposed a daily requirement that each branch employee obtain at least two applications from present borrowers to refinance their loans. In other words, each branch employee was supposed to try to flip at least two loans each day." Statement of "Jim Dough," supra note 15.

[FN17]. *Predatory Mortgage Lending: The Problem, Impact and Responses, Hearing Before Senate Comm. On Banking, Hous., and Urban Affairs, 107th Cong. (2001)* (prepared testimony of Ms. Mary Podelco, private citizen), http://banking.senate.gov/01_07hr/072601/podelco.htm.

[FN18]. See Azmy, supra note 13, at 706 (citing studies by both government sponsored agencies and the lending industry regarding the prevalence of steering).

[FN19]. Diana Henriques & Lowell Bergman, *Mortgaged Lives: A Special Report. Profiting From Fine Print With Wall Street's Help*, N. Y. Times, March 15, 2000, at Section 1 Page A1.

[FN20]. See Azmy, supra note 13, at 706 (citing studies by both government sponsored agencies and the lending industry regarding the prevalence of steering).

[FN21]. A yield spread premium is a cash bonus that a broker receives from a lender as a reward for placing borrowers in a loan with a higher interest rate that the lender would expect based on the borrowers risk profile. Eighty-five to ninety percent of subprime loan transactions involve yield spread premium payments. Ctr. For Responsible Lending, *CRL Issue Brief #11, Yield Spread Premiums: A Powerful Incentive for Equity Theft* (June 2004), http://www.responsiblelending.org/pdfs/ib011-YSP_Equity_Theft-0604.pdf. See also Howell E. Jackson & Jeremy Berry, *Kick-*

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backs or Compensation: The Case of Yield Spread Premiums (Jan 8, 2002), http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf (examining the debate surrounding the legality of yield spread premiums under the Real Estate Settlement Procedures Act of 1974).

[FN22]. Curbing Predatory Home Mortgage Lending, *supra* note 5, at 4. Statement of Michael Calhoun, *supra* note 10, at 2.

[FN23]. See Statement of Margot Saunders, *supra* note 13, at 7-8. See, e.g., Eggert, *supra* note 12, at 581 (reviewing a study of foreclosure trends in Baltimore that found that foreclosure occurs 1.8 years after origination of a subprime loan versus 3.2 years after origination for a prime loan on average).

[FN24]. Statement of Margot Saunders, *supra* note 13, at 7-8.

[FN25]. *Id.* at 8.

[FN26]. Eric Stein, Ctr. For Responsible Lending, Quantifying the Economic Cost of Predatory Lending, 2-3 (2001), <http://www.predatorylending.org/pdfs/Quant10-01.pdf>.

[FN27]. Remarks by Governor Edward Gramlich, *supra* note 8.

[FN28]. Curbing Predatory Home Mortgage Lending, *supra* note 5, at 25.

[FN29]. Even assuming a 30% benefit in the form of lower taxes because of the deductibility of home mortgage interest, the borrower still pays \$37,842 in interest for the long-term loan versus \$8,548 for the short-term loan. See Statement of Margot Saunders, *supra* note 13, at 5.

[FN30]. Statement of "Jim Dough," *supra* note 15, at P5-6. For another equally troubling example, see Henriques, *supra* note 19 (describing the sales scheme used in the First Alliance fraud, in which the finance company staffed its offices with experienced car salespeople and trained them to deliver a highly-manipulative, twenty-seven page script known as "The Track").

[FN31]. Statement of Margot Saunders, *supra* note 13, at 3.

[FN32]. See *id.*; Curbing Predatory Home Mortgage Lending, *supra* note 5, at 3, 19.

[FN33]. See Eggert, *supra* note 12, at 577-78. Several other legal and economic factors including tax incentives created by the deductibility of mortgage interest and the deregulation of financial institutions have also contributed to the exponential growth in subprime home equity lending. *Id.* at 578-80.

[FN34]. *Id.* at 535. Prior to securitization-based financing, borrowers obtained mortgage loans from a thrift or other local lending institution, which was responsible for the entire mortgage production process--originating the mortgage, funding the mortgage, and servicing the mortgage to its maturity as part of the institution's portfolio of assets. *Id.* at 536. The move toward securitization based-financing of home mortgages began in 1970 when Government National Mortgage Association (GNMA) executed the first publicly-traded mortgage-backed securitization. *Id.* at 536-37.

[FN35]. Statement of Michael Calhoun, *supra* note 10, at 4 (noting loan originations increased from \$35 billion to \$203 billion over the same time period). See also Charles Schorin, Laura Heins, & Amol Prasad, Morgan Stanley, Morgan Stanley Home Equity Handbook at 2 (2003) (stating home equity lending now accounts for over 40% of the U.S. Asset Backed Securities market, the largest single securitized asset class) [hereinafter Morgan Stanley Home Equity Handbook].

[FN36]. Statement of Margot Saunders, *supra* note 13, at 3.

[FN37]. As explained by Jeffrey Zeltzer, executive director of the National Home Equity Mortgage Association, "lenders and mortgage brokers went out to try to make as many loans as they could" to meet Wall Street's burgeoning demand for subprime mortgages in the later half of the 1990s. Henriques, *supra* note 19, at A1.

[FN38]. *Id.*

[FN39]. See Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit: Joint Hearing Before the Subcommittee on Housing and Cmty. Opportunity and the Subcommittee on Fin. Inst. and Consumer Credit. 108th Cong. 8-10 (2003) (statement of Kurt Eggert, Associate Professor of Law at Chapman University School of Law), available at <http://financialservices.house.gov/media/pdf/110503ke.pdf>.

[FN40]. See Michael G. Jacobides, Mortgage Banking Unbundling: Structure, Automation and Profit, *Mortgage Banking*, Jan. 31, 2001, at 29.

[FN41]. See Eggert, *supra* note 12, at 539.

