

Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions

*Deborah Goldstein**

Introduction

In June 1998, the New York State Attorney General prepared a federal suit accusing the Delta Funding Corporation of targeting residents of minority neighborhoods for extremely high-interest home loans. The Attorney General alleged that Delta had violated the Equal Credit Opportunity Act¹ by basing loans on the level of the borrowers' home equity, rather than on their ability to meet the terms of repayment, and by repeatedly refinancing borrowers in default for even higher fees.² State investigators noted that Delta's loan patterns very closely matched maps of Brooklyn and Queens census tracts with 80% or more minority residents.³ Faced with an impending civil rights suit in federal court, Delta agreed to a settlement.⁴

New York's case against Delta is only the latest in a series of recent attempts to combat the practice of predatory lending.⁵ Predatory lending devastates both individual victims and their neighborhoods. Individuals may be forced to forego providing for their basic needs in order to meet

* A.B., Brown University, 1997; J.D. candidate, Harvard Law School, 2001.

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¹ 15 U.S.C. § 1691 (1994).

² See Randy Kennedy, *Home Lender Settles Case Alleging Bias*, N.Y. TIMES, June 23, 1999, at B1.

³ See *id.*

⁴ See *id.*

⁵ Community advocates use the term "predatory lending" as shorthand to describe a variety of practices that exploit vulnerable borrowers, such as the elderly or undereducated. See, e.g., William J. Brennan, Jr., *Predatory Mortgage Lending Practices, New Dimensions in Home Ownership and Housing Finance—Understanding the Subprime Market* (Oct. 23, 1998) (defining predatory lenders as lenders who "purposely target homeowners with substantial equity but less than perfect credit for high cost, abusive mortgage loans") (unpublished manuscript, on file with the Harvard Civil Rights-Civil Liberties Law Review). However, there is no established, objective definition of the term. Part II suggests inquiries to help narrow the definition of predatory lending.

excessive monthly payments and avoid losing their homes.⁶ The concentration of high-cost loans in particular areas can damage entire neighborhoods causing property maintenance to deteriorate, neighboring properties to become devalued, businesses and residents to pull out, and the sense of community to decline.⁷ Predatory lending frustrates housing advocates' efforts to increase homeownership rates in low-income communities and diverts advocates' time toward helping borrowers to manage the financial stress of struggling with loan payments.⁸

The problem of predatory lending is clearly widespread. A recent study by the Federal Home Loan Mortgage Corporation ("Freddie Mac") indicated that ten percent to thirty-five percent of subprime loans, which ordinarily have higher interest rates than conventional mortgage loans, could actually have been served in the prime market at lower cost.⁹ In 1997, real estate fraud cases investigated by the Los Angeles District Attorney involved "more than \$300 million in losses to homeowners and investors."¹⁰ Poverty lawyers and consumer advocacy groups throughout the country point to rising caseloads as an indicator of increasing predatory lending.¹¹ Several Boston community groups report dramatic increases. The Ecumenical Social Action Committee, Inc. "saw 80 clients who were threatened with foreclosures stemming from second mortgage abuses" during 1998.¹² The Boston-based organization Homeowner Op-

⁶ See Kennedy, *supra* note 2, at B1 (noting allegations that many of Delta's borrowers "lived without utilities or skipped meals to meet loan payments").

⁷ See Hillel Levine & Lawrence Harmon, *Blacks and Jews: Profits and Prophets: Overcoming Civil Rights in Boston*, TIKKUN, July-Aug. 1988, at 45 (describing the disintegration of inner-city neighborhoods as a result of a banking consortium's policy to make high-risk loans available without regard to borrowers' credit histories and despite high foreclosure rates).

⁸ See Luxman Nathan, *Borrower Beware: Equity Strippers Are Preying on Elderly Homeowners*, COMMUNITIES & BANKING, Spring 1999.

⁹ See FREDDIE MAC, AUTOMATED UNDERWRITING REPORT: MAKING MORTGAGE LENDING SIMPLER AND FAIRER FOR AMERICA'S FAMILIES ch. 5 (1996) [hereinafter FREDDIE MAC UNDERWRITING]. Credit scoring is based on a borrower's credit history, as recorded by credit reporting agencies. An A borrower has no late credit payments, while a D borrower would demonstrate a pattern of late payments. An A- borrower might have fewer than two late payments and no recent history of bankruptcy. Traditional lenders, also referred to as prime lenders, serve A borrowers, while subprime lenders serve borrowers whose A-, B, C, or D ratings prevent them from obtaining credit in the prime market. See Kathy R. Kalsner & Debra L. Novak, *FDIC Subprime Lending: A Time for Caution*, REGIONAL OUTLOOK, Third Quarter 1997, at 3.

Freddie Mac is a federally chartered corporation that increases the availability of mortgage funds by serving as a secondary mortgage market conduit between mortgage lenders and investors. See FREDDIE MAC, 1998 ANNUAL REPORT.

¹⁰ NORMA GARCIA-PAZ, *THE HARD SELL: COMBATING HOME EQUITY LENDING FRAUD IN CALIFORNIA*, (Consumers Union, San Francisco, Cal., 1998) <<http://www.consumer-union.org/finance/hspart1wc898.htm>>.

¹¹ See Nathan, *supra* note 8, at 7-8; see also Heather Timmons, *Two States' Lawmakers Targeting Predatory Lending*, AM. BANKER, June 9, 1999, at 9 (quoting South Brooklyn Legal Services Attorney claiming that "hundreds of complaints" have been received in the last year).

¹² Nathan, *supra* note 8, at 8.

tions for Massachusetts Elderly reported that at least one hundred seniors sought their assistance in preventing foreclosures between August 1998 and August 1999.¹³

The harms of predatory lending are difficult to combat due to inadequate information about the scope of the problem. Without input from consumers, enforcement agencies may be unable to track questionable lenders, since many non-bank lenders are exempt from regular reporting of their data. Consumers, however, may not realize when they have been the victims of predatory practices; even those consumers who realize that they have been preyed upon might be reluctant or unable to report incidents to enforcement agencies. Moreover, observers have not formulated a single, precise definition of predatory lending that distinguishes it from high-cost lending that is not predatory.

The absence of established norms has led to divergent views on high-cost loans to inexperienced borrowers. Consumer advocates observing the simultaneous expansion of subprime lending and the increased incidence in lending abuses and foreclosures accuse the entire subprime industry of engaging in predatory practices.¹⁴ Members of the financial industry, however, argue that subprime lenders perform an invaluable financial service by lending to borrowers with poor credit histories who could not otherwise obtain financing.¹⁵ Some industry leaders claim that existing laws banning fraudulent loans sufficiently address the problem.¹⁶

Legislators have made a number of attempts to distinguish acceptable and predatory lending practices. At the state level, North Carolina and New York have proposed statutes that define predatory lending by

¹³ See *id.* It is not entirely certain, however, that the estimates cited above indicate an increase in predatory lending. Other factors, such as growth in the housing market or increased consumer awareness of how to handle lending abuses, may also play a role.

¹⁴ See, e.g., *Equity Predators: Stripping, Flipping and Packing Their Way to Profits: Hearings Before the Senate Special Comm. on Aging*, 105th Cong. 238-46 (1998) [hereinafter *Equity Predators Hearings*] (testimony of Elizabeth Renuart and Margot Saunders, National Consumer Law Center).

¹⁵ See Randy Kennedy, *Borrowers Beware: A Special Report; Suits Say Unscrupulous Lending Is Taking Homes from the Poor*, N.Y. TIMES, Jan. 18, 1999, at A1 (quoting Marc Miller, whose family manages the Delta Financing Corp., stating that "there are many people who want and need a loan and can't get one. From that standpoint we fill a very legitimate niche in the consumer finance field."); see also John R. Wilke, *Justice, FTC Probe Lenders, Allege Abuses*, WALL ST. J., Jan. 30, 1998, at A3 (quoting the spokesman of Associates First Capital Corp., the nation's largest home equity lender, saying "consumer-finance lenders make credit available to a broad spectrum of people who might not otherwise be able to borrow").

¹⁶ See *Reform of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA): Joint Hearings Before the Subcomms. on Financial Institutions and Consumer Credit and Housing and Community Opportunity of the House Comm. on Banking and Financial Services*, 105th Cong. 52-55 (1998) [hereinafter *RESPA Hearings*] (statements of Daniel W. Morton, Huntington National Bank, and John J. Hayt, National Home Equity Mortgage Association).

reference to particular terms and practices.¹⁷ However, federal laws limit the extent to which states can regulate lending practices.¹⁸ Meanwhile, federal legislation regulating predatory behavior is underenforced due to enforcement agency budget restraints.¹⁹

Other current laws focus on the information available to consumers in an attempt to help consumers recognize the higher risks and costs associated with predatory loans.²⁰ Still, these laws often fail to require lenders to provide information to consumers in a clear and useful format. Moreover, they are premised on the mistaken assumption that consumers would understand and act on increased information if it were provided.

In the absence of a coherent understanding of what constitutes predatory lending, the law cannot adequately address the problem. Without clearly articulated norms, regulations risk being either too vague, leaving loopholes through which lenders may take advantage of consumers, or too broad, threatening the suppression of ordinary subprime lending, an important source of credit for high-risk borrowers.

