

NEW TOOLS FOR COMBATING UNFAIR, DECEPTIVE AND ABUSIVE MORTGAGE PRACTICES: NEW AMENDMENTS TO REGULATION Z

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INTRODUCTION

In a press release issued July 14, 2008, the Board of Governors of the Federal Reserve System (“Board”) announced its approval of final rules amending Regulation Z.¹ The new rules promise to protect consumers against unfair, abusive, and deceptive lending practices while preserving consumers’ access to responsible lending and sustainable homeownership.² The new rules are the result of an extensive public discourse over the past several years³ and they were announced as the consequences of this decade’s rapid proliferation of subprime and Alternative-A

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¹ Press Release, Bd. of Governors of the Fed. Reserve Sys., Board Issues Final Rule Amending Home Mortgage Provisions of Regulation Z (July 14, 2008) *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm> (last visited Nov. 13, 2008); 12 C.F.R. pt. 226, Reg. Z (Truth in Lending).

² Statement by Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys. (July 14, 2008) *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/berbankereg20080714.htm> (last visited Nov. 13, 2008).

³ Press Release, Bd. of Governors of the Fed. Reserve Sys., *supra* note 1.

(“Alt-A”) mortgages were unfolding.⁴

Between 2001 and 2006 the U.S. experienced an unprecedented boom of mortgage activity fuelled by low interest rates and rapid housing value appreciation. During that time the mortgage market also experienced a sharp increase in subprime mortgage lending and in the use of Alt-A mortgage programs. As production increased in subprime and Alt-A loans, concerns began mounting by regulators and consumer advocates regarding lending practices and the types of products marketed to consumers. These concerns began materializing in late 2006 and early 2007 as rising interest rates and declining house values began affecting consumers in the subprime market. Since then, subprime and Alt-A mortgage delinquencies have reached unprecedented levels and mortgage foreclosures are now at an all time high.

Unfortunately, despite the new rules’ aim at protecting consumers in the mortgage market, it will likely provide little help to consumers already caught in the current subprime lending crisis. Yet, the introduction of the new rules is a step in the right direction, as it sends a clear message that the Board is committed to the task of forestalling further harm to consumers in the mortgage market and willing to take innovative steps within its authority to achieve this goal.

This article intends to introduce the reader to the new rules amending Regulation Z and discuss their intended impact on consumers in the mortgage market. Part I of this article is comprised of two general sections that are intended to provide the reader with the important factors that contributed to the promulgation of the new rules. The first section will introduce the reader to the problem of “predatory mortgage lending” and the “non-prime mortgage market.” These concepts are essential to understanding the events which occurred this decade in the mortgage market, which the second section discusses in more detail.

Part II will provide a general review of the Truth in Lending Act (“TILA”)⁵ and the Home Ownership and Equity Protection Act (“HOEPA”)⁶ as implemented under Regulation Z,

⁴ Bd. of Governors of the Fed. Reserve Sys., Regulation Z, Final Rule, 73 Fed. Reg. 44,522; 44,524 (July 30, 2008).

⁵ Truth In Lending Act (“TILA”), 15 U.S.C. §§ 1601-1649.

⁶ See Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 151-58, 108 Stat. 2190-98 (1994) (codified throughout 15 U.S.C. §§ 1601-1649).

which are the statutory and regulatory schemes under which the new rules will operate. Part III will provide a detailed review of key provisions of the final rules. In Part IV several of the key provisions reviewed in Part III will be discussed and their impact and benefits on consumers will be further explored.

I. BACKGROUND OF PROBLEMS AND EVENTS IN THE MORTGAGE MARKET

A. The Problem of Predatory Mortgage Lending

The problem of predatory mortgage lending has been the focus of debate by policy makers, consumer advocates and academics for more than a decade.⁷ The term predatory mortgage lending does not have a precise definition, because many lending terms and practices can be either legitimate or predatory depending on the context in which they are made.⁸ Instead, predatory mortgage lending generally refers to a range of overarching abusive lending terms and practices.⁹ Such abusive lending terms include, for example, charging excessive fees that are unjustified in relation to the services performed¹⁰ or charging

⁷ See, e.g., *Problems in Community Development Banking, Mortgage Lending Discrimination Redlining, and Home Equity Lending, Hearings Before the S. Comm. on Banking, Hous. and Urban Affairs*, 103d Cong. (Feb. 3, 17, 24, 1993); *Predatory Lending: Are Federal Agencies Protecting Older Americans From Financial Heartbreak? Hearing Before the Special Comm. on Aging*, 108th Cong. (Feb. 24, 2004), available at <http://purl.access.gpo.gov/GPO/LPS52284> [hereinafter *Hearing on Predatory Lending*]; *Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Financial Institutions, Hearing Before the Subcomm. on Fin. Inst. and Consumer Credit of the Comm. on Fin. Serv.*, 110th Cong. (Mar. 27, 2007), available at <http://purl.access.gpo.gov/GPO/LPS85194> [hereinafter *Hearing on Subprime and Predatory Lending*]; see also, Julia Patterson Forrester, *Mortgaging The American Dream: A Critical Evaluation Of The Federal Government's Promotion Of Home Equity Financing*, 69 TUL. L. REV. 373 (1994) [hereinafter *Mortgaging The American Dream*].

⁸ 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 17 (June 2000), <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (last visited Nov. 13, 2008) [hereinafter CURBING PREDATORY HOME MORTGAGE LENDING].

⁹ See *Hearing on Predatory Lending*, *supra* note 7, at 2 (statement of David Wood, Director, Fin. Mkt. and Cmty. Inv., U.S. Gen. Accounting Office).

¹⁰ See UNITED STATES GENERAL ACCOUNTING OFFICE (“GAO”) -

excessive interest rates that are far beyond justification based on the borrower's credit profile.¹¹ Abusive lending practices include, for example, lending without regard to the borrowers' ability to repay, a practice also known as "equity-based-lending",¹² or the practice of "loan flipping"¹³ and outright fraud and deception.¹⁴

Predatory mortgage lending poses serious concern to policy makers due to its effects on individual borrowers and communities.¹⁵ The harm caused by predatory mortgage lending on individual borrowers ranges from financial hardship, loss of home equity and at its worse, foreclosure and loss of homes.¹⁶ When individual foreclosure occurs the circle of harm widens and effects communities and neighborhoods by depressing property values, resulting in further loss of equity to other homeowners in the same community or neighborhood.¹⁷ Furthermore, macro effects caused by widespread foreclosures can include losses to investors in mortgage backed securities that are held by the general public at large through pension funds and investments in

FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 18 (Jan. 30, 2004), *available at* <http://www.gao.gov/new.items/do4280.pdf> [hereinafter GAO PREDATORY LENDING REPORT].

¹¹ *Id.*; *see also* *Predatory mortgage lending: the problem, impact, and responses*, *Hearing Before the Comm. on Banking, Hous., and Urban Affairs*, U.S. S., 107th Cong. 346 (July 26 and 27, 2001), *available at* <http://purl.access.gpo.gov/GPO/LPS26168> (statement of David Berenbaum, National Community Reinvestment Coalition).

¹² *See* Kurt Eggert, *Held Up In Due Course: Predatory Lending, Securitization, And The Holder In Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 588 (2002). Such practices strongly suggest that lender's sole reason for making the loan is its ability to realize the collateral through foreclosure upon a borrower's default. *See* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 22.

¹³ *See* GAO PREDATORY LENDING REPORT, *supra* note 10, at 19; *see also* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 21. Loan flipping is refinancing borrowers' loans repeatedly in a short period of time without any economic benefit for the borrowers in order to extract additional costs and fees that strip borrowers' equity from their homes.

¹⁴ *See* GAO PREDATORY LENDING REPORT, *supra* note 10, at 19; *see also* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8. Fraud and deception can be perpetrated through a variety of tactics, including changing loan application and settlement documents, engaging in "asset flipping" or "bait and switch" schemes to mislead consumers.

¹⁵ *See* *Hearing on Predatory Lending*, *supra* note 7, at 1 (statement of Sen. Larry Craig, Chairman).

¹⁶ *See* GAO PREDATORY LENDING REPORT, *supra* note 10, at 25.

¹⁷ *Id.*

mutual funds or other investments.¹⁸ Thus, widespread delinquencies and foreclosures can have adverse financial consequences on the general public vis-a-vis the financial markets at large, as experienced in the current financial market crisis.

The lack of a precise definition makes it hard to deal with the problem of predatory mortgage lending and to appraise its magnitude.¹⁹ In the course of searching for a solution to the problem of predatory mortgage lending many consumer advocates and policy makers have blurred the lines between predatory mortgage lending and subprime mortgage lending.²⁰ Nevertheless, there are those who see predatory and subprime lending as two distinct issues requiring two distinct solutions.²¹

B. The Non-prime Mortgage Market.

Today's mortgage market consists of three categories of mortgage lending: "prime", "Alt-A" and "subprime".²² Prime mortgage lending generally caters to borrowers who exhibit strong credit histories and have demonstrable repayment abilities²³ and represents approximately 75 percent of mortgage borrowers.²⁴ The remaining categories of "subprime" and "Alt-A", together referred to as "non-prime", will be discussed in more detail below.

1. Subprime Lending History in Brief

In general, subprime lending refers to both mortgages and

¹⁸ *Id.* at 37.

¹⁹ See *GAO PREDATORY LENDING REPORT*, *supra* note 10, at 23.

²⁰ See *Hearing on Subprime and Predatory Lending*, *supra* note 7, at 3 (statement Rep. Paul E. Gillmor).

²¹ See *Hearing on Subprime and Predatory Lending*, *supra* note 7, at 3 (statement Rep. Paul E. Gillmor).

²² See *Mortgage Market Turmoil: Causes and Consequence*, *Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 4 (Mar. 22, 2007) (statement of Roger T. Cole, Director, Div. of Banking Supervision & Regulation, Bd. of Governors of the Fed. Reserve Sys.) http://banking.senate.gov/public/_files/cole.pdf [hereinafter Cole, *Mortgage Market Turmoil*],

²³ Edward M. Gramlich, Governor, Fed. Reserve Bd., *Subprime Mortgage Lending: Benefits, Costs, and Challenges* (May 21, 2004), <http://www.federalreserve.gov/boarddocs/speeches/2004/20040521/default.htm> (last visited Nov. 13, 2008).

²⁴ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 4.

consumer lending, and subprime mortgage lending refers to a segment of the mortgage market. The term “Subprime Lending” was coined sometime in the early 1990s by the securitization industry, Wall Street firms or rating agencies in an attempt to distinguish securities backed by mortgages made to borrowers with excellent credit from securities backed by mortgages made to borrowers with impaired credit.²⁵ Subprime lending as a practice, however, has existed long before the term was coined, and subprime lenders prior to the early 1990s were usually known as “Finance Companies.”²⁶

Subprime lending carved its niche in the consumer credit market by providing a source of funds for those borrowers who were underserved by commercial banks and thrifts, borrowers with blemished credit characteristics, borrowers with low-to-moderate income, and minorities.²⁷ Prior to the late 1970s subprime lending consisted primarily of small, unsecured loans.²⁸ With the rise of inflation towards the end of the 1970s, interest rates on unsecured loans to riskier borrowers rose considerably and prevented subprime lenders in many states from being able to offer unsecured loans with rates within states usury limits.²⁹ The same inflation also helped home values to rise, creating large untapped pools of equity that could be used as security for lenders.³⁰ As a result, subprime lenders began making consumer loans secured by second lien mortgages.³¹ Using the homes with appreciated values as collateral enabled subprime lenders to offer borrowers lower rates than unsecured loans,³² thus avoiding

²⁵ SMR RESEARCH CORP., THE SUBPRIME LENDING INDUSTRY AND ALLEGATIONS OF PREDATORY PRACTICES 5 (Apr. 2000), *available at* <http://www.butera-andrews.com/legislative-updates/directory/Background-Reports/FINAL%20SMR%20Report.pdf>. [hereinafter SMR, THE SUBPRIME LENDING INDUSTRY].

²⁶ *Id.*

²⁷ *Id.* at 5-6; *see also* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 23 (low to moderate income borrowers and borrowers in predominantly minority neighborhoods often have limited access to mainstream financial institutions, because mainstream commercial banks and thrifts do not often have branches in those neighborhoods).

²⁸ SMR, THE SUBPRIME LENDING INDUSTRY, *supra* note 25, at 6.

²⁹ *Id.*

³⁰ Cathy Lesser Mansfield, *The Road To Subprime “Hel” Was Paved With Good Congressional Intentions: Usury Deregulation And The Subprime Home Equity Market*, 51 S.C. L. REV. 473, 521 (2000) [hereinafter *The Road To Subprime “Hel”*].

³¹ SMR, THE SUBPRIME LENDING INDUSTRY, *supra* note 25, at 6.

³² *Id.*; *see also* Patterson, *Mortgaging The American Dream*, *supra* note 7,

reaching or passing the interest rate ceiling placed by the states.³³

The subprime industry continued to grow during the 1980s primarily due to the deregulation of the mortgage industry with the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"),³⁴ which preempted states' interest rate caps on first lien mortgages;³⁵ and the enactment of the Alternative Mortgage Transaction Parity Act of 1982,³⁶ which preempted state laws regarding certain loan structures, such as adjustable rate mortgages ("ARM"s) and balloon loans.³⁷ In addition, the enactment of the Tax Reform Act of 1986, which eliminated most consumer interest deductions except for interest paid on loans secured by principal residents and second homes,³⁸ provided incentives for the accelerated use of debt consolidation loans to consolidate unsecured debt and further fueled the growth of the subprime mortgage market.³⁹

Nevertheless, during the 1980s subprime mortgage lending was still primarily concentrated in making small second lien mortgages.⁴⁰ It was in the early 1990s that favorable court decisions regarding the interpretation of "first lien" in DIDMCA expanded the role of subprime mortgage lending to concentrate on first lien mortgage refinancing, a move that considerably increased the dollar amount of subprime mortgage loans and its relative volume in the total mortgage market.⁴¹

at 383.

³³ SMR, THE SUBPRIME LENDING INDUSTRY, *supra* note 25, at 6.

³⁴ Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), Pub. L. No. 96-221, § 501(a), 94 Stat. 132, 161 (originally codified as a note to 12 U.S.C. § 1735f-7, now codified as 12 U.S.C. § 1735f-7a).

³⁵ See Mansfield, *The Road To Subprime "Hel"*, *supra* note 30, at 492; see also Souphala Chomsisengphet & Antony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 FED. RES. BANK OF ST. LOUIS REV. 31, 38 (2006).

³⁶ Alternative Mortgage Transaction Parity Act of 1982 ("AMTPA"), Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended at 12 U.S.C. § 3801-3806).

³⁷ See Mansfield, *The Road To Subprime "Hel"*, *supra* note 30, at 510.

³⁸ Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, (codified as amended in scattered sections of I.R.C.).

³⁹ See SMR, THE SUBPRIME LENDING INDUSTRY, *supra* note 25, at 8; see also Patterson, *Mortgaging The American Dream*, *supra* note 7, at 414-15.

⁴⁰ See CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 31; see also SMR, THE SUBPRIME LENDING INDUSTRY, *supra* note 25, at 8.

⁴¹ See, e.g., *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907 (3d Cir. 1990); see also Mansfield, *The Road To Subprime "Hel"*, *supra* note 30, at 518-19.

Structural changes in the mortgage market had also contributed to the growth of the subprime mortgage market. Specifically, the proliferation of non-depository mortgage companies and mortgage brokers aided significantly to in the expansion of the mortgage market as a whole and in particular to the expansion of subprime lending.⁴² In addition, the development of credit scoring and reporting, as well as the use of automated underwriting, helped fuel the expansion of the subprime mortgage market. The development of better credit scoring and reporting have enabled lenders to more efficiently assess price risk of borrowers;⁴³ it may have, however, also increased the number of subprime borrowers due to reported credit imperfections.⁴⁴

Most importantly, the growth of the subprime market has been fueled by access to cheaper capital through the secondary market and securitization.⁴⁵ Using the originate-to-distribute model, subprime lenders sold their mortgages to investors in the secondary market who pooled large numbers of mortgages together, turned them into mortgage backed securities and then sold those securities with an attached right to the resulting cash flow to investors both in the U.S. and around the world.⁴⁶ In a span of ten years, the subprime securitization industry grew from an estimated \$17.61 billion in 1995, to an estimated \$464.59 billion in 2005.⁴⁷

⁴² See generally Mansfield, *The Road To Subprime "Hel"*, supra note 30, at 526.