[FN42]. See *id.* at 538-39. See also Dominick A. Mazzagetti, [Dealing with Mortgage Loan Brokers: Legal and Practical Issues](#), 114 *Banking L.J.* 923, 931-32 (1997) (grouping the relationship between lenders and brokers into five categories, which represent a sliding scale in terms of the lenders involvement in the origination of the loan). See also relationship between Lehman Brothers and First Alliance Mortgage Company discussed *infra* Part VII.B.

[FN43]. See Eggert, *supra* note 12, at 538.

[FN44]. *Id.* at 539.

[FN45]. *Id.* at 540-41.

[FN46]. *Id.* at 543-44.

[FN47]. See *id.* at 542-43 (stating that MBS investors typically include mutual funds, pension funds, insurance companies, or other institutions, and that after the investor reviews the securities and decides to invest, the investor remains completely passive, and a third party is hired by the securitization trustee to service the mortgage pool and pass cash flows through to investors).

[FN48]. *Id.* at 543.

[FN49]. Jacobides, *supra* note 40 (as explained by a senior mortgage banking executive, "[t]he industry has been broken apart into a multitude of different entities. Mortgage origination is often distinct from mortgage funding. And mortgage funding is often quite distinct from mortgage servicing....").

[FN50]. See Eggert, *supra* note 12, at 546.

[FN51]. See *id.* at 547. See also Morgan Stanley Home Equity Handbook, *supra* note 35, at 5.

[FN52]. Eggert, *supra* note 12, at 535; 545-46.

[FN53]. Henriques, *supra* note 19, at 14 (citing Joshua Zinner, the coordinator of a foreclosure prevention project at South Brooklyn Legal Services).

[FN54]. *Id.* at 13 (citing William J. Ahearn, a spokesman for Lehman Brothers).

[FN55]. Statement of Margot Saunders, *supra* note 13, at 13-14.

[FN56]. The modern HDC doctrine is codified in section 3-305(b) of the Revised Article Three of the Uniform Commercial Code:

Defenses and Claims in Recoupment.... The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1) [that is "(i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings"], but is not subject to defenses of the obligor stated in subsection (a)(2) [that is, defenses of the obligor stated in another section of Article 3 or "that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract"] or claims in recoupment stated in subsection (a)(3) [that is claims "of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument"] against a person other than the holder.

[FN57]. Statement of Margot Saunders, *supra* note 13, at 13-14.

[FN58]. See, e.g., [Midfirst Bank, SSB v. C.W. Haynes & Co., Inc.](#), 893 F.Supp. 1304, 1312 (D.S.C. 1994) (applying the HDC defense in a commercial context to hold that: "Article Three of the UCC controls transfers of negotiable instruments, and the mortgage notes are clearly negotiable. If UCC Article Three should not apply in this case and the holder in due course doctrine is no longer warranted, then any abolishment of that body of law should come from the legislature, not the court"). See also Eggert, *supra* note 12, at 560-70 (discussing cases where the HDC doctrine was applied against consumer mortgage borrowers).

[FN59]. See Philip S. Porter, The [Two Faces of Truth--in Lending](#), 12 S. C. Lawyer 18, 23 (Mar./Apr. 2001).

[FN60]. For example, in a well known treatise on securitization, Jason Kravitt details the efforts that a securitization entity should take to become a Holder in Due Course. See Eggert, *supra* note 12, at 566-67.

[FN61]. *Id.* at 508; 522-27; 553-59 (exploring the problem of the "Boom, Bust, and Bankruptcy Cycle" of predatory lenders through a case study of the Diamond Mortgage mortgage-backed securities fraud).

[FN62]. See *Mox v. Jordan*, 436 N.W.2d 114 (Mich. Ct. App. 1990). This case was first discussed by Kurt Eggert, [Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine](#), 35 Creighton L. Rev 503, 511 (2002), along with other examples of the unfairness that results from the HDC doctrine.

[FN63]. Diamond Mortgage and A.J. Obie & Associates infamously perpetrated a Ponzi scheme whereby Diamond promised above market-returns to investors in its mortgages. The returns were paid from funds contributed by later investors, until the pyramid collapsed. See Eggert, *supra* note 12, at 522-31. Diamond Mortgage often engaged in outright theft from potential borrowers, as in the case of the Mox's. *Id.* at 524. The company would solicit home equity loans, record mortgages against the borrowers, immediately sell the mortgage to investors, and never give the borrowers a dime of their money. [Id.](#) at 525.

[FN64]. Mox, 436 N.W.2d at 115.

[FN65]. Id.

[FN66]. Id.

[FN67]. Id.

[FN68]. Id.

[FN69]. Mox, 436 N.W.2d at 115-16.

[FN70]. See Eggert, *supra* note 12, at 508, 522-7, 553-9.

[FN71]. See Erick Bergquist, Preparing for a Bad-Loan Boom, *Am. Banker*, Oct. 6, 2000, at 1.

[FN72]. See Siddhartha Venkatesan, [Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to more Effectively Police Predatory Lending](#), 7 *N.Y.U. J. Legis. & Pub. Pol'y* 177, 211-12 (2003-2004).

[FN73]. The FTC expressly stated that the HDC doctrine operated inefficiently because the assignee was better able than the consumer to protect itself from abusive retailers and to control the practices of abusive retailers. See *id.* at 212-14. As a result, the FTC adopted the Holder Rule, which requires sellers of consumer credit loans to provide notice to buyers that the buyers may be liable for any claims or defenses that the borrower has against the seller for an amount up to the amount paid by the debtor under the credit agreement. 16 *C.F.R. §433.2* (2004). Because the Holder Rule is crafted as a notice requirement, some courts have interpreted the rule narrowly. See Venkatesan, *supra* note 72, at 220.

[FN74]. See Jeffrey P. Naimon, Jacob Thiessen & Jennifer Beall, Assignee in Residential Mortgage Transactions, *Rev. of Banking & Fin. Services*, Vol. 19, No. 3, Mar. 1, 2003, at 89A.