This Note seeks to create a coherent definition of predatory lending that regulators, industry members, and community advocates can utilize in evaluating the effectiveness of existing responses to the problem and in seeking to develop new solutions. Part I identifies a continuum of subprime loan practices that runs from socially beneficial to egregiously fraudulent. Part II outlines some of the most common types of predatory lending in order to identify terms and practices characteristic of the problem and offers standards for evaluating terms and practices that fall in gray areas of the subprime lending spectrum. Part III examines existing responses to predatory lending and illustrates ways in which a definition of predatory lending can assist existing state and federal efforts to combat the problem. Part IV proposes a comprehensive set of alternative protections against predatory lending, including a preventative remedy that draws upon current laws to expand financial alternatives to predatory loans and a support infrastructure that would enable concerned actors to share information and ideas as they begin to develop consumer protection programs.

I. Identifying the Best and Worst Forms of Subprime Lending: A Continuum of Practices

There are two extremes of subprime lending—lending that is clearly beneficial and justifiable and lending that is clearly fraudulent. Between these two poles there exists a range of practices and combinations of

¹⁷ See discussion *infra* Part III.A.1.

¹⁸ See discussion *infra* Part III.A.2.

¹⁹ See discussion *infra* Part III.B.

²⁰ See discussion *infra* Part III.D.1, 2.

practices that may be labeled predatory based on the circumstances in which they are used. This section describes the two ends of the subprime lending spectrum.

A. *What Is Not Predatory Lending: Subprime Lending*

The subprime market uses risk-based pricing to serve borrowers who cannot obtain credit in the prime market. Loans with higher interest rates than those in the conventional market are not necessarily predatory. Such loans may simply be calculated to offset the higher risk and cost associated with lending to borrowers who have poor credit histories. Subprime lenders charge more for their loans because they bear higher risks and costs than traditional lenders. For example, costs may be increased by intensive servicing practices—lenders may call borrowers more frequently and may generate and mail monthly invoices rather than relying upon borrowers to submit payment coupons on their own.²¹

Meanwhile, lending to borrowers with lower equity and with flawed credit records generates higher risk. In the past, most subprime lenders relied on low loan-to-value (“LTV”) ratios and ordinarily would not have loaned more than sixty to seventy percent of the total value of a home to a subprime borrower seeking a mortgage. Subprime lenders today are more willing to make loans at high-LTV ratios.²²

Different lenders have varying cost structures and capacities for evaluating credit risk accurately.²³ This variation makes it difficult to tell whether individual loan fees and rates reflect predatory practices or differences in cost. As the subprime industry becomes increasingly standardized, the risk of subprime loans can be expected to decrease. In fact, in recent years, subprime lenders have moved toward using risk assessment models, while their use of story loans has decreased.²⁴

Subprime borrowers need lenders who will assume the higher risk that they present. This socially beneficial function of subprime lending makes it crucial to distinguish between loans that are expensive due to increased risks and costs from loans that exploit borrowers’ need, inexperience, or lack of understanding. The law can and should foster the for-

²¹ See Steve Cocheo, *Give Me Your Delinquents, Your Former Bankrupts, Yearning to Borrow . . .*, ABA BANKING J., Aug. 1, 1996, at 31, 36 (ellipses in original title).

²² See Paul Muolo, *High Allure, High Costs for B&C*, U.S. BANKER, June 1996, at 79, 80.

²³ Many subprime lenders do not rely upon traditional credit scoring techniques, but favor less standardized risk models instead. Some subprime lenders make *story* or *capacity-based loans*, for which lenders listen to applicants’ stories to “determine if their trouble [is] a one-time problem or [if it is] indicative of a history of inability to pay debt.” Cocheo, *supra* note 21, at 35.

²⁴ In addition, servicing practices like the invoice have become common in both traditional and subprime markets.

mer, thus ensuring the continued provision of financial services to the economically disenfranchised, while functioning to prevent the latter.

B. The Most Extreme Form of Predatory Lending: Fraud

At the other end of the subprime lending continuum lie practices that defraud borrowers and are unquestionably predatory. Cases of blatant fraud or misrepresentation typically involve home improvement scams or the falsification of information on loan documents.²⁵

Home improvement scams allow lenders to take advantage of borrowers at the beginning of loan transactions. These scams proceed as follows: a home improvement contractor, acting as a mortgage broker or lender, offers a loan to finance home repairs but fails to make his or her role as a broker understood to the borrower. The contractor then assigns the loan to a lender through an arrangement that has been made in advance.²⁶ In some instances, the contractor derives a fee from the lending bank for brokering a loan with high rates. Other contractors pay fees to lending banks in order to broker loans that will bring higher sums to the contractor than the repair work is worth. Loan brokers couple these home improvement scams with pressure tactics, such as coming to the borrower's home with a loan application on the day of the initial contact, to convince borrowers to purchase particular home improvement products. Some banks transfer funds directly to contractors before work on the home has begun, increasing the risk that contractors will do shoddy work or will fail to complete the repair at all.²⁷

The story of Janet G. is a typical case of recent home improvement fraud in New England.²⁸ A single mother who cares for a partially disabled adult son, Janet earns five dollars an hour as a dishwasher. A thermal window salesman telephoned her to offer replacement windows for a home that she was originally given as a gift. The salesman visited Janet's home in person, and, when Janet said that she could not afford the windows due to credit debt, the salesman called a lending company and obtained approval on-the-spot for a loan that would pay off all of Janet's existing debts. The lender brought two employees and an attorney to the closing of the loan, which was held at a McDonald's restaurant. Janet

²⁵ Such fraud can have a large impact on the financial industry. A study conducted for Freddie Mac reveals that of 44,665 cases of financial-institution fraud reported in 1996, 3.2% involved mortgage loan fraud. Mortgage loan fraud accounted for 12.9% of total monetary losses. See Michele M. Walczak, *Mortgage Industry Turns Up Heat on Fraud Artists*, SECONDARY MORTGAGE MARKETS, Oct. 1997, at 6-7.

²⁶ See *Equity Predators Hearings*, *supra* note 14, at 93 (statement of William J. Brennan, Jr., Atlanta Legal Aid Society, Inc.).

²⁷ In contrast, public programs do not allow loan funds to be dispersed directly to the contractor.

²⁸ See Telephone Interview with a local affordable housing counselor (July, 1999), supplemented by e-mail (on file with author).

attended alone. She was not told the final amount of the monthly payments until the closing. At that time, she was given a figure considerably higher than the salesman had originally quoted.²⁹ As Janet had already agreed to purchase the windows, she felt compelled to sign the loan despite the egregiously high price.

Other common fraud tactics include misrepresenting borrowers' income or debt level on loan applications, backdating documents, and forging borrowers' signatures. For example, one lender recorded a client's income at \$9,900 per month, including rental income and wages. In reality, the borrower's income was \$1,100 per month. A lender in New York City recorded one elderly woman's employment as a babysitter, despite the irregularity of this work. A Portland lender wrote on one borrower's income that she sold her cats for income.³⁰

The Mortgage Asset Research Institute estimates that, in 1993 and 1994, fifty-nine percent of mortgage fraud involved falsifying application information.³¹ Reported instances of forgery suggest that the practice is egregious and all too common. One former loan officer of a finance company said that his office employed a resident forger and that forging information was a regular part of business.³²

II. Identifying Predatory Loans Along the Continuum of Subprime Lending: Common Terms and Practices

Between the two poles of subprime lending lie numerous practices that are neither clearly socially beneficial nor clearly fraudulent. In determining whether these practices are predatory, regulators must look not only to a loan's terms, but to the circumstances surrounding the loan agreement. Either line of analysis on its own might prove too ambiguous, but together they shed light on each other and can lead to clearer conclusions.

Theoretically, predatory lending may be found in any loan where the borrower's expenses cannot be justified on the basis of the lender's additional risk and cost.³³ However, the ambiguity of the credit risk characteristics of particular loans and the lending industry's lack of uniform risk pricing models make it difficult to identify the relationship between risk and cost in individual transactions.³⁴ As a result, loan terms on their own are not necessarily sufficient to identify predatory practices.

²⁹ The loan included a 10-point origination fee, and the windows cost \$8,500.

³⁰ See Individual and Focus Group Interviews with housing counselors, Neighborhood Reinvestment Training Institute conference, Chicago, Ill. (June 28–29, 1999).

³¹ See Walczak, *supra* note 25, at 7.

³² See *Prime Time Live* (ABC television broadcast, Apr. 23, 1997).

³³ See discussion *infra* Part II.B.

³⁴ The industry is beginning to move in this direction with the advent of automated underwriting.

This indeterminacy can be remedied by looking not only to the terms of a loan but to the circumstances surrounding it. If a lender deceives a borrower, preys on the borrower's inexperience, or hides important information, the loan is more likely to be predatory. The difficulty in evaluating particular loan practices lies in discerning how much control a consumer had in agreeing to the terms of a particular loan. Therefore, an attempt to understand the circumstances must examine the borrower's knowledge and understanding of the implications of the transaction,³⁵ the lender's subjective intent, and the lender's behavior in the transaction and in other situations. The following inquiries can help evaluate loan terms to identify whether a loan is predatory:

Did the borrower have full knowledge and understanding of the terms of the loan and of the right to cancel the loan transaction at any time?

Did the lender affirmatively disclose to the borrower all material information regarding the terms of the loan and the borrower's rights?

Did the lender obscure, or attempt to obscure, material information about the loan terms? Did the lender lead the borrower to believe that the loan transaction could not be canceled?

Did the lender apply pressure to induce the borrower to enter into the loan agreement?

Did the lender know, or should the lender have known, that the borrower's income was insufficient to meet the terms of the loan? Did the lender determine the borrower's eligibility by reference to an asset in which the borrower owned equity, without regard for the borrower's ability to pay?

Has the lender exhibited a pattern of targeting vulnerable populations for the purpose of making high-cost loans?