⁴³ See *Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures*, Before the Comm. on Fin. Serv., 110th Cong. 72 (Sep. 20, 2007), available at <http://purl.access.gpo.gov/GPO/LPS90774> [hereinafter *Hearing on Legislative and Regulatory Options*] (statement of Ben S. Bernanke, Chairman of Bd. of Governors, Fed. Reserve Sys.).

⁴⁴ See SMR, THE SUBPRIME LENDING INDUSTRY, supra note 25, at 7.

⁴⁵ See *Hearing on Legislative and Regulatory Options*, supra note 43, at 72.

⁴⁶ Ben Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., *The Recent Financial Turmoil and its Economic and Policy Consequences* (Oct. 15, 2007), <http://www.federalreserve.gov/newsevents/speech/bernanke20071015a.htm> (last visited Nov. 13, 2008).

⁴⁷ See Fed. Deposit Ins. Corp. *FDIC Outlook*, Fall 2006, 5 Charts 2 and 4, available at <http://www.fdic.gov/bank/analytical/regional/ro20063q/na/t3q2006.pdf> (the volume estimates provided are a combination of the data from Chart 2, which shows the total nonagency MBS issuance volume in dollar amounts per year from 1985 to 2005, available at http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fallo1_charto2.html (last visited Nov. 13, 2008); and the data from Chart 4, which provides a percentage breakdown of nonagency MBS issuance for 1995 and 2005, available at <http://www.fdic.gov/>

2. Subprime Mortgage Lending Characteristics

Subprime mortgage lending generally caters to borrowers who have sparse credit histories or histories of payment delinquencies, collections, charge-offs, judgments, bankruptcies and foreclosures.⁴⁸ The existence of any of these characteristics on borrowers' credit histories tends to result in low credit scores.⁴⁹ Low credit scores and high debt-to-income ratios⁵⁰ are evidence of a borrower's reduced payment capacities.⁵¹ Subprime mortgage loans are loans made to borrowers that may exhibit one or more, if not all, of the above characteristics.⁵² Not surprisingly, the demographics of subprime borrowers tend to reflect communities of minorities and populations that have low or volatile income and are less well-educated.⁵³

Because of the possibility of an array of different combinations of borrowers' characteristics and circumstances, subprime underwriting typically involves careful examination of the borrower's particular circumstances.⁵⁴ Although the mortgage industry seems to have embraced the use of automated underwriting,⁵⁵ a review of a recent mortgage technology survey

bank/analytical/regional/ro20063q/na/2006_fallo1_chart04.html (last visited Nov. 13, 2008)).

⁴⁸ See Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp. & Office of Thrift Supervision, Expanded Guidance for Subprime Lending Programs 2 (Jan. 31, 2001), <http://www.federalreserve.gov/boarddocs/press/boardacts/2001/20010131/attachment.pdf> [hereinafter "Expanded Guidance for Subprime Lending Programs"].

⁴⁹ See CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 33.

⁵⁰ Debt-to-income ratios ("DTI") are calculated by dividing the borrower's fixed monthly expenses by the borrower's gross monthly income.

⁵¹ See Expanded Guidance for Subprime Lending Programs (Jan. 31, 2001), *supra* note 48, at 2-3.

⁵² *Id.*

⁵³ See CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 33, 35-37.

⁵⁴ See U.S. DEP'T OF HOUS. AND URBAN DEV., SUBPRIME MARKET, THE ROLE OF THE GSES, AND RISK-BASED PRICING 28 (Mar. 2002), *available at* <http://www.huduser.org/Publications/pdf/subprime.pdf> ("lenders believe that subprime mortgage underwriting involves making 'story loans', in which underwriters must take into account factors beyond those that can be quantified") [hereinafter SUBPRIME MARKET, THE ROLE OF THE GSES].

⁵⁵ MORTEC, LLC, MORTECH 2007 FREQUENCIES REPORT 49 (Dec. 2007), http://www.mortech-llc.com/downloads/2007_vol2.pdf (survey of 328 mortgage lenders showed that in general 92% of lenders surveyed are using

suggests that only a small percentage of lenders surveyed use automated underwriting as the sole decision maker.⁵⁶ This suggests that, by and large, underwriting determination for subprime loans remains, as it was traditionally, the result of a relatively slower manual processing of the loan.⁵⁷

The subprime mortgage market also experiences delinquency rates higher than those experienced in the prime mortgage market,⁵⁸ which results in higher servicing costs due to an increase in collection efforts.⁵⁹ Another characteristic more unique to the subprime market is early repayment through refinancing.⁶⁰ Early repayment means that subprime lenders may not realize the full potential gain from the loan. This is a particular problem for lenders holding servicing portfolios and for the attractiveness of subprime loans securitization because both rely on the continuation of the underlining mortgage asset performance.⁶¹

The combination of subprime characteristics, including: higher cost of production due to slower process, higher servicing costs due to delinquencies, as well as early prepayments and history of credit problems, generally results in higher costs of credit for subprime borrowers in terms of rates and fees and loan terms.⁶² In theory at least, the degree of cost varies based on the degree of risk, this is also known as “risk-based pricing.” This is not to say, however, that the subprime market efficiently prices borrowers’ risk. Actually it was even suggested that that the term “risk-based pricing” in the context of the subprime market is somewhat of a “misnomer” as interest rates and fees charged vary widely and may not necessarily correlate to borrowers’ risk profiles.⁶³

automated underwriting systems to underwrite loans).

⁵⁶ *Id.* at 56 (according to the survey only 24.8% of lenders always use automated underwriting systems for underwriting determinations).

⁵⁷ *See* SUBPRIME MARKET, THE ROLE OF THE GSEs, *supra* note 54, at 28.

⁵⁸ *See* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 27; *see also* Office of the Comptroller of the Currency (“OCC”), Working Paper, Economic Issues in Predatory Lending 9 (July 30, 2003), <http://www.occ.treas.gov/workingpaper.pdf> [hereinafter OCC Working Paper].

⁵⁹ *Id.* at 12.

⁶⁰ *See* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 28; *see also* OCC Working Paper, *supra* note 58 at 11.

⁶¹ *See* OCC Working Paper, *supra* note 58 at 4, 11.

⁶² *See* CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 28.

⁶³ Patricia A. McCoy, *Rethinking Disclosure In A World Of Risk-Based*

Consequently, the characteristics of subprime mortgage lending, with its borrowers' demographics and higher rates and fees, makes it fertile ground for lending abuse where predatory lending is unfortunately prevalent.⁶⁴ This in turn places the subprime market in the focus of the debate over curbing predatory lending. However, although the connection between predatory mortgage lending and the subprime market is strong, there are those who agree that predatory mortgage lending is not synonymous with subprime mortgage lending⁶⁵ and find that subprime mortgage lending provides an important source of funds for consumers who are otherwise unable to secure credit in the prime mortgage market.⁶⁶

3. Alt-A Lending Characteristics

The remaining segment of the mortgage market is that of Alternative A or "Alt-A" mortgage lending.⁶⁷ This "loosely defined" category caters to borrowers that fall between prime and subprime.⁶⁸ These borrowers have marginal to very good credit histories but they do not meet prime underwriting documentation requirements, debt-to-income ratios, or loan-to-value ratios.⁶⁹ Alt-A mortgages include loans with reduced documentation features, such as "low doc/no doc", "no income no asset", "stated

Pricing, 44 HARV. J. ON LEGIS. 123, 127 (2007).

⁶⁴ See *Subprime Lending: Defining the Market and Its Customers*, Joint Hearing Before the Subcomm. on Hous. and Cmty. Opportunity and the Subcomm. on Fin. Inst. and Consumer Credit of the Comm. on Fin. Serv., 108th Cong. 4 (Mar. 30, 2004) (statement of Rep. Maxine Waters) ("While not all subprime loans are predatory, predatory lending is concentrated in the subprime loan market. Predatory lending preys upon poor and minority neighborhoods, where the best loans are rarely available: neighborhoods where the number of subprime loan outlets usually vastly exceed the number of banks available."); see also *id.* at 24-25 (statement of George Butts, ACORN Hous. Corp.).

⁶⁵ See *Hearing on Subprime and Predatory Lending*, *supra* note 7, at 9 (statement of Hon. John M. Reich, Director, OTS).

⁶⁶ See CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 51.

⁶⁷ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 4 (Alt-A category is also referred to as "near-prime").

⁶⁸ *Id.* (according to Cole the Alt-A category is "somewhat ill-defined").

⁶⁹ *Id.*; see also Fed. Deposit Ins. Corp., *FDIC Outlook*, Summer 2006, 29, available at <http://www.fdic.gov/bank/analytical/regional/r020062q/na/t2q2006.pdf>. Loan-to-value ratios ("LTV") are calculated by dividing the loan amount by the lesser of the purchase price or appraised value.

income” or “stated assets”; or loans made to borrowers with no credit scores or credit scores higher than subprime; loans with high loan-to-value ratios, that are greater than 80 percent and do not include mortgage insurance; loans made to borrowers with high debt-to-income ratios that are not considered subprime; or loans made on investment properties.⁷⁰

At least until the beginning of this decade Alt-A borrowers were generally classified as part of the subprime mortgage market.⁷¹ Although, there is evidence to suggest that Alt-A was an independent category from subprime, at least as far as securitization was concern.⁷² As a distinct category of the mortgage market, Alt-A substantially grew in the early to mid part of this decade, and was primarily fueled by securitization, which grew from an estimated issuance of \$490 million in 1995 to an estimated issuance of \$333.55 billion in 2005.⁷³

Even though Alt-A borrowers have marginal to excellent credit rating, due to the low level of documentation they can provide to substantiate their repayment abilities, their high debt-to-income, or high loan-to-value, they are considered a higher risk.⁷⁴ Consequentially, mortgage loans made to Alt-A borrowers generally have higher rates and fees.⁷⁵

However, mortgage loans made with limited to no verification of a borrower’s ability to repay, albeit the excellent credit history, poses serious concerns regarding the motives of lenders making such loans, as they could suggest reliance on collateral in cases of default and foreclosure.⁷⁶ Moreover, reduced

⁷⁰ See Fed. Deposit Ins. Corp., *FDIC Outlook*, Summer 2006, *supra* note 69, at 29.

⁷¹ See Glenn B. Canner, Wayne Passmore & Elizabeth Laderman, *The Role of Specialized Lenders In Extending Mortgages to Lower-Income And Minority Homebuyers*, 85 FED. RES. BULL. 709, 716 (1999); see also CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 27, 34.

⁷² See Fed. Deposit Ins. Corp., *FDIC Outlook*, Fall 2006, *supra* note 47, at 5 Chart 4.

⁷³ *Id.* at 5 Charts 2&4 (the volume estimates provided are a combination of the data from Chart 2, which shows the total nonagency MBS issuance volume in dollar amounts per year from 1985 to 2005, available at http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fallo1_charto2.html; and the data from Chart 4, which provides a percentage breakdown of nonagency MBS issuance for 1995 and 2005, available at http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fallo1_charto4.html).

⁷⁴ See Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *The 2006 HMDA Data*, 93 FED. RES. BULL. A73, 76 (2007).

⁷⁵ *Id.*

⁷⁶ See Office of the Comptroller of the Currency, Bd. of Governors of the

documentation loans made to borrowers whose income could be readily verified, such as employees, using a recent pay-stub, W-2 statement, or tax return, raises the question of whether no income verification loans Alt-A loans should be provided to such borrowers in the first place.⁷⁷ Thus similar to subprime mortgage lending, Alt-A mortgage lending has the propensity to trip the wire of abusive lending practices.

C. Review of Events in the Mortgage Market: A Story of Boom and Bust

The start of the new millennium brought with it an unprecedented boom of housing and mortgage activity, fuelled by low interest rates, rapid home value appreciation and product innovations.⁷⁸ Beginning in 2001 long-term mortgage interest rates began declining rapidly, from 8.1 percent in 2000 to as low as 5.25 percent in 2003.⁷⁹ The decline was caused in part by the increased use of mortgage securitization and the departure from the simple “book-and-hold” model⁸⁰ to the more complex “originate-to-distribute” model,⁸¹ which contributed considerably to the mortgage market liquidity at low interest rates.⁸² As mortgage rates began to decline many consumers across the United States took advantage of the falling rates by refinancing their existing mortgages, often taking cash out of their homes as

Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of Thrift Supervision & Nat'l Credit Union Admin., Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609, 58,614 (Oct. 4, 2006).

⁷⁷ See generally *id.* at 58,614-15.

⁷⁸ See, e.g., *Mortgage Market Turmoil: Causes and Consequence, Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 3-4 (Mar. 22, 2007) (statement of Emory W. Rushton, Senior Deputy Comptroller and Chief National Bank examiner, Office of the Comptroller of the Currency) http://banking.senate.gov/public/_files/rushton.pdf. [hereinafter Rushton, *Mortgage Market Turmoil*],

⁷⁹ See *Residential Loan Production-1970 to 2006*, National Mortgage News, Oct. 11, 2006, Volume 31 issue 3, available at <http://www.nationalmortgagenews.com/premium/archive/?id=154094> (last visited Nov. 13, 2008) [hereinafter *Residential Loan Production -1970 to 2006*].

⁸⁰ Where lenders originate mortgages and hold them on their books until repayment. Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., *The Subprime Mortgage Market* (May. 17, 2007), <http://www.federalreserve.gov/newsevents/speech/bernanke20070517a.htm> (last visited Nov. 13, 2008).

⁸¹ See *supra* text accompanying note 46.

⁸² See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 3; see also Fed. Deposit Ins. Corp. *FDIC Outlook*, Summer 2006, *supra* note 69, at 22.

well as lowering the rates on their mortgage loans.⁸³ Other consumers fulfilled their dream of homeownership, which reached 68.6 percent by end of 2003.⁸⁴ These market conditions resulted in a significant expansion of the mortgage market, which reached its record peak in 2003, where \$3.9 trillion in residential mortgages were funded.⁸⁵ As a consequence of the surge in mortgage demand and market expansion, mortgage lenders were prompted to expand their loan operations to take advantage of the market conditions.⁸⁶

However, as mortgage interest rates began to rise in 2004, mortgage origination volumes began to correspondingly decline.⁸⁷ Yet, demand for homes was still strong and home prices continued to rise in 2004, which made it difficult for borrowers to qualify for conventional loan products, such as fixed rates and regular ARMs.⁸⁸ In addition, secondary market investors' demand for mortgage debt was still strong.⁸⁹ By the end of 2004 mortgage loan origination volume reached \$2.79 trillion, a 28.5 percent decline from the 2003 record origination high.⁹⁰

These conditions left the mortgage market in a state of overcapacity, placing significant pressure on mortgage lenders, who had expanded their operations during the boom years of 2001 to 2003, to maintain production levels to keep their lending operations afloat.⁹¹ Responding to overcapacity concerns, rising home prices, competition from other lenders and investors' demand for mortgage debt, some mortgage lenders with originate-to-distribute infrastructures began easing their credit

⁸³ See Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 3-4.

⁸⁴ U.S. Census Bureau, Table 5, Homeownership Rates for the United States: 1968 to 2008, *available at* <http://www.census.gov/hhes/www/housing/hvs/qtr208/files/tab5.xls>.

⁸⁵ See *Residential Loan Production - 1970 to 2006*, *supra* note 79.

⁸⁶ See Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 4.

⁸⁷ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 5; *see also* Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 4.

⁸⁸ *Calculated Risk: Assessing Non-Traditional Mortgage Products*, Hearing Before the SubComm. On Hous. & Transp. And Subcomm. On Economic Policy of the Comm. On Banking, Hous. and Urban Affairs, 109th Cong. 2 (Sep. 20, 2006), (statement by Sandra L. Thompson, Acting Director, Fed. Deposit Ins. Corp.) http://banking.senate.gov/public/_files/thompson.pdf [hereinafter Thompson, *Calculated Risk*].

⁸⁹ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 5; *see also* Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 4.

⁹⁰ See *Residential Loan Production - 1970 to 2006*, *supra* note 79.