[FN75]. Statement of Margot Saunders, *supra* note 13, at 14.

[FN76]. Tamara Loomis, Predatory Lending Law Has Investment Firms in Arms, *N.Y. L. J.*, Mar. 27, 2003, at 1, WESTLAW, 3/27/2003 NYLJ 1, col. 3 (emphasis added).

[FN77]. See Eggert, *supra* note 12, at 613-28 (providing an in-depth argument that the HDC doctrine is inefficient because of the assignee's superior ability to take precautions against abusive lenders, to innovate mechanisms to avoid or mitigate risk of abuse, and to respond to assignment of risk).

[FN78]. For further discussion of assignees as the least cost avoiders see Venkatesan, *supra* note 72, at 206-10.

[FN79]. The FTC made a similar argument in crafting the Holder Rule. See Venkatesan, *supra* note 72, at 211-12, n. 190 (citing Preservation of Consumers' Claims and Defenses, 40 *Fed. Reg.* at 53,522 to state: "[m]isconduct costs are not incorporated in the price of goods or services.... [thus] where certain seller misconduct costs cannot be eliminated from the market we would require that such costs be internalized, so that prices paid by consumers more accurately reflect the true social costs of engaging in a credit sale transaction").

[FN80]. Mox, 436 N.W.2d at 115-16.

[FN81]. The FTC likewise reached a similar conclusion about the effect of assignee liability on the cost of credit and access to credit in regards to consumer credit transactions. See Venkatesan, *supra* note 72, at 214-15.

[FN82]. Henriques, *supra* note 19, at Section 1 Page A1.

[FN83]. Promoting Home Ownership: Hearing before the H. Subcomm. On Housing and Community Opportunity (2004) (Statement of Bob Ney, Chairman) (stating that "[i]n a well-intentioned attempt to end abusive lending practices, some state and local governments passed laws extending liability for fraudulent origination practices to those in the secondary market that purchase the loan in a pool, but had no hand in actually writing the loan. These strict assignee liability laws threaten the availability of credit in the subprime market. Acting as a usury cap on mortgage lending, these laws effectively prevent people from receiving mortgages").

[FN84]. However, as argued throughout this article, consumers would benefit if less credit were pushed onto them because "destructive credit is worse than no credit at all." Saunders, *supra* note 1, at 141.

[FN85]. In particular, Standard & Poor's points to punitive damages or aggregated damages from class action lawsuits as examples of substantial uncertain risks that cannot be accounted for in forecasting cash flows. See, e.g., Natalie Abrams & Maureen Colement, Standard & Poor's, Standard and Poor's Addresses New Jersey Predatory Lending Law (2003), http://www.bondmarket.com/regulatory/SP_Addresses_NJ_Law.pdf.

[FN86]. [Ga. Code Ann. §§7-6A-1 to -13](#) (2004). See also Venkatesan, *supra* note 72, at 198-200.

[FN87]. See, e.g., Standard & Poor's, Press Release: Standard & Poor's to Disallow Georgia Fair Lending Act (Jan. 16, 2003), <http://www.mortgagebankers.org/industry/news/03/0116b.html>; Moody's Investors Service, Press Release: Moody's Expands Consideration of Assignee Liability for Residential Mortgages in Securitizations (Jan. 30, 2003), <http://www.mortgagebankers.org/industry/news/03/0130a.pdf>.

[FN88]. See Venkatesan, *supra* note 72, at 199-200. See also Standard & Poor's, *supra* note 87.

[FN89]. Compare [Ga. Code Ann. §7-6A-6\(b\)](#) (2004) with [15 U.S.C. § 1641\(d\)](#) (2004).

[FN90]. See Venkatesan, *supra* note 72, at 200.

[FN91]. Telephone Interview with Debbie Goldstein, Center for Responsible Lending (Sept. 27, 2004).

[FN92]. See, e.g., Standard & Poor's, Press Release: S&P Addresses Amendment to Maine Truth in Lending Act Will Rate Structured Finance Transactions that Include Maine Loans (Sept. 12, 2003), <http://www.mortgagebankers.org/industry/news/03/0912d.html>.

[FN93]. See Standard & Poor's, Press Release: Standard and Poor's Implements Credit Enhancement Criteria and Revises Representation and Warranty Criteria for Including Anti-Predatory Lending Law Loans in U.S. Rated Structured Finance Transactions (May 13, 2004), http://www.mbaa.org/industry/reports/04/sp_0513b.pdf [hereinafter Standard and Poor's Implements Credit Enhancement Criteria].

[FN94]. See Statement of Michael Calhoun, *supra* note 10, at 3 (citing SMR Research Corporation, Subprime Mortgage Loans, (2004)).

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[FN95]. See *supra* Part II.A and II.C.

[FN96]. See Standard and Poor's Implements Credit Enhancement Criteria, *supra* note 93. See also [Michael Gregory, If Trusts Were To Break Wide Open: The Shake-Up in Subprime Lending and Its Impact on ABS, Asset Sales Report, June 26, 2000](#), available at 2000 WL 3953601.

[FN97]. See Home Equity Loan Securitization: Structural Features and Credit Enhancement, in Morgan Stanley Home Equity Handbook, Section II, 37-112 (2004).

[FN98]. See, e.g., Standard & Poor's, Press Release: Standard & Poor's Permits Additional New Jersey Mortgage Loans Into Rated Single Family Transactions Available (Nov. 25, 2003), <http://www.mortgagebankers.org/industry/news/03/1125a.html>.

[FN99]. *Id.*

[FN100]. *Id.*

[FN101]. See [S. Rep. No. 103-69](#), *supra* note 3, at 28 (stating that "[t]he Committee expects that establish [sic], trustworthy originators sell their loans by entering into recourse agreements with the purchasers").

[FN102]. [15 U.S.C. §§1601-1667](#), Reg. Z, 12 C.F.R. §226.