Focusing on the circumstances surrounding loan agreements, as well as on specific loan terms, can facilitate the establishment of new laws that restrict predatory activity and can advance enforcement of current laws by helping to identify particular loans as predatory.

A. Examples of Unfair Loan Terms

Predatory lenders go beyond risk-based pricing to set loan terms far above that which is required to offset costs and earn a return that compensates them for their risk. They use high interest rates, fees far in excess of market value, lump sum credit insurance requirements, and other loan traps. While these loan terms are not predatory in themselves, each practice imposes a serious cost on the borrower and is therefore

³⁵ Indeed, many homeowners take out second mortgages to consolidate their debt for good reason, borrowing against home equity to improve homes, for example. Such borrowers may be willing to agree to disadvantageous loan terms in order to obtain financing.

justifiable only under conditions that make it clear that the borrower understood the implications of these terms.

Subprime interest rates ordinarily exceed prime interest rates in order to compensate for increased risk.³⁶ Some lenders, however, charge rates that do not correlate with risk at all. In addition, borrowers are often unable to discern an appropriate rate because the lender refuses to disclose such information, fails to disclose it in a timely manner, or because other loan products are not available to the borrower for comparison.

Subprime mortgage brokers may also demand fees up front from the borrower but fail to lower the loan's interest rate accordingly. Mortgage brokers often increase a loan's annual percentage rate by setting unreasonably high costs and fees, for example, for simple document preparation. Other brokers charge fraudulent amounts, such as appraisal fees for lender-initiated encounters or broker's fees for meetings that have never taken place. A borrower who is unfamiliar with mortgage loans or who has no means of comparing one loan to another may well be unaware that such costs are radically out of line with market norms. In setting these fees, the broker does not base the terms of the loan on risk, but takes advantage of the customer's lack of knowledge as to how mortgages are generally structured.³⁷

The sale of credit insurance as part of a mortgage loan poses another potential problem. Such sales often are accomplished through lump-sum payments or single premium requirements. The single premium requires the borrower to finance his own loan charge and thus to pay the interest on the charge, while also paying for the insurance. Critics say that such insurance is unnecessary and that it rarely pays off for the insured.³⁸ Still, lenders' revenue from credit insurance is extremely high. One former broker for a predatory lending company testified before the Senate that loan salespeople are strongly encouraged to tack credit insurance onto loan packages: "Usually," he stated, "the more naïve the customer, the more insurance I would pack on the loan before I made the initial monthly payment quote."³⁹ Often, finance companies maintain insurance sale quotas and offer bonuses for employees who engage in such tactics.

Predatory lenders also find ways to trap borrowers in existing loans and force them to refinance or enter into foreclosure. In some cases, borrowers enter into mortgage loans assuming that they can pay off existing debt and obtain more favorable loan terms when they have money to repair their credit. These borrowers are typically unaware of loan terms that prevent them from doing so. Such terms are legal in most jurisdictions and are desirable for some borrowers, but the failure to disclose

³⁶ See *supra* note 21 and accompanying text.

³⁷ See *Equity Predators Hearings*, *supra* note 14, at 87 (statement of William J. Brennan, Jr., Atlanta Legal Aid Society, Inc.).

³⁸ See *id.*

³⁹ See *id.* at 33 (testimony of "Jim Dough," former employee of a predatory lender).

such terms can lead to painful consequences for borrowers acting upon contrary expectations.

In order to trap borrowers in existing loans, some loans have negative amortization, with repayment structures set up such that the borrower's periodic payment fails to pay off accruing interest. This increases the principal balance of the loan to each month. A related practice attaches balloon payments to the end of a loan that often amount to approximately eighty-five percent of the loan's principal balance. Similarly, lenders often establish high prepayment penalties to prevent borrowers from refinancing or selling a home subject to a disadvantageous existing mortgage. Moreover, borrowers who wish to cancel a loan based on deceptive sales practices may find that their loan contract contains a binding arbitration clause.⁴⁰

Some consumer advocates argue that loans in excess of 100% LTV can lock borrowers into additional debt since delinquent borrowers ordinarily cannot pay off their debt through foreclosure sales. Once a borrower falls behind in payments, therefore, he or she faces debt that continues past the foreclosure or refinancing of the asset subject to the loan. However, high-LTV loans may be a useful product for borrowers in some cases. In fact, some affordable housing programs use high-LTV loans to assist clients. Accordingly, regulators must focus on the lender's intent in offering a product with high-LTV and the extent to which the particular borrower understood the risk associated with such a loan at the time of the transaction.

Finally, lenders often structure second mortgage and refinancing packages in ways that adversely affect borrowers. Some lenders require borrowers to pay off existing mortgages with new loan money, building the cost of that repayment into a new mortgage with a higher interest rate and principal amount. Lenders benefit since the amount of the new loan grows and the new loan retains first-lien status. First-lien status is important because it gives the lender debt collection priority in case of foreclosure.⁴¹

B. Examples of Abusive Circumstances

Although some loan terms may seem excessive, they may not be predatory standing alone. If a particular borrower is aware of and agrees to the terms, a lender may justifiably include such terms in a loan, and, indeed, may be providing an important service to the borrower. However, questionably abusive terms are more likely to be predatory when they are

⁴⁰ See *id.* at 93 (statement of William J. Brennan, Jr., Director, Home Defense Program of the Atlanta Legal Aid Society, Inc.). Lenders often perceive that an arbitration forum will be more favorably disposed to their interests than a court. Where such binding arbitration clauses exist, they usually require borrowers to help pay for the arbitration.

⁴¹ See Interview with housing advocate (June 30, 1999).

agreed to under circumstances that rob the borrower of control over the transaction. In order to determine whether a particular loan is predatory, one must look not only to the specific loan terms but to how the circumstances surrounding the loan affected the borrower's control over the transaction.

A 1997 settlement between the Federal Trade Commission ("FTC") and The Money Tree, Inc. provides an example of how unfavorable terms can be combined with abusive tactics in a pattern of predatory lending.⁴² The settlement illustrates how The Money Tree obscured information from its customers and pressured them into holding disadvantageous credit. The original complaint in that action charged The Money Tree with inducing consumers to sign statements indicating that the customer voluntarily chose rates that were actually required by the company. The complaint further charged that The Money Tree failed to include the cost of credit insurance in the financing of loans and failed to disclose such costs to consumers as part of the annual percentage rate. Instead, the cost of credit insurance was included in the amount actually financed, which hid the loan's long term cost from the borrower.⁴³

Predatory lenders often fail to explain the terms of loans until the closing transaction and then use pressure tactics to prevent the borrower from declining the disadvantageous loan. In such a circumstance, a borrower might think that she is agreeing to a certain monthly payment only to find, at the last moment, that a much higher figure is listed on the actual loan documents.⁴⁴ Often, such a borrower is made to feel that it is too late to back out of the loan. By this point, as in the case of Janet G. above,⁴⁵ the borrower already may have agreed to purchase a particular home improvement product to be financed by the loan.⁴⁶ In some cases, lenders reassure customers that the listed payment will be reduced or that the loan will be refinanced after an initial period. In other cases, lenders simply present borrowers with fraudulent documents.⁴⁷

Brokers often obscure vital information by burying the cost of a particular loan in pages of documentation and discouraging the borrower

⁴² See Agreement Containing Consent Order, *In re* The Money Tree, Inc. and Vance R. Martin, 123 F.T.C. 1187 (1997) (File No. 932 3023) <<http://www.ftc.gov/os/1997/9702/moneytree.htm>>.

⁴³ See *id.* The final settlement required that The Money Tree and its officers allow customers to cancel the insurance packages and to obtain cash or credit refunds. It also prohibited the company from requiring consumers to sign a statement that their insurance purchase was voluntary. The Money Tree was required to tell consumers that their loan applications had been approved before referring to the extras and to disclose that credit life insurance or auto club memberships were optional.

⁴⁴ See Individual and Focus Group Interviews with housing counselors, *supra* note 30.

⁴⁵ See *supra* notes 28–29 and accompanying text.

⁴⁶ See Telephone Interview with a local affordable housing counselor, *supra* note 28.

⁴⁷ See Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 389–90 (1994).

from reading the agreement. In some cases, they even avoid giving the borrower a copy of the loan documents. Such brokers occasionally place their arms over vital portions of loan documents in order to obscure terms from the borrower during a loan meeting. Borrowers have reported that when they asked during a meeting what would happen if they missed a payment, the broker laughed and said playfully, "We'll take your house," as if to indicate that the response were a joke, rather than an actual consequence.⁴⁸

Predatory sales practices such as "upselling" also push customers into the most profitable products for the lender. Lenders engaged in upselling typically use a small loan, such as a check voucher mailed to the customer or a retail sales installment loan, to obtain initial information about the new customer. Following this first transaction, the finance company can obtain information about the customer's credit history, employment, income, homeownership status, and debts. A branch employee then usually contacts the customer with the goal of converting the small initial loan into a personal or home equity loan.⁴⁹

Another common way to increase the size of the loan and the lender's profits is to pressure borrowers to consolidate their credit and mortgage debt without disclosing the risks and costs of the consolidation. Borrowers may not realize that consolidation could lengthen the amount of time that it takes to pay off credit debt, nor that previously unsecured debt is now secured by their home.⁵⁰ Using the inquiries listed above, upselling would clearly be characterized as predatory because it necessarily involves pressure tactics and because lenders engaged in the practice do not disclose the full range of credit options available to the borrower.