⁹¹ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 5; *see also* Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 4.

standards.⁹² These mortgage lenders began using “innovative” solutions to boost production.⁹³ These “innovative” solutions included relaxing underwriting standards and a shift towards origination of nontraditional mortgage products as means of “assisting” borrowers in purchasing higher-priced homes or continued access to idle home equity.⁹⁴

Products such as interest-only mortgage loans and payment-option ARMs, which were previously marketed to financially sophisticated borrowers as cash-flow tools, were being marketed to first-time home buyers as “affordable loan” products promising lower upfront monthly payments.⁹⁵ Yet, these “innovative” products were not appropriate for all borrowers.⁹⁶ While borrowers with seasonal or irregular income could find such payment schedules helpful, unsuspecting ordinary borrowers were exposed to “payment shocks” that were suddenly making their homes unaffordable and placing them in financial distress.⁹⁷ Moreover, mortgage lenders increasingly layered these nontraditional products with other high-risk practices such as no income verifications and high-loan to value ratios.⁹⁸

Similarly in the subprime mortgage market risk layering practices also took place where so called “2/28” and “3/27” hybrid ARMs were marketed to borrowers offering an initial low rate for a short fixed period of two or three years, also known as a “teaser” rate.⁹⁹ These loans, at the end of their short fixed period caused the “teaser” rate to reset and begin adjusting based on an index and margin.¹⁰⁰ While such mortgage products assisted subprime borrowers both to qualify for loans and to manage payments during the early life of the loan, these products also exposed subprime borrowers to payment shocks when the

⁹² See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 5.

⁹³ *Id.*

⁹⁴ See Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 4.

⁹⁵ See Thompson, *Calculated Risk*, *supra* note 88, at 2.

⁹⁶ See *Calculated Risk: Assessing Non-Traditional Mortgage Products*, Hearing Before the SubComm. On Hous. & Transp. And Subcomm. On Economic Policy of the Comm. On Banking, Hous. and Urban Affairs, 109th Cong. 5 (Sep. 20, 2006), http://banking.senate.gov/public/_files/ACF84D1.pdf (statement Allen J. Fishbein, Consumer Federation of America) [hereinafter Fishbein, *Calculated Risk*].

⁹⁷ *Id.*

⁹⁸ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 5.

⁹⁹ See Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 6; see also Fishbein, *Calculated Risk*, *supra* note 96, at 7.

¹⁰⁰ See Fishbein, *Calculated Risk*, *supra* note 96, at 7.

“teaser” rate adjusted.¹⁰¹ This was particularly true when rate adjustments of loans had no caps or very high caps at rest periods.¹⁰² Moreover, subprime hybrid ARMs were increasingly combined with features like interest only payments, substantial prepayment penalties or with prepayment penalties extending beyond the initial fixed period.¹⁰³ In addition, in an effort to boost production subprime lenders began relaxing underwriting criteria and began approving borrowers without fully documenting their income and properly checking their repayment ability.¹⁰⁴ Adding fuel to the fire, consumers were receiving inadequate information from lenders regarding these products’ features and terms.¹⁰⁵ The combination of these terms and practices would prove to be a disaster in the making.

By the end of 2005, the subprime market expansion reached its historical peak with 20 percent market share and \$625 billion in mortgage loan originations, up from 8 percent market share and \$312 billion of volume in 2003.¹⁰⁶ On the positive side, the subprime market expansion had also contributed to the growth in homeownership rates, which reached 69 percent by the end of 2005.¹⁰⁷ These positive effects, however, were to be short lived.

During the years 2000 through 2005 the housing market rose at an annual rate of 9 percent.¹⁰⁸ While the housing market was strong and interest rates were low, subprime borrowers facing rate reset and payment shocks were able to refinance their mortgage taking advantage of their house appreciation to qualify for a new loan and to cover the cost of refinancing.¹⁰⁹ However, by 2006 the housing market began to cool, while at the same time

¹⁰¹ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 5.

¹⁰² See Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of Thrift Supervision & Nat’l Credit Union Admin., Proposed Statement on Subprime Mortgage Lending, 72 Fed. Reg. 10,533, 10,534 (Mar. 8, 2007).

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ See Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 4; *see also Residential Loan Production-1970 to 2006*, *supra* note 79.

¹⁰⁷ See U.S. Census Bureau, Table 5, Homeownership Rates for the United States: 1968 to 2008, *supra* note 84.

¹⁰⁸ Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., The Subprime Mortgage Market (May 17, 2007), <http://www.federalreserve.gov/newsevents/speech/bernanke20070517a.htm> (last visited Nov. 13, 2008).

¹⁰⁹ See Cole, *Mortgage Market Turmoil*, *supra* note 22, at 6.

mortgage rates continued to climb.¹¹⁰ During that time subprime borrowers who thought to refinance their ARM loans before their payments reset were learning that they were unable to do so, as they did not have sufficient equity to qualify for a new loan due to the slowdown in the housing market.¹¹¹ In addition, subprime borrowers whose repayment ability was not properly verified by lenders, due to stated income, low-doc and other nontraditional features, were unable to afford their new payments and began defaulting on their ARMs by mid to late 2006.¹¹²

Nevertheless, by the end of 2006 the subprime market had retracted only slightly with origination volume at \$600 billion and market share of 20 percent.¹¹³ Alt-A originations, on the other hand, completed their cycle of highs where they grew from a mere 2 percent and estimated \$78 billion in volume in 2003 to 13 percent and estimated \$390 billion in volume in 2006.¹¹⁴

However, as housing prices continued to further decelerate in 2007, subprime borrower delinquencies continued to mount. Alarmed, consumer advocates, legislators and regulators began looking for ways to minimize the harm of delinquencies and foreclosures.¹¹⁵ By June 29, 2007, the federal agencies issued a joint statement on subprime mortgage lending requiring depository institutions to tighten loosened underwriting standards.¹¹⁶ By the third quarter of 2007 total delinquencies on subprime ARMs had reached 18.81 percent¹¹⁷ and the percentage

¹¹⁰ *Id.*

¹¹¹ See Ben Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., *The Subprime Mortgage Market* (May 17, 2007), *supra* note 108.

¹¹² See MORTGAGE BANKERS ASSOCIATION, NATIONAL DELINQUENCY SURVEY, FOURTH QUARTER 2006 at 2 (Mar. 2007) (according to the survey in the fourth quarter of 2006 a total of 14.44% of subprime ARM loans were past due, almost 3% higher than same quarter of the previous year); see also Rushton, *Mortgage Market Turmoil*, *supra* note 78, at 5.

¹¹³ See Rushton, *Hearing on Mortgage Market Turmoil*, *supra* note 78, at 4.

¹¹⁴ *Id.* at 4-5; see also *Residential Loan Production-1970 to 2006*, *supra* note 79.

¹¹⁵ See, e.g., *Hearing on Mortgage Market Turmoil*, *supra* note 22; see also *Hearing on Subprime and Predatory Lending*, *supra* note 7.

¹¹⁶ Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of Thrift Supervision & Nat'l Credit Union Admin., *Statement on Subprime Mortgage Lending*, 72 Fed. Reg. 37,569 (July 10, 2008).

¹¹⁷ See MORTGAGE BANKERS ASSOCIATION ("MBA"), NATIONAL DELINQUENCY SURVEY, SECOND QUARTER 2008 at 11 (June 30, 2008) [hereinafter MBA, NATIONAL DELINQUENCY SURVEY, SECOND QUARTER 2008].

of subprime ARM loans in foreclosure had reached 10.38 percent.¹¹⁸ Subprime originations had dropped dramatically to an estimated \$182 billion from \$600 billion a year earlier.¹¹⁹ The same was the case for Alt-A mortgages which dropped in 2007 to a mere \$55.5 billion, an 85 percent decline from 2006 level.¹²⁰

In a press release on December 18, 2007, the Board announced its intention to amend Regulation Z, which implements TILA and HOEPA.¹²¹ The news of the proposed amendments came as the overall mortgage foreclosure rates reached an all time high.¹²² By the second quarter of 2008, the percentage of subprime ARM loans in foreclosure had increased to 19.41 percent¹²³ and the 2007 all time foreclosure record was also shattered, as overall foreclosure rates stood at 2.75 percent.¹²⁴ The events of recent years had taken their toll on the Alt-A and subprime mortgage markets. In the first quarter of 2008, an industry survey showed that Alt-A mortgages plummeted 87% to \$7 billion.¹²⁵ Similarly, a more recent industry survey of subprime mortgage lenders found that only an estimated \$5 billion of subprime mortgage loans were originated for the first half of 2008, announcing that the subprime mortgage market had

¹¹⁸ *Id.*

¹¹⁹ Paul Muolo, *New Analysis: '07 Volume Off 15%*, National Mortgage News, Volume 32, Issue 30 (Apr. 28, 2008), available at <http://www.nationalmortgagenews.com/premium/archive/?id=159348> (last visited Nov. 13, 2008).

¹²⁰ See *Alt-A Plummetts by 87%*, National Mortgage News, Volume 32, Issue 26 (Mar. 31, 2008), available at <http://www.nationalmortgagenews.com/premium/archive/?id=159078> (last visited Nov. 13, 2008).

¹²¹ Press Release, Bd. of Governors of the Fed. Reserve Sys., Request for Comment on Changes to Regulation Z to Protect Consumers from Unfair or Deceptive Home Mortgage Lending and Advertising Practices (Dec. 18, 2007), <http://www.federalreserve.gov/newsevents/press/bcreg/20071218a.htm> (last visited Oct 3, 2008); Bd. of Governors of the Fed. Reserve Sys., Proposed Rule and Request for Public Comment, Regulation Z, 73 Fed. Reg. 1672, 1672 (Jan. 9, 2008).

¹²² See Les Christie, *Foreclosures Hit All-Time High*, CNNMoney.com, Mar. 6, 2008, http://money.cnn.com/2008/03/06/real_estate/defaults_continue_climb/index.htm?postversion=2008030614 (last visited Nov. 13, 2008); see also Renae Merle & Tomoeh Murakami Tse, *Mortgage Foreclosures Reach All-Time High*, WASH. POST, Mar. 7, 2008 at D1 (by the end of 2007 overall mortgage foreclosure reached 2.04 percent).

¹²³ See MBA, NATIONAL DELINQUENCY SURVEY, SECOND QUARTER 2008, *supra* note 117, at 11.

¹²⁴ *Id.* at 10.

¹²⁵ *Alt-A Plummetts by 87%*, National Mortgage News, Volume 32, Issue 26 (Mar. 31, 2008), available at <http://www.nationalmortgagenews.com/premium/archive/?id=159078> (last visited Nov. 13, 2008).

evaporated.¹²⁶

II. REVIEW OF TILA AND HOEPA STATUTORY AND REGULATORY SCHEMES

A. TILA

Congress enacted TILA in 1968 to promote the informed use of credit by consumers and to increase competition in the consumer credit market.¹²⁷ TILA requires creditors to provide consumers applying for credit with standardized disclosure of material information, thereby enabling consumers to shop for terms among creditors and make an informed decision concerning the credit transaction.¹²⁸

The Board was granted exclusive authority to promulgate regulations and provide interpretations under TILA.¹²⁹ The Board exercised its authority and implemented TILA by its promulgation of Regulation Z. However, administrative enforcement responsibilities under TILA were not granted exclusively to the Board, but rather were divided among eight federal regulatory agencies.¹³⁰ In addition, the Federal Trade Commission (“FTC”) was granted general and residual regulatory authority with regard to creditors not regulated by the other eight agencies.¹³¹

TILA applies to various types of credit transactions and covers all types of mortgage transactions secured by a consumer’s dwelling.¹³² For closed-end mortgage loans, i.e. loans other than revolving lines of credit or “open-end-credit” loans¹³³, TILA requires creditors to disclose various types of key information regarding the mortgage transaction following consumers’ credit application.¹³⁴ Creditors must disclose, for example: the identity

¹²⁶ Paul Muolo, *Subprime Evaporates*, National Mortgage News, Volume 32, Issue 50 (Sep. 22, 2008), available at <http://www.nationalmortgage.com/premium/archive/?id=161466> (last visited Nov. 13, 2008).

¹²⁷ See 15 U.S.C. § 1601(a) (congressional finding and deceleration of purpose).

¹²⁸ 15 U.S.C. § 1601(a).

¹²⁹ 15 U.S.C. § 1604.

¹³⁰ 15 U.S.C. § 1607(a).

¹³¹ 15 U.S.C. § 1607(c) (these creditors are generally non-depository, state chartered, housing creditors, such as mortgage lenders and mortgage brokers).

¹³² See 15 U.S.C. §§ 1602(h), 1631; 12 C.F.R. § 226.1(c).

¹³³ Also known as Home Equity Line of Credit (“HELOC”).

¹³⁴ 15 U.S.C. § 1638(b)(2); 12 C.F.R. § 226.19(a) (TILA disclosures must be

of the creditor,¹³⁵ the amount financed,¹³⁶ the finance charges¹³⁷ and the annual percentage rate (“APR”).¹³⁸ TILA also requires creditors to provide applicants with disclosure of other material terms, such as payment schedule,¹³⁹ the total of all payments¹⁴⁰ and information regarding variable rate transactions for adjustable rate mortgages (“ARM”).¹⁴¹ Creditors must also disclose whether the loan carries a prepayment charge or demand feature.¹⁴² Using the APR as a benchmark figure, for example, TILA disclosure allows consumers to comparison shop between creditors for the most favorable terms and costs.¹⁴³

As for consumer credit advertisements, TILA requires creditors to only advertise terms that they can actually make available to consumers.¹⁴⁴ When advertizing interest rates, TILA requires that the advertisement do so in APR and if the APR may increase after closing the advertisement must state that fact.¹⁴⁵ In addition, the advertising of certain terms, such as the percentage of down-payment or the amount of any payment, will trigger additional disclosure requirements to further explain to consumers the basis of the assumptions made in the advertisement.¹⁴⁶

In mortgage transactions secured by a consumer’s principal dwelling, TILA gives the consumer a right to rescind within three business days of i) closing, or ii) the delivery of notice of right to rescind, or iii) the delivery of all material disclosures,

provided before closing of the loan transaction or within three business days of receipt of consumer application, whichever is earlier).

¹³⁵ 15 U.S.C. § 1638(a)(1); 12 C.F.R. § 226.18(a).

¹³⁶ 15 U.S.C. § 1638(a)(2); 12 C.F.R. § 226.18(b).

¹³⁷ 15 U.S.C. § 1638(a)(3); 12 C.F.R. § 226.18(d) (which is the cost of credit expressed in dollar amount).

¹³⁸ 15 U.S.C. § 1638(a)(1); 12 C.F.R. § 226.18(e) (which is the finance charge or cost of the loan expressed as a yearly rate).

¹³⁹ 15 U.S.C. § 1638(a)(5); 12 C.F.R. § 226.18(g) (which is the number, amount, and due dates of payments scheduled to repay the loan).

¹⁴⁰ 15 U.S.C. § 1638(a)(5); 12 C.F.R. § 226.18(h) (which is the total amount to be paid by the consumer when all scheduled payments are made).

¹⁴¹ 15 U.S.C. § 1638(i); 12 C.F.R. § 226.19.

¹⁴² 15 U.S.C. § 1638(i); 12 C.F.R. § 226.18(i) and (k).

¹⁴³ See CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 54-55.

¹⁴⁴ *See, e.g.*, 12 C.F.R. § 226.24 (pertaining to closed-end credit advertising).

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

whichever occurs last.¹⁴⁷ In addition, in cases of closed-end mortgage secured by a consumer's principal dwelling, when creditors fail to provide required material disclosures or notice of right to rescission, TILA gives the consumer an extended right to rescind the loan within three years of consummation or upon the sale of the property, whichever comes first.¹⁴⁸

In the event that TILA requirements are violated, consumers are granted both individual and class rights of action and may recover statutory damages, as well as, proven actual damages and reasonable attorney's fees.¹⁴⁹ In addition, TILA has extended liabilities to assignees of the original creditors.¹⁵⁰ Moreover, for willful and knowing violations, TILA imposes criminal penalties of up to \$5,000 or up to one year imprisonment.¹⁵¹

Nevertheless, TILA was only enacted as a consumer credit cost disclosure act.¹⁵² Thus, it was primarily focused on the content, quantity, and quality of information disseminated to consumers, rather than being focused on imposing substantive prohibitions on lending practices harmful to consumers.¹⁵³ The effects of deregulations in the mortgage market industry in the 1980s¹⁵⁴ and the ineffectiveness of the then existing disclosures to alert unsophisticated consumers to the potential harmful effects of the credit terms they were getting, was portrayed in anecdotal reports of abusive lending by unscrupulous lenders who made unaffordable mortgages to house-rich but credit-poor borrowers.¹⁵⁵ In 1994, Congress responded to these anecdotal

¹⁴⁷ 15 U.S.C. § 1635; 12 C.F.R., § 226.23(a)(3); *see* 12 C.F.R. § 226.15 (for open-end mortgage loans).