[FN103]. Creditors must provide borrowers with a standard disclosure statement that clearly states the dollar amount financed by the borrower, the cost of financing in both percentage and dollar terms, and a notice of the consumer's right to rescind the transaction within three days of settlement. *Id.* TILA applies to any credit transaction by a creditor who extends credit (1) to consumers (2) regularly (3) subject to a finance charge (4) primarily for personal, family, or household purposes. *Id.*

[FN104]. For this reason, statutes such as TILA are typically inadequate to protect victims of predatory lending. See Deborah Goldstein, [Protecting Consumers From Predatory Lenders: Defining the Problem and Moving Towards Workable Solutions](#), 35 *Harv. C.R.-C.L. L. Rev.* 225, 238-45 (2000).

[FN105]. Riegle Community Development and Regulatory Improvement Act, [Pub. L. No. 103-325, §151-58](#), 108 Stat. 2160 (1994) (enacted as a part of the federal Truth in Lending Act (TILA), [15 U.S.C. §§1601-1649](#); Reg. Z, 12 C.F.R. §226). See also [S. Rep. No. 103-69](#), *supra* note 18, at *2, 21. At the time of HOEPA's passage, the federal regulatory landscape also included regulations regarding kickbacks to brokers as part of the Real Estate Settlement Procedures Act (RESPA). [12 U.S.C. §§2601-2617](#) (2004).

[FN106]. [15 U.S.C. §1639](#).

[FN107]. *Id.* See also [15 U.S.C. §1602\(aa\)](#) (defining High Cost Mortgage). Compare [15 U.S.C. §1631](#) with [15 U.S.C. §1639](#).

[FN108]. [15 U.S.C. §1602\(aa\)](#); [12 C.F.R. §226.32\(a\)](#).

[FN109]. [15 U.S.C. §1602\(aa\)](#); [12 C.F.R. §226.32\(a\)](#). See also [Cooper v. First Gov't Mortgage & Investors Corp.](#), 238 F.Supp.2d 50, 62-65 (D.D.C. 2002). The Federal Reserve Board amended HOEPA in 2001 to reduce the APR trigger from ten percent to eight percent. See Regulation Z, Final Rule (Dec. 21, 2001), *supra* note 7.

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[FN110]. For current mortgage rates see Mortgage Bankers Association, available at <http://www.mbaa.org/> (last visited Nov. 20, 2005). For current U.S. Treasury benchmark rates see Federal Reserve Board Statistical Release H.15 Selected Interest Rates, available at <http://www.federalreserve.gov/releases/h15/data.htm> (last visited Nov. 20, 2005). The HOEPA trigger for a first-lien mortgage is eight points above "the yield on Treasury securities having comparable periods of maturity to the loan maturity..." . [12 C.F.R. §226.32\(a\)\(1\)\(i\)](#). Because the federal government stopped issuing thirty-year Treasuries, the Federal Reserve Board staff has interpreted the Regulation Z trigger language to mean that lenders should use the yield for twenty-year constant maturities in place of the yield for thirty-year maturities. See Azmy, *supra* note 13, at 676-77.

[FN111]. [S. Rep. No. 103-169](#), *supra* note 3, at *21.

[FN112]. See Regulation Z, Final Rule (Dec. 21, 2001), *supra* note 7. The Rule expands the definition of High Cost Mortgage by providing for a lower APR trigger and a broader definition of costs included in the points and fees trigger. See *id.* The Rule also adds a restriction on flipping and asset-based lending. See *id.*

[FN113]. See H.R. 1182, 109th Cong. (1st Sess. 2005). See also <http://www.responsiblelending.org/pdfs/pb010-MillerWattFrank0305.pdf> (last visited Nov. 18, 2005).

[FN114]. [15 U.S.C. §1639\(c\)-\(h\)](#); [12 C.F.R. §226.32](#).

[FN115]. [Id. §1639\(a\)](#) (stating that "the creditor shall provide the following disclosures in conspicuous type size: If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan").

[FN116]. [15 U.S.C. §1639\(b\)](#).

[FN117]. [S. Rep. No. 103-169](#), *supra* note 3, at *28.

[FN118]. *Id.* (noting that "[b]y imposing assignee liability, the Committee seeks to ensure that the High Cost Mortgage market polices itself.... Providing assignee liability will halt the flow of capital to such lenders").

[FN119]. [15 U.S.C. §1641\(d\)\(1\)](#).

Any person who purchases or is otherwise assigned a mortgage referred to in [section 1602 \(aa\)](#) of this title shall be subject to all claims and defenses with respect to that mortgage that the consumer could assert against the creditor of the mortgage, unless the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by this subchapter, the itemization of the amount financed, and other disclosure of disbursements that the mortgage was a mortgage referred to in [section 1602 \(aa\)](#) of this title. The preceding sentence does not affect rights of a consumer under subsection (a), (b), or (c) of this section or any other provision of this subchapter. (emphasis added).

[FN120]. [15 U.S.C. §1641\(d\)\(1\)](#).

[FN121]. *Id.*

[FN122]. [Id. §1641\(d\)\(2\)\(A\)](#).

[FN123]. [Id. §1641\(d\)\(2\)\(B\)](#).

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[FN124]. Id. [§1639\(j\)](#) (stating that any violation of HOEPA's disclosure requirements or its substantive prohibitions constitute a "failure to deliver material disclosures," which triggers TILA's rescission remedy). The rescission remedy is sometimes an alternative to damages because several courts have held that where a borrower rescinds the mortgage, the borrower no longer has any further recoverable damages. See [In Re Murray, 239 B.R. 728, 735 \(Bankr. E.D. Pa. 1999\)](#) (citing [In re Steinbrecher, 110 B.R. 155, 159-60 \(Bkrcty. E.D. Pa. 1990\)](#)). However, where there is no "overlap" between the HOEPA claims and the state law claims, a borrower is entitled to both rescission and damages. See [15 U.S.C. §1635\(g\)](#) (stating that a court may award relief in addition to rescission for violations of TILA); Cf. [Murray, 239 B.R. at 735](#) (citing [In re Brown, 134 B.R. 134, 146 \(Bankr. E.D. Pa. 1991\)](#) accepting that TILA rescission eliminates a claim for actual damages under state law where state law and TILA claims "overlap").