After upselling, lenders may employ abusive collection tactics to prevent customers from seeking recourse. These tactics make the borrower feel powerless and bound to the transaction. Some lenders call frequently, even at night, to request payment. Other lenders send late payment notices or call when a payment plan has already been created. Some lenders threaten to evict borrowers immediately, knowing that foreclosure and eviction will actually take longer than threatened.⁵¹

In a common practice called *flipping*, lenders convince customers to refinance existing loans. Some branch managers have been told to target blue-collar workers and current customers who are delinquent on their loan payments for flipping. Personal loan customers whose terms have less than six months remaining and those who owe less than fifty percent of the original principal balance on their loans are also targets. Each loan

⁴⁸ *Fox News 5 Investigation* (WAGA-TV FOX television broadcast, May 4, 1998).

⁴⁹ See *Equity Predators Hearings*, *supra* note 14, at 31-32 (statement of "Jim Dough," former employee of a predatory lender).

⁵⁰ See *id.*

⁵¹ See *id.*

conversion or renewal results in a charge to the consumer and profit to the finance company.⁵²

The consequences of targeting vulnerable customers and flipping their loans can have disastrous costs. For example, finance companies flipped Jon K., a fifty-four-year-old homeowner in New England whose only income is Social Security Disability Insurance.⁵³ Jon K.'s medical bills average \$1,800 per month, \$300 of which he pays out-of-pocket. Jon refinanced his mortgage with two lenders who, in turn, sold the loan to a third lender. The third company then refinanced the loan. A loan that began at \$88,000 became \$96,000 in eight months and included \$4,600 in points. Jon now has a housing-debt-to-income ratio of sixty percent.

Targeting vulnerable or protected groups for high-cost mortgages, which is known as *reverse redlining*, is clearly a predatory practice because it identifies consumers for such products based on factors other than the quality of their credit. For example, brokers often target elderly homeowners with high equity levels in their homes by driving through neighborhoods looking for older homes or by purchasing from credit reporting agencies lists of elderly homeowners with recent debts.⁵⁴

Older homeowners are victims of reverse redlining because they have substantial equity in their homes, significant need for money, and are underserved by conventional sources. Rising housing prices and savings accumulated by paying down the mortgage give elderly homeowners, who presumably have owned their homes longer, considerable equity. As a result, the elderly typically hold most of their wealth in equity and have more equity in their homes than other segments of the population.⁵⁵ Moreover, as older homeowners are more likely than younger homeowners to hire home improvement contractors—primarily because elderly homeowners are less likely to do necessary repairs themselves—they are often the targets of predatory home improvement schemes.⁵⁶ Finally,

⁵² *See id.*

⁵³ *See* Telephone Interview with local affordable housing counselor, *supra* note 28.

⁵⁴ *See* Individual and Focus Group Interviews with housing counselors, *supra* note 30.

⁵⁵ Half of those age 65 or older held 58.6% or more of their wealth in home equity. Twenty percent of owner-occupied units with an elderly householder have less than \$10,000 outstanding in principal on their homes, compared with fewer than 10% of all other homeowners. *See* JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, THE STATE OF THE NATION'S HOUSING: 1997. Thirty-one percent of elderly householders have less than eight years remaining on their mortgage, compared with less than five percent of all other householders. *See* U.S. DEP'T OF COMMERCE BUREAU OF THE CENSUS, AMERICAN HOUSING SURVEY FOR THE UNITED STATES IN 1995 132, 366 (1995) (tabulations made by author). Twenty-eight percent of lower-income elderly homeowners have more than \$100,000 of equity in their homes (*lower income* refers to those earning 80% of the area median and *elderly* refers to persons aged 65 or older). Thirty-eight percent have between \$50,000 and \$99,999 of equity in their homes. *See* FEDERAL RESERVE BOARD, THE 1995 SURVEY OF CONSUMER FINANCE (tabulations made by the Joint Center for Housing Studies of Harvard University and on file with author).

⁵⁶ *See* Telephone Interview with local affordable housing counselor, *supra* note 28. Approximately half of all homeowners age 65 or older had repairs or maintenance work

older homeowners are also more susceptible to fraud and high-pressure sales tactics. They are likely to be home during the day when door-to-door salespeople or telemarketers call.⁵⁷ The enormous population of elderly who live alone or with only a spouse is particularly vulnerable to these marketing tactics.⁵⁸

Predatory lenders also target minority populations. The initial impetus for New York State's case against Delta Funding Corporation was the discovery that Delta's business was concentrated in areas whose census tracts reported at least eighty percent of the residents as being from minority groups.⁵⁹

III. Existing Remedial Efforts: The Need for a Definition of Predatory Lending

State legislators, federal regulators, consumer groups, and financial organizations have used both narrow and broad definitions in seeking to combat the problem of predatory lending. These efforts have largely taken the form of preventative measures that prohibit certain types of loans and attempt to supply consumers with increased information, in conjunction with reactive measures that punish unscrupulous behavior by lenders.

A. *State Efforts to Regulate Terms and Practices of Predatory Lenders*

States have mainly attempted to combat predatory lending by defining it in relation to specific terms and practices and by prohibiting the use of those terms and practices. Federal laws that preempt state mortgage regulation, however, limit the ability of states to take this approach. Additionally, as legislators and their constituents have had difficulty agreeing on exactly

performed on their homes during a two-year period. See U.S. DEP'T OF COMMERCE BUREAU OF THE CENSUS, AMERICAN HOUSING SURVEY FOR THE UNITED STATES IN 1993, 352 (1993). The Joint Center for Housing Studies estimates that less than 12% of do-it-yourself repairs are done by homeowners age 65 or older. In comparison, more than one-quarter of all homeowners are age 65 or over and almost one-third of owners that hire professional remodeling contractors are in this age group. See JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, IMPROVING AMERICA'S HOUSING: THE REMODELING FUTURES PROGRAM (1999). For example, while 41% of homeowners between the ages of 65 and 74 hire professionals for home repair work, only 34% of homeowners between the ages of 25 and 34 hire professionals. See U.S. DEP'T OF COMMERCE BUREAU OF THE CENSUS, AMERICAN HOUSING SURVEY FOR THE UNITED STATES IN 1997 (tabulations made by the Joint Center for Housing Studies of Harvard University and on file with author).

⁵⁷ See Monroe Friedman, *Confidence Swindles of Older Consumers*, 26 J. CONSUMER AFF. 23 (1992).

⁵⁸ Approximately 40% of persons over the age of 75 and 23% of persons between 65 and 75 live alone, while less than 10% of persons between the ages of 20 and 55 live alone. See U.S. DEP'T OF COMMERCE BUREAU OF THE CENSUS, MARCH 1997 CURRENT POPULATION SURVEYS (tabulations made by author).

⁵⁹ See *supra* note 3 and accompanying text.

which terms and practices are predatory, this approach has had limited success from state to state. Regulators and consumer groups also worry that once they designate ceilings on loan terms, those ceilings will become the norm for all lenders.⁶⁰

1. State Legislation

In North Carolina, recent state legislation addressed predatory lending by limiting terms associated with high-cost loans.⁶¹ Such loans cannot include balloon payments, negative amortization, prepayment fees, or the financing of fees.⁶² Under the legislation, the financing of upfront, single-premium credit insurance is also prohibited, while monthly payment credit insurance is permitted.⁶³ Additionally, lenders are prohibited from making high-cost mortgage loans if a particular borrower's debt-to-income ratio exceeds fifty percent.⁶⁴ In an effort to increase the understanding of information available to borrowers, the law requires borrowers who take out high-cost mortgages to receive home ownership counseling.⁶⁵

New York legislators recently proposed a bill that would limit broker fees paid by borrowers or lenders to three percent of the loan amount.⁶⁶ New York Governor George Pataki has also proposed a rule similar to North Carolina's legislation.⁶⁷

2. Federal Limitations on State-Based Solutions

Although North Carolina recently passed regulations on loan terms and New York is considering similar action, federal preemption limits the ability of states to regulate unfair loan terms. In 1980, Congress passed the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA")⁶⁸ out of concern that interest rates were so high that state usury ceilings would prevent mortgage transactions at market rates in some states. DIDMCA preempts state usury ceilings on any "federally

⁶⁰ See Interviews with regulators (June 24, 1999 and August 2, 1999).

⁶¹ See N.C. GEN. STAT. § 24-1.1 (1999). *High-cost loans* are defined as loans that either charge an interest rate more than 10% above Treasury-bill rates or have points and fees in excess of five percent of the loan amount (legitimate fees to third parties, such as appraisals or title insurance, are not included). See § 24-1.1E (A)(4).

⁶² See §§ 24-1.1E (B)(1)-(4).

⁶³ See § 24-1.1E(C)(3)(A).

⁶⁴ See § 24-1.1E(C)(2).

⁶⁵ See § 24-1.1E(C)(1).

⁶⁶ See 1999 N.Y. Laws 4731 § 4(A); see also Heather Timmons, *Home Equity: Two States' Lawmakers Targeting Predatory Lending*, AM. BANKER, June 9, 1999, at 9.

⁶⁷ See Katharine Fraser, *New York State Weighing Proposed Rule Designed to Curb Predatory Lending*, AM. BANKER, Aug. 16, 1999, at 2.