¹⁴⁸ 15 U.S.C. § 1635(f).

¹⁴⁹ 15 U.S.C. § 1640(a).

¹⁵⁰ 15 U.S.C. § 1641.

¹⁵¹ 15 U.S.C. § 1611.

¹⁵² *See* 15 U.S.C. § 1601(a).

¹⁵³ Lisa Keyfetz, *The Home Ownership And Equity Protection Act Of 1994: Extending Liability For Predatory Subprime Loans To Secondary Mortgage Market Participants*, 18 LOY. CONSUMER L. REV. 151, 173 (2005).

¹⁵⁴ Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), Pub. L. No. 96-221, § 501(a), 94 Stat. 132, 161 (originally codified as a note to 12 U.S.C. § 1735f-7, now codified as 12 U.S.C. § 1735f-7a); Alternative Mortgage Transaction Parity Act of 1982 ("AMTPA"), Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended at 12 U.S.C. § 3801-3806); *see also supra* pp. 255-56.

¹⁵⁵ *See, e.g.,* Peter S. Canellos & Gary Chafetz, *Foreclosure Comes To Family After 27 Years In Their Home*, BOSTON GLOBE, May 6, 1991, at 6. On May 6, 1991, the Boston Globe began running a series of newspaper articles

reports of lending abuse¹⁵⁶ by its enactment of HOEPA¹⁵⁷, a federal predatory lending law.

B. HOEPA

HOEPA was enacted as an amendment to TILA.¹⁵⁸ By the enactment of HOEPA, Congress intended to extend consumers enhanced protection by setting forth additional disclosure requirements and by prohibiting certain terms and lending practices in connection with HOEPA covered transactions.¹⁵⁹

Unlike TILA, which covers all types of credit transaction secured by a consumer's dwelling, HOEPA only covers a subset of mortgage transactions that are "high-cost" closed-end mortgage transactions.¹⁶⁰ Under HOEPA, a high-cost loan is defined as either first or second lien closed-end mortgage loan, made in refinance transactions, secured by a consumer's principal dwelling, if the loan exceeds the rate or fee triggers specified in Section 32 of regulation Z.¹⁶¹ At the time of the enactment of HOEPA the rate trigger was 10 percent above the yield of

about high-cost lending in the in the market for second-mortgages. These reports acted as the catalyst for state and federal probes into the second-mortgage business lending practices by companies, such as, Fleet Financial, Inc., BayBank, Shawmut and Haymarket. *See, e.g.,* Steve Marantz, *Loan Scams Prompted Swift, Varied Response*, BOSTON GLOBE, Dec. 29, 1991, at 19.

¹⁵⁶ *See generally* *Problems in Community Development Banking, Mortgage Lending Discrimination Redlining, and Home Equity Lending, Hearings Before the Senate Committee on Banking, Housing and Urban Affairs*, 103rd Cong. (Feb. 3, 17, 24, 1993); *See also* Peter S. Canellos, *Fleet, Foes Squaring Off Loan Abuse Hearings To Start*, BOSTON GLOBE, Feb. 17, 1993, at 61.

¹⁵⁷ *See* Riegle Community Development and Regulatory Improvement Act of 1994, *supra* note 6.

¹⁵⁸ *Id.* HOEPA was implemented by the Board throughout 12 C.F.R. pt. 226, Reg. Z. *See* Bd. of Governors of the Fed. Reserve Sys., Regulation Z, Final Rule, 60 Fed. Reg. 15,463 (Mar. 24, 1995).

¹⁵⁹ *See* 140 Cong. Rec. H 6782, 6784 (Conference Report On H.R. 3474, Riegle Community Development And Regulatory Improvement Act Of 1994, H.R., Aug. 4, 1994) [hereinafter *Conference Report On H.R. 3474 (Aug. 4, 1994)*] (statement by Rep. Gonzalez).

¹⁶⁰ *See* 15 U.S.C. § 1602(aa); 12 C.F.R. § 226.32. *See also* *Cunningham v. Nationscredit Fin. Servs. Corp.*, 497 F.3d 714, 717 (7th Cir. 2007). High-cost HOEPA loans are also generally referred to as "high-cost mortgages", "Section 32 loans", "high-cost loans" or simply "HOEPA loans."

¹⁶¹ *See* 12 C.F.R. § 226.32. HOEPA does not cover purchase mortgage transactions, reverse mortgage transactions, or open-end credit plans. 15 U.S.C. § 1602(aa). *See also* *Cunningham*, 497 F.3d at 717.

comparable maturity Treasury securities;¹⁶² and the fee trigger was 8 percent of the total loan amount or \$400, whichever is greater.¹⁶³

Creditors making high-cost loans must provide consumers with additional disclosures to those already mandated by TILA.¹⁶⁴ HOEPA disclosures are intended to make consumers fully aware of the terms of the loan they are about to take by providing key cost disclosures.¹⁶⁵ For example, in addition to APR and monthly payment, the disclosures provide additional information for high-cost balloon loans and ARMs, such as, alerting consumers to the amount of any balloon payment and specifying for ARMs that interest rate and monthly payment may increase.¹⁶⁶ Consumers are also made aware that by taking the loan they will have a mortgage on their home; and that if they default on the loan they may lose their home and the money they have put into it.¹⁶⁷ In addition, the disclosures emphasize that consumers are not required to complete the transaction merely because they received the disclosures or because they signed a loan application.¹⁶⁸ Another important measure of protection is HOEPA's "cooling off period" which requires that the disclosures be provided at least three business days prior to consummation, to allow consumers more time to consider the transaction or seek additional advice before closing.¹⁶⁹

HOEPA prohibits certain loan terms and lending practices deemed harmful to consumers, in connection with loans identified as high-cost.¹⁷⁰ For example, a HOEPA covered loan cannot contain a balloon payment when the loan term is less than 5 years;¹⁷¹ nor can it contain terms causing negative amortization;¹⁷²

¹⁶² 15 U.S.C. § 1602(aa)(1)(A). The rate trigger has since been amended and reduced for first lien position to 8 percent. *See* 12 C.F.R. § 226.32(a)(1)(i).

¹⁶³ 15 U.S.C. § 1602(aa)(1)(B).

¹⁶⁴ 15 U.S.C. § 1639(a); 12 C.F.R. § 226.32(c).

¹⁶⁵ *See Conference Report On H.R. 3474 (Aug. 4, 1994)*, *supra* note 159 (statement by Rep. Gonzalez).

¹⁶⁶ 15 U.S.C. § 1639(a)(2)(B); 12 C.F.R. §§ 226.32(c)(3), (4).

¹⁶⁷ 15 U.S.C. § 1639(a)(1)(B); 12 C.F.R. § 226.32(c)(1).

¹⁶⁸ 15 U.S.C. § 1639(a)(1)(A); 12 C.F.R. § 226.32(c)(1).

¹⁶⁹ 15 U.S.C. § 1639(b)(1); 12 C.F.R. § 226.31(c)(1).

¹⁷⁰ *See generally* 15 U.S.C. § 1639(c)-(j); 12 C.F.R. §§ 226.32(d), 226.34.

¹⁷¹ 15 U.S.C. § 1639(e); 12 C.F.R. § 226.32(d)(1)(i). The regulation provides a narrow exception for balloon loans with maturity of less than one year, if the loan is a "bridge" loan made in connection with the acquisition or construction of the consumer's new principal dwelling. 12 C.F.R. § 226.32(d)(1)(ii).

¹⁷² 15 U.S.C. § 1639(f); 12 C.F.R. § 226.32(d)(2). A negative amortization

or contain terms which can cause the interest rate to rise upon borrower's default.¹⁷³ In addition, HOEPA generally prohibits prepayment penalties for covered loans.¹⁷⁴ Nonetheless, a high-cost loan may contain a prepayment penalty if the following conditions are met: (i) the penalty is for less than 5 years from the date of consummation; (ii) the source funding the penalty is not a refinancing by the creditor or an affiliate of the creditor; and (iii) at consummation the consumer's total monthly debt does not exceed 50 percent of the consumer's verified monthly gross income.¹⁷⁵

HOEPA also specifically prohibits certain lending practices that are harmful to consumers.¹⁷⁶ HOEPA prohibits creditors from engaging in a pattern or practice of extending high-cost loans to a consumer without regard to the consumers' ability to repay the loans.¹⁷⁷ In addition, HOEPA prohibits creditors from requiring more than two period payments to be paid in advance at the closing, which tend to increase the loan amount when payments are financed, thereby further increasing the cost of the loan;¹⁷⁸ and prohibits making payments directly to home improvement contractors without borrower control.¹⁷⁹

Creditors who violate HOEPA by including prohibited terms or engaging in prohibited practices are deemed to have failed to deliver "material disclosures" required by TILA, thereby triggering the TILA's extended right of rescission.¹⁸⁰ In addition to the remedies provided by TILA, HOEPA has increased civil liabilities for covered loans to an amount equal to the sum of all finance charges paid by the consumer when creditors fail to comply with the disclosure requirements, unless the creditors can show that the failure to comply was not material.¹⁸¹ Most importantly, in an attempt to eliminate the "holder in due course" defense for covered loans, HOEPA extends liability to subsequent

occurs when the scheduled payments do not cause the full finance charges to be paid and the unpaid portion of the finance charges is then added to the loan principle causing the principle to increase.

¹⁷³ 15 U.S.C. § 1639(d); 12 C.F.R. § 226.32(d)(4).

¹⁷⁴ 15 U.S.C. § 1639(c); 12 C.F.R. § 226.32(d)(6).

¹⁷⁵ 15 U.S.C. § 1639(c)(2); 12 C.F.R. § 226.32(d)(7).

¹⁷⁶ *See generally* 15 U.S.C. § 1639; 12 C.F.R. §§ 226.32, 226.34.

¹⁷⁷ 15 U.S.C. § 1639(h).

¹⁷⁸ 12 C.F.R. § 226.32(3).

¹⁷⁹ 12 C.F.R. § 226.34(a)(1).

¹⁸⁰ 15 U.S.C. § 1639(j); 15 U.S.C. §§ 1635(a), (f).

¹⁸¹ 15 U.S.C. § 1640(a)(4).

holders and assignees of the original creditors and requires that assignees demonstrate, by a preponderance of the evidence, that a reasonable person using ordinary due diligence could not have determined based on the required documentation that the mortgage was a HOEPA covered loan.¹⁸² In addition, the original creditor must provide a notice to assignees and purchasers stating that the loan is a HOEPA covered loan and that the assignees will be subject to claims and defenses that the borrower may have against the original creditor.¹⁸³ HOEPA also grants States Attorneys General the power to enforce HOEPA and bring proceedings within three years of date the violation occurred.¹⁸⁴

The Board was given broad and extensive powers under HOEPA, in addition to its ability to promulgate regulations and interpretation under TILA.¹⁸⁵ Under HOEPA, the Board has the power to prohibit additional acts and practices in connection with mortgage loans that the Board finds to be unfair, deceptive or designed to evade the provisions of HOEPA,¹⁸⁶ as well as to prohibit abusive lending practices, or practices not in the interest of borrowers in connection with refinance mortgage loans.¹⁸⁷ While HOEPA does not define what is unfair or deceptive, the conference report for HOEPA indicates that the Board should look to the standards employed for determining state unfair and deceptive trade practices and federal unfair and deceptive practices under the Federal Trade Commission Act (“FTCA”).¹⁸⁸ In addition, the Board was given the authority to adjust, as necessary, the rate trigger for high-cost loans to as low as 8 percent and up to a maximum of 12 percent¹⁸⁹ and to include additional charges in the fee trigger as the Board deems appropriate.¹⁹⁰

In December 2001 the Board made its first use of its rule making powers under HOEPA by adopting amendments to Regulation Z.¹⁹¹ The amendments came as the number of

¹⁸² 15 U.S.C. § 1641(d)(1).

¹⁸³ *Id.*; 12 C.F.R. § 226.34(a)(2).

¹⁸⁴ 15 U.S.C. § 1640(e).

¹⁸⁵ 15 U.S.C. § 1639(l)(2).

¹⁸⁶ 15 U.S.C. § 1639(l)(2)(A).

¹⁸⁷ 15 U.S.C. § 1639(l)(2)(B).

¹⁸⁸ *See* 140 Cong. Rec. H 4442, 6683; 15 U.S.C. 45(a)(1).

¹⁸⁹ 15 U.S.C. § 1602(aa)(2)(B).

¹⁹⁰ 15 U.S.C. § 1602(aa)(4)(D).

¹⁹¹ *See generally* Bd. of Governors of the Fed. Reserve Sys., Regulation Z, Final Rule, 66 Fed. Reg. 65,604 (Dec. 20, 2001) [hereinafter Regulation Z,

refinance mortgage loans made in the subprime market had increased about five-fold from an estimated 138,000 loans in 1994, when HOEPA was enacted, to an estimated 658,000 in 2000.¹⁹² As the number of subprime mortgage loans increased so did the stream of reports of lending abuses.¹⁹³ Such reports caused increasing concerns to States which began taking legislative actions to curb predatory lending in their own borders.¹⁹⁴ The Board, in its December 2001 amendments, attempted to address these issues by further tightening control over abusive lending by means of bringing more loans under the coverage of HOEPA.¹⁹⁵

Effective October 2002, the Board reduced the rate trigger for first-lien loans from 10 percent to 8 percent, by bifurcating HOEPA's original rate trigger and creating two separate rate triggers, one for first-lien loans and another for subordinate-lien loans.¹⁹⁶ In addition, the Board included single-premium insurance in the points and fees trigger calculation.¹⁹⁷ These two changes intended to bring more loans within the coverage of HOEPA.¹⁹⁸

Final Rule (Dec. 20, 2001)].

¹⁹² See Memorandum to the Bd. of Governors of the Fed. Reserve Sys. from Gov. Gramlich, Chairman, Comm. on Consumer and Community Affairs, Amendments to Regulation Z addressing concerns related to predatory practices in mortgage lending, Nov. 27, 2001, at 7, <http://federalreserve.gov/boarddocs/meetings/2001/20011212/20011207-openmemo1.pdf>.

¹⁹³ *Id.*

¹⁹⁴ *Id.* at 8 n.5 (at the time of the 2001 amendment to Regulation Z, five states, namely: North Carolina, California, Massachusetts, Illinois and New York, had enacted statutes addressing high-cost loans).

¹⁹⁵ See Regulation Z, Final Rule (Dec. 20, 2001), *supra* note 191, 66 Fed. Reg. at 65,608 (while OTS data suggested that lowering the APR triggers by 2 percent will increase HOEPA coverage from 1 to 5 percent; trade association data, however, showed that a 2 percent reduction will increase HOEPA coverage from 9 to 26 percent for first-lien loans).

¹⁹⁶ 12 C.F.R. § 226.32(a)(1)(i). While asserting its power to lower the rate trigger for subordinate-liens loans the Board reasoned that it was only changing the rate trigger for first-lien loans because most evidence of lending abuse were in connection with first-lien loans and trade association data suggested that under the 10 percent trigger 47 percent of subordinate-lien loans were already covered by HOEPA. See Regulation Z, Final Rule (Dec. 20, 2001), *supra* note 191, 66 Fed. Reg. at 65,608.

¹⁹⁷ 12 C.F.R. § 226.32(b)(1)(iv).

¹⁹⁸ See Regulation Z, Final Rule (Dec. 20, 2001), *supra* note 191, 66 Fed. Reg. at 65,609 (trade association data suggested that the inclusion of single-premium insurance in the fee trigger with the lower APR trigger will result in increase in coverage from 26 percent to 38 percent for first-lien loans and from

The Board also enhanced the protection of HOEPA by prohibiting additional terms and practices. For example, subject to specific exceptions, the due-on-demand clause was added to the list of terms prohibited by HOEPA.¹⁹⁹ Also, creditors are prohibited from wrongfully documenting or structuring a loan secured by consumer's dwelling as an open-end credit plan, as a mean to evade the coverage of HOEPA.²⁰⁰ The amendment further prohibited the practice of "loan flipping", which is defined as refinancing a mortgage loan by the same creditor who extended the mortgage loan within one year of the extension of the mortgage loan to the consumer and without economic benefit to the consumer.²⁰¹ The Board also clarified the prohibition regarding equity-based-lending by adding a presumption of violation when creditors engage in a pattern or practice of making a high-cost loan without documenting borrowers' ability to repay.²⁰²

Nevertheless, faced with increasing volumes of subprime mortgages during the years 2002 to 2005 and mounting concerns over predatory lending practices, consumer advocates continued to criticize HOEPA as being a far too limited tool due to its insufficient coverage of high-cost loans.²⁰³ Critics of HOEPA pointed out that it does not cover high-cost purchase-money mortgages, home equity lines of credits, or reverse mortgages.²⁰⁴ In particular, consumer advocates stressed the need to expand HOEPA's high-cost definition by further lowering the rate and fee triggers, including adding the controversial yield spread premium ("YSP") and other third party charges to the fee calculations, so as to increase HOEPA's coverage over subprime mortgage lending.²⁰⁵

47 percent to 61 percent for subordinate-lien loans); *see also supra* notes 195, 196.