[FN125]. [15 U.S.C. § 1635](#).

[FN126]. Id. at [§1635\(b\)](#).

[FN127]. See [Bryant v. Mortgage Capital Res. Corp., 197 F.Supp.2d 1357, 1363 \(N.D. Ga. 2002\)](#) (citing [Sellers v. Wollman, 510 F.2d 119, 123 \(5th Cir. 1975\)](#)) (stating that "[t]he purpose of making creditors civilly liable is to force disclosure of credit terms. The purpose of according borrowers [entering into specified transactions] a right of rescission is broader; not only is it designed to compel disclosure, but it also serves to blunt unscrupulous sales tactics by giving homeowners a means to unburden themselves of security interests exacted by such tactics").

[FN128]. See [15 U.S.C. §1641\(c\)](#) (stating that "[a]ny consumer who has the right to rescind a transaction under [section 1635](#) of this title may rescind the transaction as against any assignee of the obligation"); [15 USC §1641\(d\)](#) (stating that safe harbor does not affect a consumer's right to rescission under 1641(c)). See also [Stone v. Mehlberg, 728 F.Supp. 1341, 1348 \(W.D. Mich. 1989\)](#) (citing [S. REP. No. 96-368](#), 96th Cong., 2d Sess. 32- 33, reprinted in 1980 U.S.C.C.A.N. 236, 268 to state that [section 1641\(c\)](#) was added by Congress to "eliminate ambiguity on the question of assignee liability for rescission by stating explicitly [sic] that a consumer's exercise of this right is effective against an assignee," even when no violation is apparent on the face of the document presented to the assignee).

[FN129]. [15 U.S.C. §§1635\(f\), 1635\(i\)](#). See [Beach v. Ocwen Fed. Bank, 118 S.Ct. 1408, 1409 \(1998\)](#) (holding that [section 1635\(f\)](#) "completely extinguishes" any right to rescind after the three-year statute of limitations period, including rights to rescind that arise as a defense in the nature of recoupment or set-off).

[FN130]. Community development financial institutions such as Self-Help, <http://www.self-help.org/>, have home loan programs through which borrowers can obtain such refinancings.

[FN131]. Compare 1641(a) with 1641(d)(1); Cf. [Cooper v. First Gov't Mortgage & Investors Corp., 2002 WL 31520158, at *56 \(D.D.C. Nov. 4, 2002\)](#) (interpreting the meaning of HOEPA's safe harbor by comparing it to the existing language in TILA's safe harbor).

[FN132]. [15 U.S.C. §1641\(a\)](#) (stating that "any civil action for a violation of this subchapter... which may be brought against a creditor may be maintained against any assignee" (emphasis added)).

[FN133]. [S. Rep. No. 103-69](#), supra note 3, at *28 (emphasis added).

[FN134]. The "safe harbor" refers to a provision which provides an exemption from liability for assignees who engage in due diligence of the loans they purchase. Both TILA and HOEPA contain a "safe harbor" for diligent assignees, but apply a dif-

ferent standard to evaluate diligence. Compare [15 U.S.C. §1641\(a\)](#) [TILA Safe Harbor] with [15 U.S.C. §1641\(d\)\(1\)](#) [HOEPA Safe Harbor].

[FN135]. [15 U.S.C. §1641\(a\)](#). Section 1641(a) appears to have been somewhat of a compromise between the common law Holder in Due Course Doctrine and needed consumer protections at the time of TILA's passage.

[FN136]. [15 U.S.C. §1641\(d\)\(1\)](#). See also [Cooper, 2002 WL 31520158 at *55](#) (stating that "[i]n contrast to the apparent on the face standard, Congress intended to subject high cost mortgage (HOEPA loan) assignees to a more expansive standard of liability than provided pursuant to TILA").

[FN137]. C.f. [Cooper, 2002 WL 31520158 at *56](#) (stating that "[t]he comparison [between section 1641(d)(1) and [§1641\(a\)](#)] demonstrates that ordinary due diligence must require at least more than a mere review of relevant loan documents and disbursements). See supra Part V.B.

[FN138]. [S. Rep. No. 103-69](#), supra note 3, at *25 (HOEPA includes a more expansive definition of creditor "to prevent brokers from evading the legislation by matching each borrower with a different private individual acting as a lender").

[FN139]. [15 U.S.C. §1602\(f\)](#).

[FN140]. Id.

[FN141]. See, e.g., [Robey-Harcourt v. Bencorp Fin. Co., Inc., 212 F. Supp. 2d 1332, 1334 \(W.D. Okla. 2002\)](#) (dismissing TILA claims against mortgage brokers because they are not creditors within the meaning of TILA).

[FN142]. See [Curbing Predatory Home Mortgage Lending](#), supra note 5, at 81- 84. See also [Eggert](#), supra note 12, at 553 (noting that over sixty percent of subprime loans are originated by brokers).

[FN143]. See 1641(d). See also [S. Rep. No. 103-69](#).

[FN144]. [15 U.S.C. §1641\(a\)](#) (emphasis added).

[FN145]. See [S. Rep. No. 103-69](#), supra note 3, at *28.

[FN146]. Id. See also [Pulphus v. Sullivan, No. 02 C 5794, 2003 WL 1964333, at *21 \(N.D. Ill. Apr. 28, 2003\)](#).

[FN147]. [Pulphus, No. 02 C 5794, 2003 WL 1964333, at *21 n.11](#) (internal citations omitted).