⁶⁸ See 12 U.S.C. § 1735f-7(a) (1994).

related mortgage loan" secured by a first lien on residential real estate.⁶⁹ When enacted, the statute allowed states to opt out of the usury preemption within a certain period of time.⁷⁰ Sixteen jurisdictions did so.⁷¹

DIDMCA's critics argue that the statute's provisions are too broad and thus invite unscrupulous practices.⁷² According to a ruling by the U.S. Court of Appeals for the Third Circuit, federal preemption on loans secured by a first lien is not limited to loans made for the purchase of a home, but refers to any first lien.⁷³ As a result, some home equity lenders may require homeowners to pay off existing mortgages with new high-rate home equity loans and thereby turn their homeowners' loans into first liens.⁷⁴ In addition, many states have followed federal deregulation of first liens by removing rate caps and other restrictions on various types of home lending.⁷⁵

In 1983, Congress enacted the Alternative Mortgage Transaction Parity Act ("AMTPA"),⁷⁶ which similarly preempted state laws restricting alternative mortgage financing arrangements including balloon payments, negative amortizing loans, and variable interest rate loans. AMTPA is not restricted to purchase money loans, but applies to any "loan or credit sale secured by an interest in residential real property."⁷⁷ Thus, it goes beyond the scope of DIDMCA, which only applies to first liens.⁷⁸

States must have more freedom to regulate predatory lending. Federal preemption laws severely restrict states' ability to formulate specific definitions of prohibited practices and terms. DIDMCA and AMPTA are necessary to preserve the general availability of credit and uniformity in credit markets across states, but these laws could be amended to limit the scope of federal preemption only to home purchases and market rate loans. States would then be free to devise their own regulation of high-cost and abusive loans. Predatory lending is better regulated at the state level because state governments are more likely to be familiar with the specific lending practices that affect their constituents locally.⁷⁹ Differing

⁶⁹ § 1735f-7(a)(1)(A).

⁷⁰ See § 1735f-7(b)(2).

⁷¹ For a list of jurisdictions that opted out (fifteen states and Puerto Rico), see William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consistent with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1109 n.92 (1984).

⁷² See *Home Ownership and Equity Protection Act, 1993: Hearings on S. 924 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 6-7 (1993).

⁷³ See *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907 (3d Cir. 1989).

⁷⁴ See Forrester, *supra* note 47, at 417.

⁷⁵ See *RESPA Hearings*, *supra* note 16, at 432 (testimony of Margot Saunders, National Consumer Law Center).

⁷⁶ 12 U.S.C. § 3800 (1994).

⁷⁷ § 3802.

⁷⁸ AMTPA could be amended so that it applied only to first and second liens primarily for the acquisition or construction of a residence or to allow its refinancing structure to offer a more favorable rate to the borrower.

⁷⁹ Certainly, there are disadvantages associated with leaving regulation to the states.

practices also mean that it is difficult for the federal government to reach national agreement on standards for high-cost mortgages and delivery of loan services.

B. Broad-Based Legislative Remedies: A Case-by-Case Approach

Federal regulators have taken a different approach to addressing predatory lending. They have defined predatory lending more broadly and have used existing laws to target particular suspicious lenders.⁸⁰ While regulators cannot detect every case of abuse and do not have the resources to prosecute every predatory lender, single cases can serve as an example to other lenders of the potential risk involved in unscrupulous practices.

The federal government also has sought to increase the amount of information available to consumers in the subprime market. Statutes providing increased information are premised on the idea that consumers armed with such information are more able to identify and avoid disadvantageous loans.⁸¹

There exist some potential problems with the federal approach. Regulating specific practices may limit legislators' ability to address the most extreme predatory practices and may also limit legislative consensus in other state forums or at the national level. As mentioned before, many predatory practices are ambiguous; they are not always clearly illegal or even consistently wrong. Broader laws can be useful in confronting lenders who evade regulations and take advantage of vulnerable borrowers.

The FTC is one of the few regulatory organizations that, in recent years, has sought to combat the full scope of abusive practices in the subprime market by addressing the acts of specific lenders.⁸² Its enabling legislation, the Federal Trade Commission Act ("FTC Act"),⁸³ allows the FTC to file complaints against any companies that engage in unfair and deceptive trade practices. The FTC also uses the Truth in Lending Act ("TILA")⁸⁴ to address unfair and deceptive trade practices.

These include the fear that some states would not choose to enact regulations on predatory lending or would not be able adequately to reach those lenders doing business in multiple jurisdictions.

⁸⁰ See, e.g., Truth in Lending Act, 15 U.S.C. § 1601 (1994 & Supp. II 1996).

⁸¹ See, e.g., Real Estate Settlement Procedures Act, 12 U.S.C. § 2601 (1994 & Supp. II 1996). This approach assumes that borrowers respond rationally to information about their loans. Unfortunately, some lenders or brokers are able to find ways to obfuscate information and circumvent disclosure requirements.

⁸² See *Effects of Consolidation on the State of Competition in the Financial Services Industry: Hearings Before the House Comm. on the Judiciary*, 105th Cong. 26-28 (1998) (statement of William J. Baer, Director of Bureau of Competition, FTC).

⁸³ 15 U.S.C. § 45 (1994).

⁸⁴ 15 U.S.C. § 1601 (1994 & Supp. II 1996). See discussion *infra* Part III.D.1.

An FTC suit filed against Capital City Mortgage, in January 1998, alleged several counts of unfair and deceptive trade practices.⁸⁵ Although not yet resolved, the suit demonstrates that a broad-based law can be used to reach practices that are potentially predatory. The complaint alleged six violations of the FTC Act, including misrepresentation of loan terms and collection of money for false purposes.⁸⁶ Capital City allegedly represented to borrowers that there would be only a slight difference between a loan payment on an existing loan and a new loan that consolidated the old loan with new funds. In reality, the new payment was both much higher than the existing loan and, indeed, exceeded the borrower's entire monthly income.⁸⁷ The complaint alleged TILA violations, including failure to identify the creditor; to disclose the annual percentage rate; and to disclose the payment schedule (including the balloon payment).⁸⁸ While these practices may not have been explicitly prohibited by law, the evidence suggests a pattern of deceit by the lender.

The major disadvantage of a case-by-case prosecution approach is the cost and time needed to prosecute a single lender. The FTC does not have the resources to gather evidence against and prosecute every predatory lender. Further, the relative ease with which a lender can reenter the market as a new business entity even after a guilty verdict makes it almost impossible to realize improvements in the mortgage field.

Two additional pieces of federal legislation may be used to counteract abusive collection practices.⁸⁹ The Fair Credit Reporting Act ("FCRA")⁹⁰ requires credit reporting agencies to report accurate and complete information to creditors. FCRA also requires a creditor to inform a consumer if his or her application for credit has been denied.⁹¹ Notably, however, FCRA does not require creditors to report when customers do not pay their debts on time, a weakness which prevents subprime borrowers from improving their credit ratings.

The Fair Debt Collection Practices Act ("FDCPA")⁹² also prohibits certain abusive, deceptive, and unfair debt collection practices for personal and household debts. FDCPA limits the hours during which debt collectors may contact debtors,⁹³ requires debt collectors to identify

⁸⁵ See Brief for the Federal Trade Comm'n, *FTC v. Capital City Mortgage Corp.*, et al. (D.D.C. 1998) (Civ. No. 98-237).

⁸⁶ See *id.*

⁸⁷ See *id.*

⁸⁸ See *id.*

⁸⁹ Predatory lenders are more likely than other lenders to use abusive collection practices because they have made high-risk, high-cost loans and may view aggressive collection as the only way to obtain payment.

⁹⁰ 15 U.S.C. § 1681 (1994).

⁹¹ See § 1681(h). Predatory lenders may avoid reporting to credit agencies because they want to prevent competitors from obtaining information about their customers.

⁹² 15 U.S.C. § 1692 (1994).

⁹³ See § 1692(c).

themselves when they contact the borrower,⁹⁴ and prohibits any harassment or abusive contact.⁹⁵

C. Reverse Redlining Charges: State and Federal

Regulators have also pressed charges of reverse redlining at both the federal and state levels and have been reasonably successful at reacting to predatory lending through civil rights legislation. The Equal Credit Opportunity Act ("ECOA")⁹⁶ was the basis of both the suit against Capital City Mortgage⁹⁷ and the New York State suit against the Delta Funding Corporation.⁹⁸ ECOA prohibits discrimination against an applicant for any credit transaction and includes a prohibition against discrimination based on age.⁹⁹ The Act also requires that, within thirty days of adverse action on a credit application, a creditor must inform the unsuccessful applicant of the action and provide a statement of reason.¹⁰⁰ The creditor must also supply a copy of the appraisal report used to determine eligibility upon request of the applicant.¹⁰¹

As the FTC complaint against Capital City Mortgage shows, ECOA can be used to reach predatory practices.¹⁰² Allegations in that case included several violations of the Act's requirements, including failure to take a written application for credit; to record information about the applicants race, sex, marital status, and age; to provide applicants with either written notification of adverse action or the principal reasons for the action taken; and to provide borrowers with the name of the federal agency that administers compliance with ECOA.¹⁰³

In 1998, the Fair Housing Council of Greater Washington filed racketeering charges under the Racketeer Influenced and Corrupt Organizations Act ("RICO")¹⁰⁴ against Capital City, including ECOA allegations in the complaint.¹⁰⁵ The complaint charged that Capital City specifically targeted its advertising towards African Americans in Washington, D.C., concentrating its business in predominately African American census tracts. To accomplish this goal, Capital City allegedly sent flyers through

⁹⁴ See § 1692(e).

⁹⁵ See § 1692(d).

⁹⁶ 15 U.S.C. § 1691 (1994).

⁹⁷ See Brief for the Federal Trade Comm'n, *supra* note 85, and accompanying text.

⁹⁸ See *supra* notes 1-4 and accompanying text.

⁹⁹ See 15 U.S.C. § 1691 (1994).

¹⁰⁰ See § 1691(d).

¹⁰¹ See § 1691(e).