¹⁹⁹ 12 C.F.R. § 226.32(d)(8).

²⁰⁰ 12 C.F.R. § 226.34(b).

²⁰¹ 12 C.F.R. § 226.34(a)(3).

²⁰² 12 C.F.R. § 226.34(a)(4); *See also* Regulation Z, Final Rule (Dec. 20, 2001), *supra* note 191, 66 Fed. Reg. at 65,614.

²⁰³ *See, e.g., Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit: Hearing Before the Subcomms. on Fin. Inst. and Consumer Credit and Hous. and Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 108th Cong. 150-51 (Nov. 5, 2003) [hereinafter *Hearing on Protecting Homeowners*] (testimony of Allen J. Fishbein, Director of Hous. and Credit Policy, Consumer Federation of America).

²⁰⁴ *Id.*

²⁰⁵ *Id.* at 277 n.21 (statement by Margot Saunders, National Consumer

In addition, during that time States' anti-predatory legislations, which were intended to fill in the gaps left by HOEPA, were facing preemption challenges by federal banking regulatory agencies, such as the Office of the Comptroller of the Currency²⁰⁶ and the Office of Thrift Supervision.²⁰⁷ As more States across the nation were enacting anti-predatory lending laws, federally chartered financial institutions were asserting exemption due to federal preemption from state mortgage licensing and supervision requirement and declined to be bound by States' anti-predatory lending laws.²⁰⁸ Therefore, up until the end of 2006 the focus of the debate over curbing abusive lending practices rested primarily on the need to find tailored solutions on a national level to the issues of predatory and subprime mortgage lending in the form of a congressional expansion to TILA and HOEPA.²⁰⁹

C. Recent Federal Action in Response to Concerns Regarding the Mortgage Market

As the subprime market peaked in 2005 and mortgage lenders' marketing of nontraditional mortgage products was in full force, it became evident to federal regulatory agencies that a more immediate action was needed to protect consumers from ongoing harmful lending practices. On December 29, 2005, federal regulatory agencies announced their intention to provide

Law Center).

²⁰⁶ See Office of the Comptroller of the Currency, Bank Activities and Operations; Real Estate Lending and Appraisals, Final Rule (Jan. 13, 2004), 69 Fed. Reg. 1904 (Jan. 13, 2004) (rules promulgated in this amendment asserted OCC preemption of State laws as they pertain to mortgage lending operations of national banks and their subsidiaries, amongst other things); see also generally GAO PREDATORY LENDING REPORT, *supra* note 10.

²⁰⁷ See, e.g., Office of Thrift Supervision, Preemption of New York Predatory Lending Law (Jan. 30, 2003), <http://files.ots.gslsolutions.com/56302.pdf>.

²⁰⁸ See, e.g., *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007).

²⁰⁹ See, e.g., *Legislative Solutions To Abusive Mortgage Lending Practices*, Joint Hearing Before the Subcomm. on Hous. and Cmty. Opportunity and the Subcomm. on Fin. Inst. and Consumer Credit of the Comm. on Fin. Servs., 109th Cong. (May 24, 2005), available at <http://purl.access.gpo.gov/GPO/LPS75150> [hereinafter *Hearing on Legislative Solutions To Abusive Mortgage Lending Practices*] (discussing proposed bills "The Responsible Lending Act", H.R. 1295, and "The Prohibit Predatory Lending Act", H.R. 1182); see also *Hearing on Protecting Homeowners*, *supra* note 203 (discussing proposed "Responsible Lending Act", H.R. 833).

guidance to depository institutions regarding the practices of lending nontraditional products and risk layering.²¹⁰ The agencies were concerned that nontraditional mortgage products are offered to a wide spectrum of borrowers, including subprime and Alt-A, who may not otherwise qualify for conventional fixed rate or ARM products and who may not fully understand the risk involved in taking such loans.²¹¹

By early 2006 the Board became concerned due to continued reports of predatory and mortgage lending abuses. In a press release on May 1, 2006 the Board announced that it intended to hold hearings under HOEPA in response to reports of predatory lending practices in the underserved markets.²¹² Amongst the Board's stated goals for the hearings was to assess the impact of HOEPA rules on the mortgage market, including the effectiveness of the amendments made in 2002, in light of States promulgation of anti-predatory lending laws.²¹³ In addition, due to the proliferation of nontraditional mortgages, in particular in the subprime and Alt-A markets, the Board was interested in learning whether sufficient information was provided to borrowers about these products and whether Regulation Z disclosures should be revised.²¹⁴ Last, the Board wanted to learn more about the role of mortgage brokers and the way they are perceived by consumers in the subprime mortgage market.²¹⁵ The 2006 hearings were held during the months of June and July in four cities around the country.²¹⁶

A few months after the 2006 HOEPA hearings, on

²¹⁰ See Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of Thrift Supervision & Nat'l Credit Union Admin., Proposed Interagency Guidance on Nontraditional Mortgage Products, 70 Fed. Reg. 77,249 (Dec. 29, 2005).

²¹¹ Proposed Interagency Guidance on Nontraditional Mortgage Products, 70 Fed. Reg. at 77,250.

²¹² Bd. of Governors of the Fed. Reserve Sys., Board to Hold Four Public Hearings on the Home Equity Lending Market, Press Release, May 1, 2006 *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/20060501a.htm> (last visited Nov. 13, 2008).

²¹³ Bd. of Governors of the Fed. Reserve Sys., Home Equity Lending Market, Notice of Public Hearings, 71 Fed. Reg. 26,513, 26,514 (May 5, 2006).

²¹⁴ 71 Fed. Reg. at 26,514-15.

²¹⁵ 71 Fed. Reg. at 26,515-16.

²¹⁶ June 7, 2006, Chi., Ill.; June 9, 2006, Phila., Pa; June 16, 2006, S.F., Ca; and July 11, 2006, Atlanta, Ga. 71 Fed. Reg. at 26,514. See <http://www.federalreserve.gov/events/publichearings/hoepa/2006/default.htm> (last visited Nov. 13, 2008) (for complete transcripts of the 2006 HOEPA hearings).

October 4, 2006, the federal regulators had issued their interagency guidance on nontraditional mortgage products.²¹⁷ As 2006 was near to a close, there was increasing concern that subprime borrowers were defaulting on their ARM loans and that more defaults and foreclosures are underway.²¹⁸ These concerns began materializing in early 2007 as evidence of subprime ARM loans defaults and foreclosures began mounting.²¹⁹ On March 3, 2007 federal agencies issued proposed comments on an interagency subprime mortgage lending statement intended to address concerns that subprime borrowers may not fully understand the risks and consequences of products marketed to them.²²⁰ The statement also sought to provide additional guidance to depository institutions regarding the risks involved in improperly determining subprime borrowers' ability to repay.²²¹

In addition, responding to the ensuing turmoil in the mortgage market, on May 3, 2007, the Board announced it would be holding another hearing to explore methods by which it may use its rulemaking authority under HOEPA to rein in abusive lending practices.²²² Based on the hearings conducted in 2006, the Board focused its concern on the following mortgage lending

²¹⁷ Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of Thrift Supervision & Nat'l Credit Union Admin., Interagency Guidance on Nontraditional Mortgage Products, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

²¹⁸ See Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS, CENTER FOR RESPONSIBLE LENDING 7, 15 (Dec. 2006), <http://www.responsiblelending.org/pdfs/CRL-foreclosure-rprt-1-8.pdf> (reported 318,000 foreclosures filed in the third quarter of 2006 alone—a 43% increase from third quarter 2005—and further projected that one out of five subprime loans made in 2005-06 will end in foreclosure).

²¹⁹ See generally *Hearing on Mortgage Market Turmoil*, supra note 22; see also *Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Financial Institutions: Hearing Before the Subcomm. on Fin. Inst. and Consumer Credit of the Comm. on Fin. Serv.*, 110 Cong (Mar. 27, 2007), available at <http://purl.access.gpo.gov/GPO/LPS85194>.

²²⁰ Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Office of Thrift Supervision & Nat'l Credit Union Admin., Proposed Statement on Subprime Mortgage Lending, 72 Fed Reg. 10,533, 10,534 (Mar. 8, 2007).

²²¹ *Id.*

²²² Press Release, Bd. of Governors of the Fed. Reserve Sys., Board to Hold Public Hearing Under the Home Ownership and Equity Protection Act on June 14, 2007 (May 3, 2007) available at <http://www.federalreserve.gov/newsevents/press/bcreg/20070503a.htm> (last visited Nov. 13, 2008).

practices: prepayment penalties, escrows for taxes and insurance on subprime loans, “stated income” or “low-doc” loans and consideration of borrower’s ability to repay a loan.²²³ The 2007 HOEPA hearing was conducted on June 14 in Washington DC.

Shortly following the hearing on June 29, 2007, federal agencies issued a final Statement on Subprime Mortgage Lending providing guidance on the standards that depository institutions must follow in evaluating mortgage applications by subprime borrowers.²²⁴ Nevertheless, due to the fact that the guidance only covers depository institution, as oppose to non-depository mortgage lenders and brokers, and due to consumers’ inability to enforce the guidance provisions and have an effective remedy, the Board heeded to consumer advocates and legislators’ requests and in a press release on December 18, 2007 announced its proposed changes to Regulation Z.²²⁵

Relying on its rulemaking authority under § 1639(l)(2) and § 1604(a), the Board’s proposed amendments set out to achieve three goals: (1) prevent unfair, deceptive and abusive acts or practices in connection with “higher-priced” mortgages and closed-end credit transactions secured by a consumer’s principal dwelling; (2) improve mortgage disclosures in advertisements for credit secured by a consumer’s dwelling and prohibit deceptive or misleading practices in connection with closed-end mortgage advertising; and (3) provide consumers with early disclosures in closed-end mortgage transactions.²²⁶

III. NEW AMENDMENTS TO REGULATION Z: TOOLS FOR COMBATING UNFAIR, DECEPTIVE AND ABUSIVE LENDING

On July 14, 2008 the Board announced its approval of final rules amending Regulation Z.²²⁷ The final rules adhere to

²²³ Bd. of Governors of the Fed. Reserve Sys., Home Equity Lending Market, Notice of Hearings (May 31, 2006), 72 Fed. Reg. 30,380, 30,382-83.

²²⁴ See Statement on Subprime Mortgage Lending, *supra* note 116, 72 Fed. Reg. 37,569.

²²⁵ Press Release, Bd. of Governors of the Fed. Reserve Sys., Request for Comment on Changes to Regulation Z to Protect Consumers from Unfair or Deceptive Home Mortgage Lending and Advertising Practices (Dec. 18, 2007) available at <http://www.federalreserve.gov/newsevents/press/bcreg/20071218a.htm> (last visited Nov. 13, 2008).

²²⁶ Bd. of Governors of the Fed. Reserve Sys., Regulation Z, Proposed Rule, 73 Fed. Reg. 1672, 1673 (Jan. 9, 2008).

²²⁷ See Press Release, Bd. of Governors of the Fed. Reserve Sys., Board Issues Final Rule Amending Home Mortgage Provisions of Regulation Z,

goals set out to be achieved in the proposed amendments.²²⁸ The new rules are comprised of seven new consumer protections relating to mortgage lending, servicing and advertising practices, as well as, additional disclosure enhancements and requirements.²²⁹ The Board adopted the new protections pursuant to its rulemaking authority under HOEPA,²³⁰ while adopting disclosure enhancements and requirements pursuant to its general rulemaking authority under TILA.²³¹ The new rules added two new sections, §§ 226.35 and 226.36, and amended several provisions throughout Regulation Z.²³² The new rules will become effective October 1, 2009, except for the requirements pertaining to escrows that will become effective on April 1, 2010.²³³

A. New Category of Higher-Priced Mortgage Loans (“HPML”)

Addressing its first goal of preventing unfair, deceptive and abusive acts or practices in connection with “higher-priced” mortgages and closed-end credit transactions secured by a consumer’s principal dwelling, the Board, pursuant to its rule making authority under HOEPA, finalized four prohibitions for a newly defined category of “higher-priced mortgage loan” (“HPML”).²³⁴ Although the Board’s adopted category is substantially the same as proposed in terms of coverage, following public comments the Board opted to change its proposed definition for this category.²³⁵ The Board changed its proposed benchmark of yield of comparable Treasury securities and substituted it with a benchmark of “average prime offer rate” (“APOR”) of a comparable transaction.²³⁶ The APOR benchmark will be derived from the average interest rates, points and fees currently offered to consumers by a representative sample of creditors for mortgage transactions having low-risk

supra note 1.

²²⁸ 73 Fed. Reg. at 1673.

²²⁹ *See generally* 73 Fed. Reg. 44,522 (to be codified at 12 C.F.R. pt. 226).

²³⁰ 15 U.S.C. 1639(l)(2).

²³¹ 15 U.S.C. 1604(a).

²³² *See generally* 73 Fed. Reg. 44,522.

²³³ 73 Fed. Reg. at 44,595.

²³⁴ 73 Fed. Reg. at 44,603; 12 C.F.R. § 226.35(a)(1) [effective Oct. 1, 2009].

²³⁵ 73 Fed. Reg. at 44,534.

²³⁶ *Id.*; 73 Fed. Reg. at 44,603; 12 C.F.R. § 226.35(a)(2) [effective Oct. 1, 2009].

characteristics.²³⁷ According to the Board, at least initially, the APOR will be derived from Freddie Mac's Weekly Primary Mortgage Market Survey ("PMMS"),²³⁸ which publishes weekly average rates, points and fees for four types of mortgage programs: (1) "30-Year Fixed Rate Mortgage"; (2) "15-Year Fixed Rate Mortgage"; (3) "5/1-Year ARM"; and (4) "1-Year ARM".²³⁹ The Board will use the information contained in the PMMS to calculate an average APR for each of the loan programs contained in the PMMS, as well as for other types of mortgage programs not contained in the PMMS.²⁴⁰ The Board will then publish the derived APORs in a table on the internet at least on a weekly basis, which will indicate how to identify a comparable transaction to facilitate compliance.²⁴¹

Due to making changes to the benchmark, the Board had also modified the initially proposed thresholds of 3 percent for first-lien and 5 percent for subordinate-liens and substituted them with thresholds of 1.5 percentage points for first-lien and 3.5 percentage points for subordinate-liens, to better reflect coverage under the new benchmark.²⁴² The amendment requires creditors to use the date the rate is locked for the final time before consummation, rather than the application date as the timing mechanism to check the benchmark APOR and add the threshold to determine whether the loan is an HPML.²⁴³

Accordingly, the Board's definition for the new category of HPML is: (1) a consumer credit transaction; (2) secured by the consumer's principal dwelling; (3) with an APR that exceeds the APOR for a comparable transaction; (4) as of the date the interest rate is set; (5) by: (i) 1.5 percentage point for closed-end mortgage loans secured by a first-lien; or (ii) 3.5 percentage points for closed-end mortgage loans secured by a subordinate-liens.²⁴⁴

The new HPML category covers a broad range of

²³⁷ 73 Fed. Reg. at 44,603; 12 C.F.R. § 226.35(a)(2) [effective Oct. 1, 2009].

²³⁸ 73 Fed. Reg. at 44,534.

²³⁹ See generally <http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp> (last visited Nov. 13, 2008).

²⁴⁰ 73 Fed. Reg. at 44,535-36.

²⁴¹ 73 Fed. Reg. at 44,535, 44,603; 12 C.F.R. § 226.35(a)(2) [effective Oct. 1, 2009].

²⁴² 73 Fed. Reg. at 44,536.

²⁴³ 73 Fed. Reg. at 44,537.