[FN148]. [Bryant v. Mortgage Capital Res. Corp., 197 F.Supp.2d 1357, 1364- 65 \(N.D. Ga. 2002\)](#). See also [In re Barber, 266 B.R. 309, 320 \(Bankr. E.D. Pa. 2001\)](#) (holding that 1641(d) imposes liability on assignee of High Cost Mortgage for borrower's claims pursuant to Pennsylvania's unfair trade practices act).

[FN149]. See [Bank of N.Y. v. Heath, No. 98-CH-8721, 2001 WL 1771825, at * 2-3 \(Ill. Ct. Cl. Oct. 26, 2001\)](#) (barring RESPA and state law fraud claims against assignee); [Murray v. First Nat'l Bank of Chicago, 239 B.R. 728, 736 \(Bankr. E.D. Pa. 1999\)](#) (asserting that it is unlikely that 1641(d) could "ever sweep [RESPA] liability onto an assignee"); [Dowdy v. First Metro. Mortgage Co., No. 01C7211, 2002 WL 745851, at *3 \(N.D. Ill. Jan. 29, 2002\)](#) (barring state law fraud claim against assignee). Cf. [Dash v. Firstplus Home Loan Trust 1996-2, No. 1:01 CV 00923, 2003 WL 1038355 at *10 \(M.D.N.C. Mar. 6, 2003\)](#) (stating that "[b]y its terms, [section 1641\(d\)](#)... only affects... the 'holder in due course' defense, which a defendant as-

signee might raise against the holder of their loan'). See also [Harvey v. EMC Mortgage Corp., No. Civ. A. 02- 1386, 2003 WL 21460063, at *7 \(Bankr., E.D. Pa. 2003\)](#) (stating that "I also refuse to hold, as it appears the Heath court did and as the Defendants argue here, that [§1641\(d\)\(1\)](#) only results in creating assignee liability if the law under which the claim was asserted provides for assignee liability. To do so renders [§1641\(d\)\(1\)](#) superfluous and undercuts the legislative intention to hold purchasers of high cost loans liable for the infractions of the originators of the loan"); [Pulphus v. Sullivan, No. 02 C 5794, 2003 WL 1964333, at *21 \(N.D. Ill. Apr. 28, 2003\)](#) (highlighting the split among courts regarding whether [section 1641\(d\)](#) also applies to the original lender's violations of state law and non-HOEPA federal laws). A similar conflict in the case law has occurred regarding the scope of the FTC Holder Rule. Certain courts hold that the Holder Rule merely provides consumers with rights that he or she would have under state law while other courts hold that the Holder Rule creates an affirmative claim against any assignee regardless of the consumer's rights under state law. See Venkatesan, *supra* note 72, at 221.

[FN150]. [Bank of N.Y., No. 98-CH-8721, 2001 WL 1771825, at *2](#) (citing [Vandenbroeck v. Contimortgage Corp., 53 F. Supp. 2d 965, 968 \(W.D. Mich. 1999\)](#)).

[FN151]. As asserted by the Secretary of the Federal Trade Commission in response to a proposed amendment to section 1641(d): "The Board proposes a new comment that would 'clarify' that assignees of HOEPA loans are subject to all claims and defenses, including but not limited to violations of TILA and HOEPA, that the borrower could bring against the originating creditor. However, because the Commission believes that the existing law clearly establishes this principle, it is an unnecessary addition to the HOEPA commentary. The statutory language is unambiguous--an assignee is subject to 'all claims and defenses.'" Letter from Donald S. Clark to Jennifer J. Johnson (Mar. 9, 2001), available at <http://www.ftc.gov/be/v010004.htm>. It is not clear why the Board rejected the proposed clarification of [§ 1641\(d\)](#). However, the Board certainly must have considered the substantial risk that the proposed clarification would have created difficulties and uncertainty surrounding enforcement of claims against assignees by pre-clarification borrowers. As further asserted by the Secretary of the Federal Trade Commission: "[T]he proposed 'clarification' could potentially complicate the Commission's efforts to enforce HOEPA against secondary market purchasers. Assignees might argue that the Board's action suggests that, prior to the 'clarification,' the law was unclear on this issue and, thus, assignees who previously purchased HOEPA loans should not be held liable." *Id.* Arguably, the proposed clarification posed an unnecessary risk given [§ 1641\(d\)](#)'s already-unambiguous language.

[FN152]. [15 U.S.C. §1641\(d\)\(2\)](#).

[FN153]. HOEPA itself does not include punitive or treble damages. Arguably, HOEPA's drafters included section 1641(d)(2)'s cap to protect assignees against punitive or treble damages available under certain state laws. Cf. [Murray, 239 B.R. at 733](#) (applying section 1641(d)(2) to foreclose additional damages on claims brought by debtor under state and non-HOEPA federal law). Still, it is possible that section 1641(d)(2)'s two-part structure may be interpreted only to provide an additional limit, or maximum liability, for those states that do choose to pass their own laws imposing liability on assignees.

[FN154]. See [S. Rep. No. 103-69](#), *supra* note 3, at *28.

[FN155]. See [Harvey v. EMC Mortgage Corp., No. Civ. A. 02- 1386, 2003 WL 21460063, at *7 \(Bankr. E.D. Pa. June 9, 2003\)](#) (citing 139 Cong. Rec. S 5705-06 at 5711 (1993), HOEPA co-sponsor Senator D'Amato: "[u]nfortunately, current laws--the Real Estate Settlement and Procedure Act [RESPA] and Truth in Lending--do not provide adequate protection for consumers and borrowers in the second mortgage market. The con artists exploit these gaps to the financial and emotional detriment of our constituents and our communities").

[FN156]. Compare [§ 1641\(d\)](#) with [§ 1641\(a\)](#). See also [Cooper v. First Gov't Mortgage & Investors Corp., F. Supp. 2d 50, 56](#)

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(D.D.C. 2002) (stating that "[i]n contrast to the apparent on the face standard, Congress intended to subject high cost mortgage (HOEPA loan) assignees to a more expansive standard of liability than provided pursuant to TILA").