¹⁰² See Brief for Federal Trade Comm'n, *supra* note 85, and accompanying text.

¹⁰³ See *id.*

¹⁰⁴ 18 U.S.C. §§ 1962(c)-(d), 1964(c) (1994).

¹⁰⁵ See Complaint, Fair Housing Council of Greater Washington, Inc. v. Capital City Mortgage Corp., (D.D.C. 1998) (visited Jan. 15, 1999) <<http://www.fairhousing.org/Casenotes/casenotes.html>>.

brokers with contacts in the African American community and promised commissions in return for new loans.¹⁰⁶

D. Regulations that Increase Information Available to Consumers

Additional regulations seek to increase the information available to consumers about mortgage transactions. These rules attempt to prevent predatory lending by enabling consumers to shop for the most advantageous loan products on the market and by forcing more costly lenders out of the market. Unfortunately, the rules often fall short of their purpose. Since lenders typically provide the information in a format that is confusing to many borrowers, consumers either do not understand the information or do not respond rationally to the information given. These statutes seek to reverse this tendency by providing increased education coupled with improvements in the presentation of information to consumers.

1. Legally Required Information Disclosure

Enacted in 1968 and 1974 respectively, TILA¹⁰⁷ and the Real Estate Settlement Procedures Act ("RESPA")¹⁰⁸ are designed to provide information to consumers about the cost of credit during the transaction process. The goal of both laws is to help consumers shop for mortgage loans by comparing various disclosures and estimates. TILA requires disclosures about the cost and terms of consumer credit, including both closed-end and open-end credit for personal, family, or household purposes. Under the Act, the lender must disclose the finance charge, the annual percentage rate ("APR"), the amount financed, and the total number of payments due.¹⁰⁹ Under RESPA, any transaction involving a "federally related mortgage loan" must include an estimate of the costs of settlement services after the consumer has applied for a loan, as well as an actual settlement statement at closing. RESPA also requires disclosure of aspects of the mortgage servicing process, including initial and annual escrow account statements and notices of the transfer of servicing.¹¹⁰

In addition, both laws contain consumer protections regarding the transactions and their costs. RESPA prohibits certain practices that add to settlement costs. For example, lenders cannot add fees for services not provided, nor may they require the borrower to obtain title insurance from a particular title company.¹¹¹ TILA offers a three-day right of rescission for loans secured by the consumer's primary home after the con-

¹⁰⁶ See *id.*

¹⁰⁷ 15 U.S.C. § 1601 (1994 & Supp. II 1996).

¹⁰⁸ 12 U.S.C. § 2601 (1994 & Supp. II 1996).

¹⁰⁹ See 15 U.S.C. § 1605 (1994 & Supp. II 1996).

¹¹⁰ See 12 U.S.C. § 2603(a) (1994 & Supp. II 1996).

¹¹¹ See § 2607.

sumer's obligations on the loan have begun. This does not apply to home purchase loans.¹¹²

These laws are an important response to predatory lending. They address situations in which a borrower is unaware either of specific loan terms or of the quality of the loan as compared to other available choices. For example, the 1997 FTC complaint against The Money Tree alleged that the company violated TILA by requiring consumers to purchase some combination of credit insurance, accident insurance, or automobile club membership.¹¹³ The cost of these extras was not included in the finance charge nor disclosed to the consumer as part of the APR, but instead included in the amount financed.¹¹⁴ The second count of the complaint charged that the company induced consumers to sign statements that they voluntarily chose the required extras.¹¹⁵ The FTC also considered this practice an unfair and deceptive trade practice. These violations are exactly the kind of terms and practices that are difficult to identify as predatory in particular cases. TILA helps to identify some of the factors that make these practices more predatory in nature.

Nonetheless, TILA and RESPA do not go far enough in providing useful information to consumers. In 1996, the Federal Reserve Board and the Department of Housing and Urban Development ("HUD") were asked to promulgate regulations that simplified and improved the disclosure requirements under each law. By the following year, the agencies concluded that such changes required new legislation and issued a joint report of their recommendations.¹¹⁶ One recommendation was to expand the APR to include all of the costs that the consumer must pay for credit and to require disclosure of the loan's interest rate. HUD also recommended that consumers be provided guarantees about credit costs, including good faith estimates of closing costs, earlier in the application process.¹¹⁷ The lending industry has proposed a guaranteed *closing costs package* as an alternative to rate guarantees.¹¹⁸

At the very least, it seems clear that a lender should be required to provide full disclosure about the real cost of a loan, whether through an expanded APR or through another set of numbers describing all costs factored into the loan. In addition, it is critical for borrowers to receive disclosed information prior to closing so that they can use it to shop for the best loan.

¹¹² See 15 U.S.C. §§ 1635(a),(e) (1994 & Supp. II 1996).

¹¹³ See Brief for Federal Trade Comm'n, *FTC v. The Money Tree, Inc. and Vance R. Martin* (F.T.C. 1997) (No. C-3735).

¹¹⁴ See *id.*

¹¹⁵ See *id.*

¹¹⁶ See FEDERAL RESERVE BOARD AND DEP'T OF HOUSING AND URBAN DEVELOPMENT, 1998 JOINT REPORT CONCERNING REFORM TO TILA AND RESPA 2.

¹¹⁷ See *id.* at 15.

¹¹⁸ See *RESPA Hearings*, *supra* note 16, at 365 (testimony of John J. Hayt, National Home Equity Mortgage Association).

In response to this suggestion, lenders might argue that increasing disclosure responsibilities will only increase the cost of providing each loan at the consumer's expense. However, this argument disregards the fact that increased costs from information disclosure will be outweighed by savings to lenders later in the process. Accurate loan information allows borrowers to make informal choices about whether they can actually meet the terms of a particular loan. In turn, fewer borrowers ultimately will take loans for which they are unable to pay. Absent such information, lenders will be forced to bear much higher costs when borrowers are unable to repay their loans. The costs of collecting late payments or foreclosing on loans (and, ultimately, of the loss if a borrower never repays) are much higher than the costs of initial disclosure.

2. Increased Disclosure for High-Cost Loans

While federal legislation already requires strict disclosure for very high-cost loans, consumer advocates argue that many predatory loans nevertheless fall outside of federal parameters. The Home Ownership and Equity Protection Act ("HOEPA"),¹¹⁹ a 1994 amendment to TILA, restricts the terms of high-cost mortgages and requires special disclosure for such loans.¹²⁰ *High-cost mortgages* are defined in that legislation as closed-end loans that are not used for acquisition or construction and that have an APR exceeding ten percentage points above the rate on comparable-maturity Treasury securities.¹²¹ High-cost loans also include those with up-front fees and points exceeding the greater of \$400 or eight percent of the total loan amount.¹²²

HOEPA requires that a disclosure form accompany all high-cost loans, telling borrowers that they need not complete the transaction and that they could lose their homes by failing to meet the terms of repayment.¹²³ This form must state the APR and monthly payment for fixed-rate loans.¹²⁴ Variable-rate loans must disclose that the rate can increase and must list the maximum monthly payment.¹²⁵ Disclosure must occur three days before consummation of the loan.¹²⁶ Loans are prohibited from containing certain prepayment penalties, points on loan amounts refinanced, default interest rates above the rate prior to default, balloon payments, negative amortization, or consolidated prepayment of more than two of the regular payments.¹²⁷ In addition, assignees of high-cost

¹¹⁹ 15 U.S.C. § 1601 (1994 & Supp. II 1996).

¹²⁰ See §§ 1605–1606 (restricting terms); § 1639 (specifying disclosure requirements).

¹²¹ See §§ 1602(aa)(1)–(5).

¹²² See § 1602(aa)(1)(B).

¹²³ See § 1639(a)(1).

¹²⁴ See § 1639(a)(2)(A).

¹²⁵ See § 1639(a)(2)(B).

¹²⁶ See § 1639(b)(1).

¹²⁷ See §§ 1639(c)–(g).

mortgages were made subject to all claims and defenses that could be raised against the original lender.¹²⁸ Discretionary regulatory authority went to the Federal Reserve, while Attorneys General have authority to enforce the regulation.¹²⁹

Critics charge that the HOEPA interest rate trigger is set too high and that the Act, therefore, allows abusive lenders to use the rate as a ceiling, setting their high-cost loan rates just below HOEPA limits.¹³⁰ In addition, HOEPA fails to limit the amount that lenders can charge in fees and other up-front costs as part of high-cost loans. Critics suggest two approaches to fill these gaps. The National Consumer Law Center proposes a graduated set of triggers that would reach both "very high cost loans" and "high cost loans."¹³¹ The North Carolina statute takes a different approach to remedy these defects. It incorporates the HOEPA interest rate trigger, but incorporates a tighter fee trigger and limits terms of high-cost loans.¹³²

3. Addressing Consumer Knowledge and Confidence

While the information requirements of TILA, RESPA, and HOEPA help consumers make informed choices about credit options, the laws do not go far enough in leveling the playing field between lenders and borrowers. Consumers are typically uninformed about credit options and unfamiliar with the complications of financial transactions. The information included in loan documents under these statutes cannot overcome this barrier. A study by the Consumer Federation of America found that while over seventy percent of those surveyed knew what APR stands for, only half understood its significance as an indicator of the cost of credit.¹³³ Disclosure of the APR, or even an expansion of the costs that it captures, is useless if consumers do not understand its meaning. This gap between the information that must be disclosed and the information that consumers recognize and understand is particularly wide for risky borrowers. A recent survey by Freddie Mac found that subprime borrowers typically are less confident about their own finances and are less aware of credit options than other borrowers.¹³⁴

¹²⁸ See § 1641.