²⁴⁴ 73 Fed. Reg. at 44,603; 12 C.F.R. §§ 226.35(a)(1), 226.35(a)(3) [effective Oct. 1, 2009].

transactions, including, home purchase loans,²⁴⁵ refinancing²⁴⁶ and home equity loans.²⁴⁷ Excluded from the new definition of HPML are²⁴⁸: (1) mortgage loans for the initial construction of the dwelling; (2) temporary or “bridge” mortgage loans with terms of twelve months or less;²⁴⁹ (3) reverse-mortgage transactions; and (4) home equity lines of credit.

B. New Consumer Protections Applicable to HPMLs

New Section 226.35 creates four new protections for consumers by prohibiting creditors making HPMLs from engaging in the following practices: (1) making HPML based on the value of the consumer’s collateral in the dwelling without regard to the consumer’s ability to repay as of consummation; (2) including a prepayment penalty in HPML, except under specific conditions; (3) making a first-lien HPML without establishing an escrow account for payment of property taxes and premiums for mortgage related insurance required by the creditor; or (4) structuring a home-secured loan as an open-end plan to evade the prohibitions applicable to HPMLs.²⁵⁰ Section 226.35 new prohibitions were adopted by the Board under its HOEPA rulemaking powers.²⁵¹

I. Prohibition on Disregarding Consumer’s Ability to Repay

The final rules prohibit creditors from making HPMLs based on collateral without verifying the consumer’s ability to repay as required by Section 226.34(a)(4) as amended by the final rules.²⁵² Current Section 226.34(a)(4), implementing TILA

²⁴⁵ See 15 U.S.C. § 1602(w) (“residential mortgage transaction”); 12 C.F.R. § 226.2(a)(24).

²⁴⁶ See 12 C.F.R. § 226.20(a); *see also* 12 C.F.R. pt. 226 Supplement I para. 20(a) (Refinancings).

²⁴⁷ The term “home equity loan” is not specifically defined in Regulation Z. It generally means a mortgage loan where the borrower’s equity in the dwelling is used as collateral for the loan, and could be a first-lien or subordinate lien. Although, generally the term refers to a subordinate-lien.

²⁴⁸ 73 Fed. Reg. at 44,603; 12 C.F.R. § 226.35(a)(3) [effective Oct. 1, 2009].

²⁴⁹ 73 Fed. Reg. at 44,603; 12 C.F.R. § 226.35(a)(3) [effective Oct. 1, 2009] (“a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months”).

²⁵⁰ 73 Fed. Reg. at 44,603-04.

²⁵¹ 73 Fed. Reg. at 44,539; 15 U.S.C. § 1639(l)(2).

²⁵² 73 Fed. Reg. at 44,603; 12 C.F.R. §§ 226.35(b)(1), 226.34(a)(4) [effective

Section 129(h),²⁵³ prohibits creditors from engaging in a pattern or practice of making loans based on collateral without regard to the consumer's ability to repay when making HOEPA covered high-cost loans.²⁵⁴ The Board, using its authority under HOEPA, amended Section 226.34(a)(4) in three ways.²⁵⁵

First, the new rule removes the "pattern or practice" condition in the current rule, which was a major consumer obstacle for enforcing the provision.²⁵⁶ Accordingly, the new amendment prohibits creditors from extending HOEPA covered high-cost loans without verifying the consumer's ability to repay as of consummation.²⁵⁷

Second, in addition to the prohibition, the final rules explicitly require creditors to verify a consumer's ability to repay under Section 226.34(a)(4) and provides the following method by which this requirement is met: a creditor must verify the current or expected income or assets that it relies upon in determining the consumer's ability to repay using the consumer's tax returns, IRS Form W-2, payroll receipts, financial institution statements, or other reasonably reliable third-party evidence of the consumer's income or assets.²⁵⁸ Nevertheless, if a creditor fails to verify income or asset as required, it may still raise an affirmative defense showing that the income or assets relied upon were not "materially greater" than what the creditor could have verified complying with the requirement.²⁵⁹ In addition, the amendment explicitly requires that creditors verify the consumer's current obligations.²⁶⁰

Third, the final rules removed the initially proposed presumption of violation and substituted it with a modified presumption of compliance with Section 226.34(a)(4).²⁶¹ The

Oct. 1, 2009].

²⁵³ 15 U.S.C. § 1639(h).

²⁵⁴ See 12 C.F.R. 226.34(a)(4) [effective until Oct. 1, 2009].

²⁵⁵ 15 U.S.C. § 1639(l)(2)(A).

²⁵⁶ See 12 C.F.R. § 226.34(a)(4) [effective until Oct. 1, 2009].

²⁵⁷ 73 Fed. Reg. at 44,543, 44,603; 12 C.F.R. § 226.34(a)(4) [effective Oct. 1, 2009].

²⁵⁸ 73 Fed. Reg. at 44,546, 44,603; 12 C.F.R. § 226.34(a)(4)(ii)(A) [effective Oct. 1, 2009].

²⁵⁹ 73 Fed. Reg. at 44,546, 44,548, 44,603; 12 C.F.R. § 226.34(a)(4)(ii)(B) [effective Oct. 1, 2009].

²⁶⁰ 73 Fed. Reg. at 44,546, 44,603; 12 C.F.R. § 226.34(a)(4)(ii)(C) [effective Oct. 1, 2009].

²⁶¹ 73 Fed. Reg. at 44,548; 12 C.F.R. § 226.34(a)(4)(iii) [effective Oct. 1, 2009].

revised presumption of compliance is a closed list of underwriting procedures, and it arises if the creditor satisfies three requirements: (1) verifies the consumer's ability to repay under Section 226.34(a)(4)(ii),²⁶² (2) determines the consumer's ability to repay using the largest scheduled payment of principle and interest in the first seven years following consummation and taking into account current obligations and mortgage-related obligations;²⁶³ and (3) assesses the consumer's ability to repay by using at least one of the following measures: debt-to-income ratio, or the income the consumer will have remaining after paying debt obligations.²⁶⁴ The presumption of compliance, however, will not be available for a transaction in which the regularly scheduled payments for the first seven years will cause the principle balance of the mortgage loan to increase, i.e. will cause negative amortization and eventually a balloon payment; or the term of the mortgage loan is less than seven years and the regular scheduled payments in the aggregate do not fully amortize the outstanding principle balance, i.e. will cause a balloon payment at the end of the term.²⁶⁵

Accordingly, by incorporating by reference the prohibition and requirements of Section 226.34(a)(4), as newly amended, Section 226.35(b)(1) substantiates its prohibition and extends the new prohibitions and requirements for HOEPA covered loans to the newly defined category of HPMLs.²⁶⁶

2. Prohibition on Prepayment Penalties

Prepayment penalties on HPMLs are prohibited by the new rules, unless certain conditions are complied with. Issued under the Board's HOEPA rulemaking authority, the final rules are substantially different and provide additional consumer protection than the proposed rules, specifically in relation to the condition allowing exception from the prepayment penalty prohibition. The proposed rules made the prepayment penalty

²⁶² 73 Fed. Reg. at 44,548; 12 C.F.R. § 226.34(a)(4)(iii)(A) [effective Oct. 1, 2009].

²⁶³ 73 Fed. Reg. at 44,548-49; 12 C.F.R. § 226.34(a)(4)(iii)(B) [effective Oct. 1, 2009].

²⁶⁴ 73 Fed. Reg. at 44,549; 12 C.F.R. § 226.34(a)(4)(iii)(C) [effective Oct. 1, 2009].

²⁶⁵ 73 Fed. Reg. at 44,549; 12 C.F.R. § 226.34(a)(4)(iv) [effective Oct. 1, 2009].

²⁶⁶ 73 Fed. Reg. at 44,603; 12 C.F.R. §§ 226.35(b)(1) [effective Oct. 1, 2009].

conditions for HOEPA covered loans applicable to HPMLs.²⁶⁷ In contrast, in crafting the final rules the Board revised the proposed conditions for HPMLs and at the same time revised and expanded the current conditions for HOEPA covered loans.²⁶⁸

Under the final rules, HPMLs may contain prepayment penalties provided that it is permitted by law, including prepayments allowed by HOEPA, and under the term of the loan: (1) the penalty will not apply after two-years following consummation; (2) the penalty will not apply if the source of the funds for paying the prepayment is a refinancing by the creditor or an affiliate; (3) and the amount of the scheduled payments may not change for four-year following consummation.²⁶⁹ In a similar fashion, the Board revised the current exceptions from the prohibition on prepayment penalty for HOEPA covered loans, to allow prepayment penalties only if under the term of the loan, the above conditions are met, as well as, if at consummation the consumer's total debt-to-income ratio, as verified under the newly amended Section 226.34(a)(4)(ii), does not exceed 50 percent.²⁷⁰

3. Prohibition on Making HPMLs without Escrows for Taxes and Insurance

The new rules prohibit a creditor from extending a HPML secured by a first-lien without establishing an escrow account before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor.²⁷¹ The rule was adopted, by and large, as proposed and it was adopted pursuant to the Board rulemaking authority under HOEPA.²⁷² Unlike other provisions of final rules, the requirements for escrows will become effective April 1, 2010, except for loans secured by first liens on manufactured housing for which it will become effective on October 1, 2010.²⁷³

²⁶⁷ 73 Fed. Reg. at 44,551.

²⁶⁸ 73 Fed. Reg. at 44,555.

²⁶⁹ 73 Fed. Reg. at 44,555-56, 44,603; 12 C.F.R. § 226.35(b)(2) [effective Oct. 1, 2009].

²⁷⁰ 73 Fed. Reg. at 44,555-57, 44,603; 12 C.F.R. § 226.32(d)(7) [effective Oct. 1, 2009].

²⁷¹ 73 Fed. Reg. at 44,559, 44,604; 12 C.F.R. § 226.35(b)(3)(i) [effective Apr. 1, 2010].

²⁷² 15 U.S.C. § 1639(l)(2).

²⁷³ 73 Fed. Reg. at 44,562.

The final rules provide exemption from escrow requirements for loans secured by shares in a cooperative²⁷⁴ and a partial exemption for condominiums from escrows of insurance premiums if the condominium association requires unit owners to pay premiums to a master homeowners' insurance policy covering all units in the condominium.²⁷⁵ In addition, the final rules allows creditors or servicers to permit a consumer to cancel the escrow account upon consumer written request to cancel, provided that the request is not received earlier than 365 days after consummation.²⁷⁶

4. Anti-Evasion Provision

Because the coverage of HPMLs does not include home equity lines of credit or open-end plans,²⁷⁷ the Board pursuant to its rulemaking authority under HOEPA, prohibits creditors from structuring a loan, secured by consumer's principle dwelling that do not meet the definition of open-end credit, as an open-end plan, in order to evade the prohibitions on HPMLs.²⁷⁸

C. New Protections for Closed-End Mortgages Secured by Consumer Principle Dwelling

As an integral part of the Board's first goal, the provisions of new Section 226.36 are aimed at preventing unfair and deceptive practices in connection with mortgage lending and servicing. Unlike the provisions of Section 226.35, which are only applicable to HPMLs, new Section 226.36 provides new protections to all types of closed-end mortgages secured by the consumer's principle dwelling.²⁷⁹ Yet, similar to the prohibitions in connection with HPMLs, these new provisions were adopted

²⁷⁴ 73 Fed. Reg. at 44,561, 44,604; 12 C.F.R. § 226.35(b)(3)(ii)(A) [effective Apr. 1, 2010].

²⁷⁵ 73 Fed. Reg. at 44,561, 44,604; 12 C.F.R. § 226.35(b)(3)(ii)(B) [effective Apr. 1, 2010].

²⁷⁶ 73 Fed. Reg. at 44,560, 44,604; 12 C.F.R. § 226.35(b)(3)(iii) [effective Apr. 1, 2010].

²⁷⁷ 73 Fed. Reg. at 44,603; 12 C.F.R. § 226.35(a)(3) [effective Oct. 1, 2009].

²⁷⁸ 73 Fed. Reg. at 44,563, 44,604; 12 C.F.R. § 226.35(b)(4) [effective Oct. 1, 2009].

²⁷⁹ 73 Fed. Reg. at 44,563, 44,604; 12 C.F.R. §§ 226.36, 226.36(d) [effective Oct. 1, 2009].

by the Board under its HOEPA rulemaking authority.²⁸⁰ The new final rules of Section 226.36 generally prohibit: (1) creditors or mortgage brokers from coercing, influencing, or encouraging an appraiser to misstate or misrepresent an appraisal; and (2) servicers from engaging in unfair servicing practices.²⁸¹ Departing from the proposed amendments, the final rule did not adopt the prohibition of payments to a mortgage broker by a creditor beyond the amount a consumer agreed to in advance a broker would receive,²⁸² or the proposed requirement of servicers to provide consumers with a written schedule of fees and charges within reasonable time upon a consumer's request.²⁸³

I. New Prohibition on Coercing Appraisers

The final rules prohibit creditors or mortgage brokers from coercing, influencing or encouraging an appraiser to misstate or misrepresent the value of a consumer's principle dwelling in connection with a consumer credit transaction secured by such dwelling.²⁸⁴ In addition, the new rule includes a subset provision prohibiting a creditor from extending credit secured by consumer's principle dwelling if it has knowledge, at or before consummation, that an appraiser was coerced, influenced or otherwise encouraged to misrepresent or misstate the value of the dwelling.²⁸⁵ This prohibition is in effect unless the creditor can document that it acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of the dwelling.²⁸⁶

The final rules pertaining to coercion of appraisers were adopted substantially as proposed. To enforce the new prohibition, the Board had to create new definitions for "appraiser" and "mortgage broker", terms previously not defined in Regulation Z. According to the new definition a "mortgage broker" is a person, other than an employee of a creditor, who for

²⁸⁰ 73 Fed. Reg. at 44,563, 44,566, 44,571.

²⁸¹ 73 Fed. Reg. at 44,563.

²⁸² 73 Fed. Reg. at 44,563-65.

²⁸³ 73 Fed. Reg. at 44,570.

²⁸⁴ 73 Fed. Reg. at 44,566-67, 44,604; 12 C.F.R. § 226.36(b)(1) [effective Oct. 1, 2009].

²⁸⁵ 73 Fed. Reg. at 44,568, 44,604; 12 C.F.R. § 226.36(b)(2) [effective Oct. 1, 2009].

²⁸⁶ 73 Fed. Reg. at 44,568, 44,604; 12 C.F.R. § 226.36(b)(2) [effective Oct. 1, 2009].

compensation or gain, or expectation of compensation or gain, arranges, negotiates, or obtains extension of credit for another person.²⁸⁷ The definition further provides that the term “mortgage broker” includes a person meeting the definition even if the consumer credit obligation is initially payable to such person, for example in table funded transactions, unless that person actually provides the funds for the transaction at consummation.²⁸⁸ The new term “appraiser” means a person who is in the business of assessing the value of dwellings, and includes persons who employ, refer, or manage an appraiser and affiliates of such persons.²⁸⁹

Moreover, the new rules provide a non-exhaustive list of five examples of actions by a creditor or mortgage broker that violate the prohibition of coercing appraisers: (1) implying to the appraiser retention of services, either current or future, depends on the amount at which the appraiser values a consumer’s principle dwelling; (2) excluding an appraiser from being considered for future engagement because the value of a consumer’s dwelling the appraiser reported does not meet or exceed a minimum threshold; (3) telling an appraiser the minimum appraised value of a consumer principle dwelling needed to approve the loan; (4) not compensating an appraiser because the appraised value of a consumer’s dwelling was not at or above a certain amount; and (5) conditioning the compensation of an appraiser on the consummation of the loan.²⁹⁰

Similarly, the new rules provide a non-exhaustive list of five examples of actions by a creditor or mortgage broker that would not violate the prohibition of coercing appraisers, including: (1) asking an appraiser to consider additional information about comparable properties or about a consumer’s principle dwelling; (2) asking that the appraiser provide additional information regarding the basis of a valuation; (3) asking that an appraiser correct factual errors in the appraisal report; (4) obtaining multiple appraisers on of a consumer’s principle dwelling, provided that the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that has the highest value; and (5) taking action permitted or

²⁸⁷ 73 Fed. Reg. at 44,565, 44,604; 12 C.F.R. § 226.36(a) [effective Oct. 1, 2009].

²⁸⁸ *Id.*

²⁸⁹ 73 Fed. Reg. at 44,604; 12 C.F.R. § 226.36(b)(3) [effective Oct. 1, 2009].