[FN157]. [15 U.S.C. §1641\(d\)](#). Sellers of High Cost loans are required to notify buyers of the risk of assignee liability. *Id.* at [§1641\(d\)\(4\)](#) (requiring that "[a]ny person who sells or otherwise assigns a mortgage referred to in [section 1602\(aa\)](#) of this title shall include a prominent notice of the potential liability under this subsection as determined by the Board").

[FN158]. [Cooper, 238 F. Supp. 2d at 56](#) (emphasis added).

[FN159]. *Id.*

[FN160]. *Id.* at 57.

[FN161]. *Id.* at 56.

[FN162]. [Jenkins v. Mercantile Mortgage Co., 231 F.Supp.2d 737, 746-47 \(N.D. Ill. 2002\)](#).

[FN163]. *Id.* at 743.

[FN164]. *Id.*

[FN165]. *Id.*

[FN166]. *Id.* at 746-47.

[FN167]. [Jenkins, 231 F. Supp. 2d at 746-47](#).

[FN168]. See Gregory, *supra* note 96.

[FN169]. Mazzagetti, *supra* note 42, at 926.

[FN170]. Cf. Eggert, *supra* note 12, at 591-92 (criticizing HOEPA for failing to provide protections against intentionally deceitful brokers and lenders and concluding that "HOEPA primarily deters the honest predatory lender").

[FN171]. See [Bryant v. Mortgage Capital Res. Corp., 197 F.Supp.2d 1357, 1365 \(N.D. Ga. 2002\)](#) (emphasis added).

[FN172]. See Saunders, *supra* note 1, at 128-29.

[FN173]. *Id.* at 129 (highlighting HOEPA's high triggers as one of three main problems with the statute).

[FN174]. E-mail Interview with Tara Twomey, Esq., Hale and Dorr Legal Services Center (Nov. 17, 2004) (explaining that calculation of HOEPA's points and fees trigger is so complex and unclear that there are probably only a few attorneys in the country who can do the calculation). See also [Bostic v. Am. Gen. Fin., Inc., 87 F. Supp. 2d 611, 616 n.11 \(S.D. W. Va. 2000\)](#) (accepting statement of borrower's attorney that no other attorney in the state of West Virginia sufficiently understood TILA and the Equal Credit Opportunity Act to aid him in litigating the case, thus necessitating that he bring in counsel from out of state).

[FN175]. See Regulation Z, Final Rule (Dec. 21, 2001), *supra* note 7 (noting that data compiled by the Office of Thrift Super-

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vision in 2001 indicated that the Board's 2001 amendment of Regulation Z would expand HOEPA's coverage to include 5% (or about \$15 billion of the current \$332 billion) of subprime loans).

[FN176]. [15 U.S.C. §1640\(e\) \(2000\)](#) (setting a one-year statute of limitations on affirmative actions for damages under [§1641\(d\)\(2\)](#)). [15 U.S.C. §1635\(f\) \(2000\)](#) (setting a three-year statute of limitations for rescission). The one-year limitation does not bar HOEPA claims for damages asserted defensively by recoupment or set-off. [15 U.S.C. §1640\(e\)](#). However, the three-year limitation on rescission does bar HOEPA claims asserted defensively by recoupment or set-off. [Beach v. Ocwen Fed. Bank, 523 U.S. 410, 417-18 \(1998\)](#).

[FN177]. Section 1639(j) deems any violation of section 1639's substantive protections for High Cost Mortgages a "failure to deliver the material disclosures... for the purpose of section [§1635](#)," which entitles the borrower to section 1635's rescission remedy. However, statutory protections against predatory lending which are not part of HOEPA (e.g. RESPA, ECOA, or other laws enacted by the Board, the OCC, the OTS, or other federal agencies) are nowhere deemed a "failure to deliver material disclosures." As a result, HOEPA's rescission remedy does not apply to these statutory protections. Arguably, this was a drafting mistake created by structuring HOEPA as an amendment to TILA.

[FN178]. See *infra* Part V.B. This ambiguity is layered onto an already confusing statutory scheme. For example, TILA's rescission remedy combined with TILA's safe harbor for assignees is itself confusing, leading some courts to erroneously apply TILA's safe harbor against a borrower's claim for rescission against an assignee. See [Pulphus v. Sullivan, No. 02 C 5794, 2003 WL 1964333, at *15-16 \(N.D. Ill. Apr. 28, 2003\)](#) (noting the court's disagreement with [Coleman v. Equicredit Corp. of Am., No. 01 C 2130, 2002 WL 88750 \(N.D. Ill. Jan. 22, 2002\)](#) in applying safe harbor to protect "innocent" assignee from borrower's right to exercise rescission).

[FN179]. A search of WESTLAW's database for all federal and state cases in which borrowers of High Cost Mortgages brought claims against assignees pursuant to section 1641(d) in November 2004 returned only twenty-six published and unpublished cases over the statute's ten-year history. Given an estimated \$15 billion in High Cost Mortgages outstanding, see *infra* note 175, and widespread assignment and abuse in the subprime market, see *supra* Part II.A, there seems to be a clear problem of under enforcement of HOEPA.

[FN180]. Telephone Interview with Debbie Goldstein, Center for Responsible Lending (Sept. 27, 2004).

[FN181]. *Id.*

[FN182]. See Standard and Poor's Implements Credit Enhancement Criteria, *supra* note 93.

[FN183]. Telephone Interview with Debbie Goldstein, Center for Responsible Lending (Sept. 27, 2004). See also Assignee Liability: Protecting Homeowners, Strengthening the Market, Center for Responsible Lending, Oct. 18, 2004, available at http://www.responsiblelending.org/pdfs/ib020-Assignee_Liability-1004.pdf.

[FN184]. See Home Ownership Security Act, [N.J. Stat. Ann. §46:10B-27 \(2004\)](#).