¹²⁹ See § 1639(1); § 1640(e).

¹³⁰ See *Equity Predators Hearings*, *supra* note 14, at 249–50 (testimony of Elizabeth Renuart and Margot Saunders, National Consumer Law Center).

¹³¹ See *id.*

¹³² See N.C. GEN. STAT. § 24-1.1 (1999).

¹³³ See *Problems in the Home Equity Market: Predatory Lending: Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs*, 103d Cong. 3 (1993) (statement of Kathleen Keest and Margot Saunders, National Consumer Law Center).

¹³⁴ While 76.3% of prime borrowers strongly agreed that they were in control of their finances, only 57.3% of subprime borrowers felt the same. 8.7% of subprime borrowers felt that they were not in control of their finances, compared to 4.1% of prime borrowers. Seventy-five percent of prime borrowers said that they searched for the best interest rates

Even if consumers are well informed and understand the terms of their loans, they may not respond to credit options by making rational choices. A number of scholars have argued that cognitive biases influence the decisions of consumers and that manufacturers reinforce such biases in the sales of their products.¹³⁵ Behavioral studies demonstrate that people continually underestimate the occurrence of low-probability, high-loss events such as the loss of their home to foreclosure.¹³⁶ People also tend to make judgments in reference to conceptual starting points such that, even when new information is available, they remain biased toward their original view. This tendency is known as *anchoring*. For example, if the borrower has been able to make payments on time in the past, he may underestimate the risk that he will default on a new loan, even if facing new financial obligations.¹³⁷ Researchers have also found that people believe that adverse events happen only to others, leading to a sense of “unrealistic optimism.”¹³⁸ Finally, researchers have found that the more control that individuals feel they have in avoiding a risk, the more optimistic they are likely to be regarding the possibility of harm.¹³⁹

Predatory lenders recognize all of these phenomena and exploit them through their tactics. For example, predatory lenders often offer a given loan package only to attach extras or higher interest rates later in the process. This tactic takes advantage of the anchoring tendency and influences borrowers to conclude that they can afford the debt. Borrowers consistently overlook indications that a loan is more expensive than it first appeared, and their reluctance to restart the loan application process elsewhere encourages this view. A broker who speaks in a joking tone with a client about the risks and additional expenses of a mortgage intentionally encourages that client's belief that foreclosure is an unrealistic eventuality and that the loan will remain only as expensive as it initially appeared.

Finally, predatory lenders often market their products as a way for consumers to gain control over their debts. This plays on consumers' ten-

some or a lot, while only 56.4% of subprime borrowers did. 28.6% of subprime borrowers said that they did not search at all, compared to 13.2 % of prime borrowers. See Freddie Mac, *Consumer Knowledge and Confidence* (1997) (unpublished survey, on file with the Harvard Civil Rights-Civil Liberties Law Review).

¹³⁵ See, e.g., Jon Hanson & Douglas Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630 (1999). For a discussion of how cognitive biases influence consumer decisions in the home mortgage market see Forrester, *supra* note 47.

¹³⁶ See Forrester, *supra* note 47, at 384. Forrester suggests that people may underestimate foreclosure risk due to the *availability heuristic*, which represents the tendency to view an event as probable if the event is easy to imagine or remember. Because foreclosure is rare and not very public, homeowners are unfamiliar with the event and underestimate its likelihood. See *id.* at 384.

¹³⁷ See *id.* at 384–85.

¹³⁸ *Id.* at 385.

¹³⁹ See *id.*

dency to be overly optimistic about events over which they feel they have control. For example, borrowers may be led to feel that they are gaining increased control over their finances by consolidating a variety of unwieldy debts into a single loan that can be paid monthly over a period of years. In reality, however, many *consolidation loans* require borrowers to trade unsecured loans for secured ones, leaving such borrowers' assets in greater jeopardy to the risk of foreclosure of home or personal property.

4. *Evaluating Requirements for Increased Consumer Education*

Requiring lenders to provide additional information about the quality and cost of loans is not a sufficient aid to consumers. Because of the difficulty of understanding mortgage issues and the tendency of consumers to underestimate risk, more consumer education is necessary in order to make loan information accessible to borrowers. Lenders must be compelled to educate consumers about the real cost of loans. Lenders are in the best position to accomplish this, as they have the most immediate contact with borrowers.

Current disclosure laws and regulations of unfair trade practices can be used to penalize lenders who pressure borrowers into taking loans that they do not understand. Even if a borrower is in need of capital immediately, lenders should make the cost of the loan clear enough that the borrower can compare options and make sound choices. For example, lenders should review with a borrower the cost of each fee built into the loan and explain that monthly payments may vary. Any balloon payments or additional sums, such as credit insurance, should be disclosed at the outset. Such information should not be buried in a pile of loan papers, but outlined clearly on a separate explanation page at the beginning of the borrower's loan documents.

More generally, consumers should be empowered to make financial choices and recognize the risks of any credit transaction. Banks and consumer advocates could join together to offer one-day education sessions about predatory lending or even full-length courses on how to manage credit and shop for good loans. Federal and state agencies could also increase outreach efforts to educate consumers about credit in general. Learning to say no to credit solicitations or to exercise the right to back out of an exploitative loan during the three-day right of rescission period should be part of any such education program. In addition, consumers should be made aware of common scams and should be informed of advocates to whom they can turn for assistance if they think that they have been preyed upon.

IV. An Alternative Solution: Preventing Predatory Lending by Increasing Options

A. *Increased Involvement of Traditional Lenders and Government-Supported Entities in Subprime Markets*

An alternative approach to the problem of predatory lending does not respond directly to predatory practices but attempts to push unscrupulous lenders out of the market by encouraging traditional lenders and government-sponsored entities to enter the subprime market. This approach circumvents the difficult definitional problem plaguing existing laws. It proceeds upon the assumption that underserved populations often turn to predatory loans because of the absence of other options in the market and posits that increased competition will create better options for consumers.

One way to achieve this goal is to use mortgage data to monitor the lending industry, highlight discriminatory practices, and encourage more standardized and advantageous lending. Currently, regulators often fail to receive the kind of information necessary to evaluate loan products or lending patterns of questionable lenders. While it may be costly to maintain additional information for the public, increased data is essential to understanding predatory practices and replacing high-cost loans with more affordable products. Furthermore, as noted above, the cost of assisting consumers facing foreclosure is far greater than the cost of preventing predatory loans through increased information up front.

1. *Consumer Need*

Borrowers facing an emergency or a drastic life change are often forced to turn to costly loans to meet their needs quickly. A recent survey by Freddie Mac shows that borrowers in the subprime market are more likely to have experienced a recent major life disruption than are borrowers in the prime market.¹⁴⁰ According to the study, subprime borrowers are more likely than prime borrowers to have had a member of their household suffer a major illness, carry large medical expenses, have experienced periods of unemployment, or have had a change in family structure.¹⁴¹

The point is that consumers who need funds the most are also the most vulnerable to predatory tactics. A comparison of refinancing loan patterns of major lenders in the New York Metropolitan Statistical Area

¹⁴⁰ See Freddie Mac, *supra* note 134.

¹⁴¹ See *id.* For example, approximately 30% of subprime borrowers have experienced an illness or unexpected medical expense, compared to approximately 15% of prime borrowers. Twenty-one percent of subprime borrowers face unemployment, while only eight percent of prime borrowers are unemployed (tabulations made by author).

("MSA") confirms that predatory lenders thrive where consumers have limited options.¹⁴² The study listed the top twenty-five lenders in the MSA by market share and then sorted them by market share in aggregated census tracts of differing median incomes. A comparison of the market share of Delta Funding to that of Chase Manhattan Bank, which has the largest market share in the MSA, illustrates Delta's success in subprime markets with few borrowing alternatives. While Delta Funding has the largest market share in low- and moderate-income tracts by far (8.8%), it is virtually absent in higher-income census tracts, where Chase Manhattan dominates.¹⁴³ In addition, Chase Manhattan possesses a much smaller market share in low-income tracts (4.9% in the lowest median income tract) than it does in the higher-income tracts (9.3% in the highest median income tract).¹⁴⁴ This pattern holds when additional lenders are included in the analysis.¹⁴⁵

Conventional lenders and Government-Supported Entities ("GSEs") can offer readily available credit alternatives in subprime markets where no alternatives currently exist. Predatory lenders then would be forced to match the lower rates and terms of more conventional loans or leave the market. In addition, the standard disclosure mechanisms associated with more conventional loans could establish new norms of behavior in the subprime market.

2. *Information Available to Advocates and Regulators*

Current regulations of banking involvement in communities could be used to monitor whether lending institutions adequately serve borrowers that are more vulnerable to predatory lenders. Such laws should be amended to assist parties interested in tracking predatory lending. For example, regulators and advocates should be able to use the Home Mortgage Disclosure Act of 1975 ("HMDA")¹⁴⁶ to identify patterns of lending abuses. Similarly, the Community Reinvestment Act of 1977 ("CRA")¹⁴⁷ should be applied to the affiliates of regulated banks to encourage provision of credit services to subprime borrowers.

Regulators and advocates typically use HMDA to monitor lenders by neighborhood or by individual characteristics. However, this law fails to reach many lenders who engage in predatory practices. HMDA requires most federally regulated banks, savings and loan institutions, and credit

¹⁴² These data were initially published by the Federal Financial Institutions Examination Council and tabulated by Michael Collins as part of a cooperative project between the Neighborhood Reinvestment Corporation and the Joint Center for Housing Studies (data on file with the *Harvard Civil Rights-Civil Liberties Law Review*).