²⁹⁰ 73 Fed. Reg. at 44,567, 44,604; 12 C.F.R. § 226.36(b)(1)(i) [effective Oct. 1, 2009].

required by law.²⁹¹

2. New Prohibition on Unfair Servicing

The final rules prohibit unfair fees and servicing practices in connection with closed-end consumer credit transactions secured by a consumer's principal dwelling.²⁹² For the final rules, promulgated under the Board's HOEPA rulemaking authority, the Board adopted three of the proposed unfair servicing practices, while deciding against prohibiting servicers from failing to provide a schedule of servicing fees and charges within a reasonable time of request.²⁹³ For the purpose of prohibiting unfair servicing practices, the Board adopted by reference the terms "servicer" and "servicing" as defined by Section 3500.2(b) of Regulation X, which implement Real Estate Settlement Procedures Act ("RESPA").²⁹⁴

Accordingly, the final rules prohibit servicers from: (1) failing to credit a payment as of the date of receipt, except when the delay does not result in any charges to the consumer or in reporting of negative information to credit reporting agencies, except when a payment is made that does not conform to the servicer's reasonable payment requirements;²⁹⁵ (2) imposing late fees or delinquency charges on a payment, due to late fee or delinquency charge assessed on prior payment, if the payment is paid as agreed;²⁹⁶ or (3) failing to provide an accurate statement of the total outstanding balance required to satisfy the obligation as of a specified date, i.e. payoff statement, within reasonable time after receiving a request from or on behalf of a consumer.²⁹⁷

The rules also provide that if a servicer specifies to the consumer in writing reasonable requirements for making

²⁹¹ 73 Fed. Reg. at 44,568, 44,604; 12 C.F.R. § 226.36(b)(1)(ii) [effective Oct. 1, 2009].

²⁹² 73 Fed. Reg. at 44,570, 44,604; 12 C.F.R. § 226.36(d) [effective Oct. 1, 2009].

²⁹³ 73 Fed. Reg. at 44,570.

²⁹⁴ 73 Fed. Reg. at 44,570, 44,604; 12 C.F.R. § 226.36(c)(3) [effective Oct. 1, 2009]; Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601-2617; Regulation X, 24 C.F.R. § 3500.2(b).

²⁹⁵ 73 Fed. Reg. at 44,570, 44,604; 12 C.F.R. §§ 226.36(c)(1)(i), 226.36(c)(2) [effective Oct. 1, 2009].

²⁹⁶ 73 Fed. Reg. at 44,570, 44,604; 12 C.F.R. § 226.36(c)(1)(ii) [effective Oct. 1, 2009].

²⁹⁷ 73 Fed. Reg. at 44,570, 44,604; 12 C.F.R. § 226.36(c)(1)(iii) [effective Oct. 1, 2009].

payments, but accepts payments that do not conform to the requirement, the servicer must credit the payment to the consumer loan account within five days.²⁹⁸ This requirement is directed at remedying the results of instances where servicers accept the payment from a consumer yet fail to timely credit the account on the grounds that the consumer did not follow its payment procedures, which could also result in late payment being reported on the consumer's credit report.

D. New Consumer Protections in Mortgage Advertising

Addressing its second goal of improving mortgage disclosures in advertisements for credit secured by a consumer's dwelling and prohibit deceptive or misleading practices in connection with closed-end mortgage advertising, the Board revamped and expanded the rules pertaining to mortgage advertising disclosures in the new amendments. The Board addressed this task in two broad ways: first, by prohibiting certain acts or practices in advertisements for closed-end mortgage loans pursuant to its rule making authority under HOEPA; and second, by revamping and expanding rules governing advertising disclosures practices for both closed-end and open-end credit in accordance with its general rulemaking authority under TILA.²⁹⁹ This part will cover the new prohibited acts or practices for closed-end mortgages advertising and will provide an overview of the amendments made for closed-end mortgage advertisement disclosure requirements.

I. New Prohibited Acts and Practice for Closed-End Mortgage Advertising

Under its HOEPA rulemaking authority, the Board adopted, substantially as proposed, new Subsection 226.24(i), which prohibits seven acts or practices in advertisements for closed-end mortgages as unfair and deceptive.³⁰⁰ First, the final rule prohibits using the word "fixed" rate or payment in an

²⁹⁸ 73 Fed. Reg. at 44,571, 44,604; 12 C.F.R. § 226.36(c)(2) [effective Oct. 1, 2009].

²⁹⁹ See generally 73 Fed. Reg. at 44,574-90, 44,599-602; see 12 C.F.R. § 226.16 [effective Oct. 1, 2009] (for amendments regarding open-end credit advertising disclosures); see also 12 C.F.R. § 226.24 [effective Oct. 1, 2009] (for amendments regarding closed-end credit advertising disclosures).

³⁰⁰ 73 Fed. Reg. at 44,586.

advertisement for a variable rate mortgage or a mortgage where the payment will increase.³⁰¹ However, the rule permits the use of the word “fixed” in advertisements for variable rate or payments provided that the advertisement clearly discloses that it refers to a variable-rate mortgage and that the time duration for which the payment or rate will be fixed will be disclosed as closely to the fixed statement and be equally prominent.³⁰² Second, the rule prohibits comparing in an advertisement between an actual or hypothetical rate or payment and an advertised rate or payment, where the advertised rate or payment compared will not be available for the full duration of the loan.³⁰³

The third prohibition is regarding advertisement stating that the product offered is a “government loan program”, “government sponsored loan”, or otherwise sponsored or endorsed by a federal or state government entity, unless the advertised product is in fact endorsed or sponsored by a federal or state government entity, such as FHA or VA loans.³⁰⁴ Fourth, the rule prohibits using the name of the consumer’s current lender by an advertisement that was not sent by or on behalf of the consumer’s current lender, unless the advertisement in equal prominence discloses the name of the person or creditor making the advertisement and states in a clear and conspicuous manner that the person making the advertisement is not associated with or acting on behalf of the consumer’s current lender.³⁰⁵

Fifth, the rule prohibits making misleading claims in an advertisement that the product offers debt elimination or results in a waiver or forgiveness of a consumer’s existing obligations to another creditor.³⁰⁶ Sixth, the rule prohibits using the term “counselor” in an advertisement when referring to a for-profit mortgage broker or creditor involved in offering, originating, or

³⁰¹ 73 Fed. Reg. at 44,586-87, 44,602; 12 C.F.R. § 226.24(i)(1) [effective Oct. 1, 2009].

³⁰² 73 Fed. Reg. at 44,588, 44,602; 12 C.F.R. § 226.24(i)(1)(i) [effective Oct. 1, 2009].

³⁰³ 73 Fed. Reg. at 44,587-88, 44,602; 12 C.F.R. § 226.24(i)(2) [effective Oct. 1, 2009] (the subsection however allows advertised payment comparisons if additional requirements of the subsection are met.); 12 C.F.R. §§ 226.24(i)(2)(i),(ii) [effective Oct. 1, 2009].

³⁰⁴ 73 Fed. Reg. at 44,489, 44,602; 12 C.F.R. § 226.24(i)(3) [effective Oct. 1, 2009].

³⁰⁵ 73 Fed. Reg. at 44,489, 44,602; 12 C.F.R. § 226.24(i)(4) [effective Oct. 1, 2009].

³⁰⁶ 73 Fed. Reg. at 44,489, 44,602; 12 C.F.R. § 226.24(i)(5) [effective Oct. 1, 2009].

selling mortgages.³⁰⁷ Seventh and last, the rule prohibits providing, in a foreign language advertisement, only information about a trigger term or required disclosure, such as initial rate or payment, in the foreign language but providing other required disclosures and trigger terms in English, in the same advertisement.³⁰⁸

2. Overview of Advertising Rules for Closed-End Mortgage Loans

Apart from prohibiting unfair and deceptive advertising acts or practices the final rules amend the requirements for closed-end mortgage advertising in two additional and significant ways. First, the final rules add a clear and conspicuous standard that is applied for all closed-end credit, including closed-end mortgages.³⁰⁹ The new requirement provides an important framework for clarifying how the clear and conspicuous standard should apply to advertising disclosures.³¹⁰

Second, the final rule amended the regulation adding a new provision Subsection 226.24(f) to address disclosures of rates and payments for closed-end mortgages other than for television or radio advertisements.³¹¹ The new provisions of Subsection 226.24(f) are designed to ensure that advertisements adequately disclose all rates or payments that will apply over the term of the loan and the time period for which those rates and payments will apply.³¹² For example, the new rules prohibit an advertisement for a variable rate mortgage loan from disclosing a “teaser” rate or an interest rate lower than the rate at which interest is accruing.³¹³ In addition, the new provisions require that such an advertisement disclose the APR and one or more simple annual rates of interest, which for variable rate loans are fully indexed

³⁰⁷ 73 Fed. Reg. at 44,489-90, 44,602; 12 C.F.R. § 226.24(i)(6) [effective Oct. 1, 2009].

³⁰⁸ 73 Fed. Reg. at 44,490, 44,602; 12 C.F.R. § 226.24(i)(7) [effective Oct. 1, 2009].

³⁰⁹ 73 Fed. Reg. at 44,580, 44,601; 12 C.F.R. § 226.24(b) [effective Oct. 1, 2009].

³¹⁰ 73 Fed. Reg. at 44,580.

³¹¹ 73 Fed. Reg. at 44,583, 44,601-02; 12 C.F.R. § 226.24(f) [effective Oct. 1, 2009].

³¹² 73 Fed. Reg. at 44,601-02; 12 C.F.R. §§ 226.24(f)(2),(3) [effective Oct. 1, 2009].

³¹³ 73 Fed. Reg. at 44,601; 12 C.F.R. §§ 226.24(c), 226.24(f)(2) [effective Oct. 1, 2009].

rates.³¹⁴

In addition, the final rules add an alternative disclosure provisions for television and radio advertisements, providing a framework for compliance for such advertising mediums with the general advertising disclosure requirements.³¹⁵ Last, the rules add a disclosure requirement for advertisements distributed through paper or internet for closed-end mortgages secured by a consumer's principal dwelling that state the loan may exceed the fair market value of the property.³¹⁶ The new provisions require such advertisements disclose the tax implications of such transactions, such as that the interest on the portion that exceeds the fair market value of the property is not deductible for federal income tax.³¹⁷

E. New Early Disclosures for Closed-End Mortgage Loans

Addressing its third and final goal of providing consumers with early disclosures in closed-end mortgage transactions, the Board, pursuant to its general rulemaking authority under TILA,³¹⁸ adopted an early disclosure requirement for all closed-end mortgage loans secured by a consumer's principal dwelling. The new rules amend the current requirements that early mortgage transaction-specific disclosures be provided only in primary residence purchase-money mortgage transactions.³¹⁹

The new amendments require that in a closed-end mortgage transaction subject to RESPA and secured by a consumer's principal dwelling, a creditor provide good faith estimates of required disclosures to a consumer either before credit is extended, or shall be delivered not later than three business days after the creditor receives the consumer's written application, whichever is earlier.³²⁰ Accordingly, the early disclosure requirements are triggered by the date a creditor

³¹⁴ *Id.*

³¹⁵ 73 Fed. Reg. at 44,585, 44,602; 12 C.F.R. § 226.24(g) [effective Oct. 1, 2009].

³¹⁶ 73 Fed. Reg. at 44,585, 44,602; 12 C.F.R. § 226.24(h) [effective Oct. 1, 2009].

³¹⁷ *Id.*

³¹⁸ 73 Fed. Reg. at 44,591; 15 U.S.C. § 1604(a).

³¹⁹ 73 Fed. Reg. at 44,591; 12 C.F.R. § 226.19(a)(1) [effective until Oct. 1, 2009].

³²⁰ 73 Fed. Reg. at 44,591, 44,600; 12 C.F.R. § 226.19(a)(1)(i) [effective Oct. 1, 2009].

receives the consumer's mortgage application.³²¹

The new rules further prohibit a creditor or any other person from imposing any fee on the consumer before the consumer receives the required early disclosures,³²² except that a creditor or other person may impose a fee that is bona fide and reasonable in amount for obtaining the consumer's credit report.³²³

IV. DISCUSSION OF KEY ISSUES IN THE NEW AMENDMENTS AND THEIR IMPACT ON CONSUMERS IN THE MORTGAGE MARKET

Recent events in the subprime and Alt-A mortgage markets and their added affect to the turmoil in both the U.S. and global credit markets highlight the enormously important and commendable task the Board undertook in amending Regulation Z. The breadth of the new amendments is extensive and the Board's approach in crafting the provisions was innovative. The resulting final rules underscore the important role of public discourse in shaping future policy of consumer protection. In particular, the HOEPA mandated hearing process was a great source of ideas and balancing considerations which ultimately assisted the Board in tightening control over unfair, deceptive and abusive mortgage lending practices.

A. The Board's Use of its HOEPA Powers

In taking this regulatory action the Board made extensive use of its broad powers under HOEPA.³²⁴ Specifically, in increasing coverage to mortgage transactions beyond refinancing, the Board had to rely on its authority under Section 1639(l)(2)(A), which empowers the Board to prohibit acts or practices in connection with *mortgage loans* in general that the Board finds unfair, deceptive or intended to evade HOEPA's prohibitions.³²⁵ Pursuant to this power, the Board may prohibit any acts or practices, taken by anyone not just creditors, in connection with *mortgage loans* that are unfair or deceptive.

³²¹ 73 Fed. Reg. at 44,594.

³²² 73 Fed. Reg. at 44,591, 44,600-01; 12 C.F.R. § 226.19(a)(1)(ii) [effective Oct. 1, 2009].

³²³ 73 Fed. Reg. at 44,591, 44,601; 12 C.F.R. § 226.19(a)(1)(iii) [effective Oct. 1, 2009].

³²⁴ 73 Fed. Reg. at 44,528-29.

³²⁵ 15 U.S.C. § 1639(l)(2).

HOEPA, however, does not define a standard for what is unfair or deceptive, rather, according to the Conference Report on HOEPA, the joint explanatory statement of the committee of the conference indicates that in determining what is unfair or deceptive the Board should look to the standards of interpreting state unfair and deceptive trade practices acts and to the standard use under the FTCA Section 45(a)(1).³²⁶ Under the FTCA Section 45(n) unfair acts or practices are defined as those: (1) causing or likely to cause substantial injury to consumers; (2) which are not reasonably avoidable by consumers themselves; and (3) are not outweighed by countervailing benefits to consumers or to competition.³²⁷ Furthermore, in determining whether an act or practice is unfair, established public policies may be taken into consideration although they may not be primarily relied on for unfairness determination.³²⁸

While it is beyond the scope of this piece to evaluate each of the new prohibitions in accordance with these standards, a general observation is offered. Industry commentators have suggested that practices such as prepayment penalties, no escrows or “low-doc” or “no-doc” loans are not inherently unfair or deceptive.³²⁹ These commentators thus argued that the use of HOEPA rulemaking powers should be reserved for cases where practices are clearly unfair, deceptive or abusive.³³⁰ However, the new prohibited practices adopted by the Board were only prohibited in connection with HPMLs because these practices were developed to facilitate making higher cost mortgage loans to high risk borrowers in the subprime market. The mandate provided to the Board, as indicated by the Conference Report on HOEPA, was made with the recognition that the Board may need to prohibit new products and practices developed to facilitate reverse redlining. Reverse redlining are unfair, deceptive and abusive practices targeted at low-income, minorities and vulnerable communities.³³¹ Research has shown

³²⁶ 140 Cong. Rec. H at 6683.

³²⁷ 15 U.S.C. § 45(n).

³²⁸ *Id.*

³²⁹ Mortgage Bankers Association, Comments in Response to the Bd. of Governors of the Fed. Reserve’s Proposed Rule Amending Reg. Z 52 (Apr. 8, 2008), http://www.mortgagebankers.org/files/News/InternalResource/61776_MBAHOEPACommentsLetter.pdf.

³³⁰ *Id.*

³³¹ See CURBING PREDATORY HOME MORTGAGE LENDING, *supra* note 8, at 72.

that subprime borrowers are primarily comprised of low-income, minorities and vulnerable communities and are most likely to get mortgage loans at higher cost.³³² Therefore, by prohibiting practices developed to facilitate higher cost subprime mortgage lending, the Board's rulemaking action falls within its mandate to prohibit practices that facilitate reverse redlining.