[FN185]. See *id.* at [§46:10B-27\(b\)](#):

Notwithstanding any other provision of law, any person who purchases or is otherwise assigned a high-cost home loan shall be subject to all affirmative claims and any defenses with respect to the loan that the borrower could assert against the original creditor or broker of the loan; provided that this subsection shall not apply if the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising reasonable due diligence could not

determine that the mortgage was a high-cost home loan. It shall be presumed that a purchaser or assignee has exercised such due diligence if the purchaser or assignee demonstrates by a preponderance of the evidence that it: (1) has in place at the time of the purchase or assignment of the loan, policies that expressly prohibit its purchase or acceptance of assignment of any high-cost home loan; (2) requires by contract that a seller or assignor of home loans to the purchaser or assignee represents and warrants to the purchaser or assignee that either (a) it will not sell or assign any high-cost home loan to the purchaser or assignee or (b) that the seller or assignor is a beneficiary of a representation and warranty from a previous seller or assignor to that effect; and (3) exercises reasonable due diligence at the time of purchase or assignment of home loans or within a reasonable period of time thereafter intended by the purchaser or assignee to prevent the purchaser or assignee from purchasing or taking assignment of any high-cost home loan.

[FN186]. *Id.*

[FN187]. See *id.* at §46:10B-27.

(c) Notwithstanding any other law to the contrary, but limited to amounts required to reduce or extinguish the borrower's liability under the home loan plus amounts required to recover costs including reasonable attorney's fees, a borrower acting only in an individual capacity may assert against the creditor or any subsequent holder or assignee of the home loan:

1) within six years of the closing of a high-cost home loan, a violation of this act in connection with the loan as an original action; and

2) at any time during the term of a high-cost home loan after an action to collect on the home loan or foreclose on the collateral securing the home loan has been initiated or the debt arising from the home loan has been accelerated or the home loan has become 60 days in default, any defense, claim or counterclaim (emphasis added).

(e) Nothing in this section shall be construed to limit the substantive rights, remedies or procedural rights, including, but not limited to, recoupment rights under the common law, available to a borrower against any creditor, assignee or holder under any other law. The limitations on assignee liability in subsection b. of this section shall not apply to the assignee liability in subsections a., c. and d. of this section.

[FN188]. See *supra* Part IV.C. (discussing [Jenkins v. Mercantile Mortgage Co., 231 F. Supp. 2d 737 \(N.D. Ill. 2002\)](#)).

[FN189]. Given the recent passage of the New Jersey Act, there is not yet any published case law analyzing the statute's scope.

[FN190]. [In re First Alliance Mortgage Co., 298 B.R. 652 \(C.D. Cal. 2003\)](#). See also Anne Linberry, Lehman Liable in Predatory Lending Case Reports Say Company Liable for 10% of First Alliance, FTC Settlement, MortgageDaily.com, June 19, 2003, <http://www.mortgagebankers.org/briefs/03/0619a.html>.

[FN191]. [First Alliance Mortg. Co., 298 B.R. at 660-664](#).

[FN192]. Not With Our Money, Caught in the act:

Lehman ordered to pay \$5 million for financing First Alliance's fraudulent loans (2002) (quoting Federal District Court Judge David O. Carter), http://www.notwithourmoney.org/04_lehman/lending5.html (last visited: Dec. 23, 2004).

[FN193]. See Linberry, *supra* note 190.

[FN194]. See Henriques, *supra* note 19.

[FN195]. Telephone Interview with Debbie Goldstein, Center for Responsible Lending (Sept. 27, 2004).

[FN196]. Compare [§1641\(d\)\(1\)](#) with [In re First Alliance Mortg. Co. 298 B.R. at 668](#).

[FN197]. See [In re First Alliance Mortg. Co., 298 B.R. at 668](#).

[FN198]. Substantial review and analysis of these theories is beyond the scope of this article. For further consideration of these theories and recent cases which illustrate their application see [Jeffrey P. Naimon, Jacob Thiessen & Jennifer Beall, Assignee Liability in Residential Mortgage Transactions, Review of Banking and Financial Services, Vol. 19, No. 3, Mar. 1, 2003, 2003 WL 14680965](#).

[FN199]. See [U.C.C. §3-302 \(2002\)](#) (defining a "holder in due course" as the holder of an instrument if:

- (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and
- (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a)) (emphasis added).

[FN200]. See, [Midfirst Bank, SSB v. C.W. Haynes & Co., Inc., 893 F.Supp. 1304, 1318 \(D.S.C. 1994\)](#) (discussing the "close-connectedness" doctrine); Jeffrey P. Naimon, Jacob Thiessen & Jennifer Beall, Assignee in Residential Mortgage Transactions, Review of Banking and Financial Services, Vol. 19, No. 3, Mar. 1, 2003 (discussing the application of the Holder in Due Course doctrine in "sham" transactions).

[FN201]. See Donald C. Lampe, [Federal Preemption and the Future of Mortgage Loan Regulation, 59 Bus. Law. 1207, 1210-11](#) (reviewing the preemption orders and opinion of various state agencies).

[FN202]. [Bank Activities and Operations, Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 \(OCC, Jan. 13, 2004\)](#) (to be codified at 12 C.F.R. pt. 7).

[FN203]. Id. (stating that the OCC ruling was silent on the issue of whether assignee liability provisions contained in state including anti-predatory lending laws apply to non-national bank assignees of loans originated by national banks).

[FN204]. See Priv. Ltr. Rul. P-2003-5, Preemption of New Jersey Predatory Lending Act, Home Owners' Loan Act/Savings Association Powers (Office of Thrift Supervision, July 22, 2003), available at <http://www.ots.treas.gov/docs/5/56305.pdf>.

[FN205]. See Saunders, *supra* note 1, at 115.

[FN206]. See <http://www.huduser.org/Publications/pdf/brd/12Bunce.pdf> (last visited Nov. 19, 2005) (examining data showing the increased number of foreclosures attributed to subprime loans).

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