¹⁴³ See *id.*

¹⁴⁴ See *id.*

¹⁴⁵ See *id.*

¹⁴⁶ 12 U.S.C. § 2801 (1994).

¹⁴⁷ § 2901.

unions to report annually by census tract the number and dollar amount of mortgage loans in all metropolitan areas.¹⁴⁸ Depository institutions with more than \$29 million in assets, or nondepository lenders with assets over \$10 million in assets, must also report.¹⁴⁹ Reporting institutions must also collect information about the race, gender, income, and final disposition of each mortgage loan applicant.¹⁵⁰

Unfortunately, HMDA has not proven effective in tracking information about predatory lending for three reasons. First, the statute simply does not require reporting from many institutions guilty of predatory practices. Many home equity lenders do not collect deposits at all, and their loan volume is too small to require reporting. In addition, depository institutions with no first-lien home purchase loans on one-to-four-family dwellings or nondepository institutions whose home purchase loans account for less than ten percent of loan originations are exempt from HMDA.¹⁵¹ Second, some mortgage companies and banks fail to report the racial data on home loans. Indeed, such data often is not collected for home improvement loans because transactions are conducted over the telephone. When transactions are conducted over the telephone or Internet, lenders must report race only if the applicant chooses to supply that information.¹⁵² Third, HMDA data does not differentiate between subprime and prime loans.¹⁵³ This is because HMDA does not require information about loan terms or interest rates. Consequently, the data offers little information about the predatory nature of loans. This information is important if regulators hope to build a case against a particular lender or if advocates wish to convey evidence of predatory lending to the general public. Because the information is unavailable, advocates have difficulty quantifying patterns of predatory lending in a clear, comprehensive, and accurate way.

CRA could also be used to encourage conventional lenders to regulate their affiliates better and to become more involved in serving subprime borrowers. CRA requires federal banking agencies to evaluate whether federally regulated financial institutions meet the credit needs of the communities in which they are chartered when those institutions apply for depository facility rights, such as new charters or mergers with regulated financial institutions.¹⁵⁴ The agencies' conclusions in this re-

¹⁴⁸ See 12 U.S.C. § 2803(a).

¹⁴⁹ See § 2803(h)(5)(i).

¹⁵⁰ See § 2803(b)(4).

¹⁵¹ See FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, A GUIDE TO HMDA REPORTING: GETTING IT RIGHT! (1998).

¹⁵² See *id.* The Woodstock Institute recently estimated that the percentage of denied loans reported without racial data in Chicago has climbed from 10% in 1991 to 42% in 1997. WOODSTOCK INSTITUTE, NEW LENDING FACT BOOK SHOWS LENDERS NOT REPORTING RACIAL DATA; PROBLEM WORSENS IN LATEST DATA (1999).

¹⁵³ See 12 U.S.C. § 2801.

¹⁵⁴ See § 2903(a).

gard, and the facts and data supporting those conclusions, are public.¹⁵⁵ However, CRA does not apply to lenders that are not federally regulated, nor to wrongful actors that are not lenders but other players in the mortgage process, such as bank affiliates.

CRA could be used to affect the activities of banks affiliated with predatory lenders. Consumer advocates argue that some banks receive CRA credit for loans made by affiliates or for predatory loans made by others that they have securitized. For example, in recent testimony before the Senate, Deborah Goldberg of the Center for Community Change suggested that Bankers Trust, a wholesale bank, may have received CRA credit for loans made by Delta Funding because Bankers Trust acts as a trustee for some of Delta's securitizations.¹⁵⁶ Many other banks own subsidiary subprime lending institutions that have been accused of predatory practices. Regulators have not yet developed a method for assessing the quality of loans made by bank affiliates.

CRA should be used to encourage traditional lenders to provide quality loan products that serve the needs of the elderly, as well as low- and moderate- income borrowers. The provision of such loans could earn the lender credit during its evaluation for service to the community. Lenders could provide traditional home equity loans and refinancing options to those who qualify. They could also offer alternative products for emergency events, individual savings accounts, and reverse mortgages for the elderly. Where such products are available, lenders could join together with community groups to publicize them and to make them accessible for those who are unfamiliar with banking practices and mortgage products. None of this is meant to suggest that CRA should require lenders to make bad or risky loans that will not be repaid. Instead, it is to argue that CRA should encourage lenders to participate in a vital market, thus providing an alternative to the costly products that currently dominate.

Traditional lenders could also combat predatory lending by adopting *best practices agreements* with community groups. A recent such agreement between the Office of Thrift Supervision and Lehman Brother Holdings, Inc. is an excellent first step toward involving traditional lenders in the subprime market and should serve as a model for other such compacts.¹⁵⁷ The agreement provided that, in connection with its acquisition of Delaware Savings Bank, Lehman Brothers would guard against

¹⁵⁵ See § 2906(b)(1)(A).

¹⁵⁶ See *The Financial Services Act of 1999: Hearings Before the House Comm. on Banking and Financial Services*, 106th Cong. 163-93, 188-202 (1999) (statement of Deborah Goldberg, Center for Community Change).

¹⁵⁷ See Office of Thrift Supervision Order No. 99-39, *Approval of Applications for Permission to Organize a Federal Savings and Bank and Holding Company Acquisition* (June 30, 1999).

predatory pricing practices.¹⁵⁸ To that end, the company committed to adopting policies and procedures to identify predatory pricing practices by its clients.¹⁵⁹

Finally, traditional lenders and GSEs could create opportunities for low-quality credit borrowers to obtain mortgage loans at competitive prices. The credit risk models and securitization offered by Fannie Mae and Freddie Mac would help to standardize the subprime market, reducing risk for traditional lenders and isolating predatory loan products that do not conform to industry norms.¹⁶⁰ Department of Justice Special Litigation Counsel Alexander Ross recently suggested such an approach at a conference of mortgage regulators, saying, "Fannie and Freddie will drive the bad guys out and make it safe for the good guys to come in and make that loan."¹⁶¹ Indeed, Fannie Mae and Freddie Mac have both recently created new mortgage products that serve risky borrowers. These new products offer step-down plans that lower the interest rate if the borrower regularly sends in loan payments and improves his or her credit history. Such products bring subprime borrowers into the mainstream market and offer them an alternative to predatory loans.

B. Additional Needs: Information and Support Infrastructure

Any proposed remedy to the problem of predatory lending requires better communication and information sharing among regulators, advocates, industry representatives, and consumers. In the past, each group has depended on its own resources to build a knowledge base and has relied upon limited sources for new information. Local groups need to improve connections with the full spectrum of organizations that interact with the financial industry. Listservs, conferences, and printed materials can be used to spread information to a broad audience and to encourage dialogue among organizations. Federal agencies and state attorneys general should establish contacts with local groups to facilitate expedient reporting of predatory lending. This effort could be enhanced by using local hotlines, informational meetings, and liaisons among organizational staff.

National support organizations can also assist in creating better dialogue between local groups by providing information about model programs and legislative action in other states. A national conference or publication describing the best resources available could help advocates learn from each other about how best to serve their own communities. Local groups could also join together with state consumer affairs agen-

¹⁵⁸ *See id.*

¹⁵⁹ *See id.*

¹⁶⁰ *See* FREDDIE MAC UNDERWRITING, *supra* note 9.

¹⁶¹ RESPA, HOEPA Reform Called For, NATIONAL MORTGAGE NEWS, Sept. 2, 1999.

cies and state banking regulators to share information, develop education programs, and collaborate on ideas for regulatory reform. Information sessions on predatory lending should be held in neighborhoods and should include information on how to report predatory lenders to regulators or to seek redress if a borrower thinks that she has been victimized. The staffs of local groups can also act as sources of information and support for regulators developing cases against particular lenders.

Housing counselors must also develop relationships with local legal aid societies and bar associations. Combined staff from each organization could build consumer protection teams, joining together to offer comprehensive services to clients that include both credit counseling and legal representation. Sharing resources and skills would enable each group to resolve individual cases more rapidly and would equip each group with information for referrals and more generally complete knowledge. Attorneys could offer clinics at local housing organizations, allowing potential borrowers to bring in loan documents for review. Housing counselors, who currently help clients work out new repayment plans with lenders after questionable loans have been signed, should be in regular contact with local attorneys who could help to negotiate with lenders or even seek redress for illegal sales tactics or loan terms. Counselors could also receive legal training on how to spot potentially illegal lending practices while counseling borrowers. Generally, following the contents and results of each organization's casework would help both legal aid organizations and community counselling offices to track the full extent of predatory lending and identify patterns over time.

Conclusion

In order to work together on a comprehensive response to predatory lending, concerned groups must agree on a common definition of the problem. Predatory lending is best characterized as a combination of unfair loan terms and pressure tactics that limit the information and choices available to borrowers and target consumers because of particular vulnerabilities.

Current regulations help mitigate some predatory practices. At the state level, some legislatures have passed limits on the most egregious predatory tactics. These efforts are restricted, however, by federal legislation that preempts state regulation of mortgage markets. Nationally, laws that focus on increasing the flow of information to consumers could help borrowers to recognize the true costs of available loan products and combat predatory lending. Such laws should be improved to require that disclosed information be clear and that lenders educate consumers regarding financial transactions and choices. It is also important to encourage traditional lenders to enter the subprime market, thereby creating more financial choices for borrowers.

Finally, advocates, regulators, and industry members should work together to create comprehensive solutions to consumers' problems. By sharing knowledge of the problem and partnering to create programs that draw on a variety of skills, these groups can make substantial gains in improving financial services for vulnerable borrowers.