B. Consumer Remedies for Newly Prohibited Practices

By adopting the prohibited practices in connection with HPMLs under § 226.35, all closed-end mortgages under § 226.36 and advertising under § 226.24(i) pursuant to the Board's HOEPA authority under § 1639(l)(2), the Board has extended to consumers the remedies afforded under HOEPA for violations of these prohibitions.³³³ Accordingly, a consumer who timely brings action against a creditor or assignee for violation of these prohibitions may be able to recover proven actual damages, statutory damages and attorney's fees, as well as, HOEPA special statutory damages equal to the amount of finance charges and fees paid by the consumer, unless the creditor can show that the failure to comply was not material.³³⁴

Moreover, as the prohibitions were adopted under the Board's HOEPA authority, failure to comply with the prohibition constitutes a failure to deliver "material disclosures" for rescission purposes.³³⁵ Although, the right of rescission generally does not apply to purchase-money mortgages, construction loans, or certain refinance consolidations with the same creditor.³³⁶ The current scope of the term "material disclosures" for the purpose of rescission under TILA is defined in Section 226.23(a)(3), footnote 48.³³⁷ Material disclosures include required disclosures of APR, the finance charge, the amount financed, the total payments, the payment schedule, as well as, the disclosures and limitations in Section 226.32 (c) and (d).³³⁸ Thus, according to current footnote 48, HOEPA prohibited

³³² *Id.* at 35-37, 72.

³³³ 73 Fed. Reg. at 17116.

³³⁴ 15 U.S.C. §§ 1640(a), 1641(a).

³³⁵ 73 Fed. Reg. at 17117; 15 U.S.C. §§ 1639(j), 1635(a), (f).

³³⁶ 15 U.S.C. § 1635(e); 12 C.F.R. § 226.23(f).

³³⁷ 12 C.F.R. § 226.23(a)(3) n.48 [effective until Oct. 1, 2009]. Under Reg. Z rules of construction, footnotes have the same legal effect as the text of the regulation. 12 C.F.R. § 226.2(b)(4).

³³⁸ 12 C.F.R. § 226.23(a)(3) n.48 [effective until Oct. 1, 2009].

practices and required disclosures are all included within the term “material disclosures.”³³⁹ The Board in the final rules amended footnote 48 by adding to the existing definition of “material disclosures” only the newly prohibited prepayment penalties practice in connection with HPMLs.³⁴⁰ Therefore, consumers may bring claims for rescission for violations of the prohibited prepayment practice in connection with HPMLs, as long as they are not made in mortgage transactions specifically exempt from the rescission remedy of TILA.³⁴¹

D. Prohibited Practices in Connection with HPMLs

Taking an innovative approach in focusing protection efforts on the subprime and higher-cost Alt-A markets, the Board crafted a new category of “high price mortgage loan” (“HPML”). Measuring the loan APR against a newly created “average prime offer rate” (“APOR”) benchmark plus thresholds of 1.5 and 3.5 percentage points for first and subordinate liens respectively, the new rules divide the mortgage market into three types of loan categories: (1) HOEPA high-cost loans or Section 32 loans; (2) HPMLs or Section 35 loans; and (3) a residual category, comprised of the majority of loans in the mortgage market, characterized by loans with lower risk and rates that do not meet the definition of either HOEPA or HPML.

In shaping its final rule concerning HPMLs the Board had to balance the views of mortgage industry commentators with those of several consumer advocates. For example, comments by a large industry trade association indicated that the initially proposed benchmark of comparable Treasury securities and thresholds would have resulted in significant coverage of prime loans.³⁴² On the other hand, several consumer advocate groups urged the Board to expand new protections to all loan types and programs that are secured by consumers’ principal dwelling regardless of APR triggers.³⁴³

³³⁹ *Id.*

³⁴⁰ 73 Fed. Res. at 44,551, 44,601; 12 C.F.R. § 226.23(a)(3) n.48 [effective Oct. 1, 2009].

³⁴¹ 15 U.S.C. § 1635(e); 12 C.F.R. § 226.23(f).

³⁴² American Bankers Association (“ABA”), Comments to Proposed Rule Amending Reg. Z 7-8 (Apr. 8, 2008), http://www.aba.com/NR/rdonlyres/365382A4-2EC6-4B41-93A6-28BFAD2779FB/52410/RegZ_Apr8_2008.pdf [hereinafter ABA Comments].

³⁴³ *See, e.g.*, Comments of the National Consumer Law Center, and

Nonetheless, consensus was apparent between certain consumer advocates and some industry trade associations who supported the use of an APR trigger, on the premise that the Board should use a mortgage-based benchmark rather than Treasury securities to ensure that the rate triggers more accurately reflect the credit risk in the mortgage market.³⁴⁴ These commentators echoed similar suggestions to use the Freddie Mac Weekly PMMS as a possible benchmark to avoid undue coverage of the mortgage market.³⁴⁵ This suggestion was largely adopted by the Board in the final rules. Consequently, the resulting Board's formulation of an APOR as a benchmark is sensible, particularly since the Board seeks to identify loans that are more expensive for consumers than regular prime loans for targeting abuse; and as the Board indicated, the new APOR benchmark and thresholds will cover all of the subprime market and part of the Alt-A market.³⁴⁶

The final rules prohibit four practices in connection with HPMLs, namely: (1) making loans without verifying consumer's ability to repay; (2) including prepayment penalties, except under certain conditions; (3) failing to make loans without escrows; and (4) documenting a loan as home equity lines of credit in a sham attempt to evade the new provisions.

In crafting the final rules the Board took an additional step forward in protecting consumers with its elimination of the "pattern of practice" precondition for enforcing the requirement that creditors verify consumer's ability to repay prior to extension of mortgage credit, for both HOEPA loans and HPMLs. As a result, the new rules will allow consumers to bring individual action against a creditor for this violation without the need to show that the lender engaged in a "pattern or practice", which

Consumer Action, Consumer Federation of America, Consumers Union Leadership Conference on Civil Rights, National Association of Consumer Advocates, National Fair Housing Alliance, and the Empire Justice Center to the Bd. of Governors of the Fed. Reserve's Proposed Rule Amending Reg. Z 4-5, 9-10 (Apr. 8, 2008), http://www.consumerlaw.org/issues/predatory_mortgage/content/HOEPACommentsAprilo8.pdf.

³⁴⁴ See, e.g., Comments of the Center for Responsible Lending ("CRL") on Proposed Rules Regarding Unfair, Deceptive, Abusive Lending and Servicing Practices 6-7 (Apr. 8, 2008), <http://www.responsiblelending.org/pdfs/fed-udap-comments-final-040808.pdf> [hereinafter CRL Comments]; see also ABA Comments, *supra* note 342, at 8.

³⁴⁵ See, CRL Comments, *supra* note 344, at 6-7; see ABA Comments, *supra* note 342, at 8.

³⁴⁶ 73 Fed. Reg. at 44,536.

was a major hurdle for individual enforcement in HOEPA cases.³⁴⁷

However, the Board took a step back on consumer protection when it removed the initially proposed presumption of violation of verification of consumer's ability to repay and replaced it with presumption of compliance.³⁴⁸ Unfortunately, the removal of the presumption of violation will make it harder for consumers to prove that the creditor failed to comply. In addition, the presumption of compliance does not set a bright line standard for failure to comply. The Board stated that it did not adopt a debt-to-income ratio requirement so as not to stifle future product innovations. However, this leaves some open questions regarding creditors' compliance with the prohibition. For example, at what point is a consumer deemed not to have an ability to repay? Where the debt-to-income ratios are 50, 60 or maybe 70 percent?

The Board's prohibition of prepayment penalties for HPMLs is another welcome protection for consumers in the subprime market. Specifically, prepayment penalties included in hybrid ARMs where the term of the prepayment exceeds the terms of fixed payment periods were particularly problematic for consumers in the subprime market. These prepayments trapped consumers in high cost loans, especially in times where the values of homes decreased, preventing some consumers in the subprime market from even having the opportunity to refinance into a more affordable fixed rate mortgage.

The Board's new rules prohibit prepayment penalties outright for loans where the principle or interest may change in the first four year after consummation; therefore, doing away with "2/28" and "3/27" ARMs having prepayment penalties for consumers in the subprime market. While the rule does not prohibit prepayment penalties completely it does provide consumers in the subprime market enough time, at the very least two years, to get better terms in the mortgage market.³⁴⁹

D. Prohibited Practices Regarding Closed-End Mortgages

The final rules prohibit two additional practices in

³⁴⁷ See, CRL Comments, *supra* note 344, at 13-17.

³⁴⁸ 73 Fed. Reg. at 44,549.

³⁴⁹ 73 Fed. Reg. at 44,555-56, 44,603; 12 C.F.R. § 226.35(b)(2) [effective Oct. 1, 2009].

connection with all types of closed-end mortgage loans secured by a consumer's principal dwelling. The rules prohibit creditors and mortgage brokers from coercing appraisers to misstate or misrepresent the value of an appraised property, as well as prohibit servicers from engaging in unfair fees and billing practices.³⁵⁰

Similar to the prohibition on HPMLs, the Board adopted the rules prohibiting acts and practices in connection with appraisers and mortgage loan servicing pursuant to its authority under HOEPA. However, civil remedies are only available for consumers against creditors and assignees. The new rules make it clear that mortgage brokers are not creditors even where the credit obligation is initially payable to the mortgage broker, as in table funded transactions.³⁵¹ In addition, under TILA a servicer is neither a creditor, unless the creditor is also the servicer of its own loans, nor is a servicer an assignee, unless it is or was the owner of the obligation.³⁵² Therefore, both in the case of mortgage brokers and servicers the new rules do not provide consumers enforcement remedies against either one of these parties.³⁵³ This is a gaping hole for consumers' ability to enforce the new protections that must be addressed by an amendment to TILA and HOEPA.

Nevertheless, redress is available for consumers against creditors and assignees for prohibited practices in connection with appraisers. Also, if the arrangement between a creditor or an assignee and a servicer gives rise to agency relationship between the parties, timely enforcement action may be brought for servicer's engagement in prohibited practices, against the principal creditor or assignee and the remedies discussed above may be available for a consumer under these circumstances.

In addition, apart from consumers' ability to enforce the new prohibitions, covered persons or entities under the new rules could be subject to enforcement action by the various administrative agencies charged with enforcement under TILA and Regulation Z,³⁵⁴ including State attorneys general that may enforce violations under prohibited under HOEPA.³⁵⁵

The final amendments failed to adopt any rules pertaining

³⁵⁰ 12 C.F.R. § 226.36 [effective Oct. 1, 2009].

³⁵¹ 12 C.F.R. § 226.36(a).

³⁵² 73 Fed. Reg. at 1716-17; 15 U.S.C. § 1641(f).

³⁵³ 73 Fed. Reg. at 1716-17.

³⁵⁴ 15 U.S.C §§ 1607(a),(c).

³⁵⁵ 15 U.S.C. § 1640(e).

to the payments of YSPs by creditors to mortgage brokers. The matter of payments of YPSs by creditors to mortgage brokers is one that deserves serious debate and consideration beyond the scope of this introduction. Nevertheless, it is this writer's opinion that it would be in the best interest of consumers and competition in the mortgage market that both creditors and mortgage brokers dealing directly with consumers provide full information to consumers regarding their compensation in the transaction. Such a requirement, which is currently only imposed on mortgage brokers, is especially warranted for creditors who use the originate-to-distribute model of mortgage loan origination, as those creditors are more likely to be able to provide a good faith estimate of YSP on the sale of the loan.

E. Prohibited Advertizing Practices

The Board's adoption of prohibited practices for closed-end mortgage advertising provides an important protection for consumers. The new rules protect consumers from unfair and misleading dissemination of information by any party, including creditors and mortgage brokers.

Although the prohibitions were adopted pursuant to the Boards HOEPA authority, it is not clear how consumers may enforce the prohibitions in a case where prohibited information is disseminated to individual consumers or mass disseminated through newspapers or the internet, even though no loan was taken. In addition, civil remedies may only be available against creditors and assignees and not advertising mortgage brokers. Nevertheless, similar to the above mentioned prohibitions, administrative enforcement is available and consumer complaints to enforcement agencies may prove to be a useful solution to curb unfair, misleading, and abusive mortgage advertising.³⁵⁶

F. Final Thoughts

The final rules are prospective provisions, which are due mostly to become effective by October 1, 2009.³⁵⁷ Yet, this

³⁵⁶ 15 U.S.C §§ 1607(a),(c); 15 U.S.C. § 1640(e).

³⁵⁷ 73 Fed. Reg. at 44,594-95. However, the effective date for the requirement of escrows on HPMLs is Apr. 1, 2010, except that the requirement of escrows on HPMLs for manufactured housing is effective Oct. 1, 2010. 73 Fed. Reg. at 44,595.

important regulatory action taken by the Board will do little to help consumers currently facing hardship, defaults, and foreclosures as a consequence of the loose underwriting standards and proliferation of unfair and abusive mortgage products to high-risk borrowers in the subprime market. It was estimated that 1.5 million loans representing over 40% of outstanding subprime ARM loans are scheduled to reset in 2008³⁵⁸ and an additional 1.5 million subprime ARM loans are estimated to reset in 2009.³⁵⁹ With an estimated \$350 monthly payment increase for average subprime ARM, it is very likely that more hardship, default and foreclosures are on the way.³⁶⁰

While one may criticize the Board that its recent regulatory actions should have been taken sooner to prevent the damage to consumers that is currently unfolding, one also realizes that hindsight is 20/20 and that it is not only the Board that should have acted sooner. On more than one occasion consumer advocates were prompted to consider asking the Board to exercise its authority under HOEPA.³⁶¹ Having been overly focused on attempting to find solutions on a national level to the growing problems of predatory and subprime mortgage lending, consumers and their advocates were blind to existing solutions that might have helped to mitigate the unfolding defaults and foreclosures disaster. Therefore, rather than criticized, the Board's undertaking of amending Regulation Z should, at the very least, be commended for its future salutary effect, as by and large the Board achieved its stated goal of enhancing consumer protection in the mortgage market.

Nonetheless, certain provisions in the new rules need

³⁵⁸ Ben S. Bernanke, Chairman, Bd. of Governors, Fed. Reserve Sys., Reducing Preventable Mortgage Foreclosures (Mar. 4, 2008), <http://www.federalreserve.gov/newsevents/speech/bernanke20080304a.htm> (last visited Nov. 13, 2008).

³⁵⁹ Randall S. Kroszner, Governor, Bd. of Governors, Fed. Reserve Sys., Protecting Homeowners and Sustaining Home Ownership (Feb. 4, 2008), <http://www.federalreserve.gov/newsevents/speech/kroszner20080204a.htm> (last visited Nov. 13, 2008).

³⁶⁰ Randall S. Kroszner, Governor, Bd. of Governors, Fed. Reserve Sys., The Challenges Facing Subprime Mortgage Borrowers (Nov. 5, 2007), <http://www.federalreserve.gov/newsevents/speech/kroszner20071105a.htm> (last visited Nov. 13, 2008).

³⁶¹ See, e.g., *Hearing on Protecting Homeowners*, *supra* note 203, at 36 (question by Rep. Spenser Bachus, Chairman, to Thomas Miller, Att'y Gen., Iowa); see also *Hearing on Legislative Solutions To Abusive Mortgage Lending Practices*, *supra* note 209, at 11 (statement by Rep. Dennis Moore).

further strengthening to prevent them from being challenged by creditors in the courts, specifically the prohibited acts and practices in connection with HPMLs. This could and should be achieved through codification of the provisions through additional congressional action. Congressional action is also required to address consumer remedies against servicers and in particular against mortgage brokers. While the Board acknowledged the large role of mortgage brokers in the origination process of mortgages, estimating over 60 percent of mortgages are originated through mortgage brokers,³⁶² it is striking that many of TILA and HOEPA disclosure provisions are now evidently unenforceable, neither by consumers nor by administrative agencies, against mortgage brokers. If mortgage brokers are to continue their significant role in the mortgage market, TILA and HOEPA must be amended to cover mortgage brokers, so as to provide consumers redress in cases of violations by mortgage brokers.

CONCLUSION

The Board's final rules amending Regulation Z are an important step forward for consumer protection from abusive lending acts or practices in the mortgage market. Through the adoption of the final rules, the Board made it clear that it has powerful tools at its disposal and that it is ready when necessary to take action to protect consumers in the mortgage market. Nevertheless, consumers and their advocates should continue working to fortify the protections afforded by new regulations with congressional legislation.

³⁶² 73 Fed. Reg. at 44,526.