

UNMASKING THE PREDATORY LOAN IN SHEEP'S CLOTHING: A LEGISLATIVE PROPOSAL

*Debra Pogrund Stark**

When you sign all those papers, it's like Greek. I'm like trusting him, figuring he wouldn't do it like that.

—Comments of Margaret Dickens,
whose trust in her mortgage broker caused
her to enter into a predatory loan.¹

* Professor of Law, The John Marshall Law School, and Vice-Chairperson, B-4 Pro Bono Committee of the Real Property, Probate and Trust Law Section of the American Bar Association, which is working on preparing training materials to assist volunteer attorneys to provide the type of counseling described in this Article. Professor Stark thanks the members of the B-4's Subcommittee on Preventing Predatory Lending, particularly Jay Weiser and Patrick Dillon, for their review and helpful suggestions relating to the model law proposed in this Article. The opinions expressed in this Article are solely those of the author. She also thanks David Rutter, Andrew Cook, Colette Karam, and Carolina Sales, former and current students at The John Marshall Law School, for their excellent research assistance. In particular, she wishes to acknowledge the assistance of Carolina Sales in creating the text of the model law. Professor Stark is also grateful to Patricia Mell, Dean of the The John Marshall Law School, for her support.

1. Based on her credit, Ms. Dickens could have qualified for a loan at 8.5% but her mortgage broker induced her to enter into a loan for 12.5%, with \$5,190 in points, a \$5,700 charge for life insurance, and a prepayment penalty of six months' interest if she refinances the loan. See Jim Gallagher, *Be Careful When Dealing with Household Finance*, Simply Family, available at http://www.simplyfamily.com/display.cfm?articleID=010604_finance.cfm (last visited Feb. 5, 2005). When the author asked a former mortgage broker how mortgage brokers are able to induce borrowers to enter into such high-cost loans when there is advertising for much lower-cost loans, he emphasized the trust the mortgage broker first builds with the client, before making any quotes, during the initial contacts, when the broker determines the borrower's motivations and qualifications for the loan. The former mortgage broker indicated that a typical response to a question from a customer on a high rate would be:

I know. It's frustrating, isn't it? The rates they put in the paper are great, and if you make a million bucks a year you might be able to get it. You know the rule: the people that don't really need the darn loan are the ones that get the best deal. What I did was search long and hard for the best deal that fits your situation; that's how I get paid. But, do me a favor. Let's put the deal on hold, do some calling around and try to beat the deal. What's most important to me is your trust, and you just won't know for sure until you check around. Then, in a few days, if the house is still available, we either go forward here, or you take the better deal. For me, it's just one deal lost. But for you, it's a 30-year commitment. Can you do that for me? Or if you like, we can still go forward here today.

I. INTRODUCTION

For the past ten years, unscrupulous, silver-tongued mortgage brokers and lenders have successfully induced financially unsophisticated borrowers to enter into “predatory loans”² secured by their homes. Not only have such victims of predatory lending been deceived into paying tens of thousands of dollars more for credit than they should have, but a substantial number of these victims are eventually unable to continue to make these payments and have lost their homes at foreclosure sales.³ Whole communities have been adversely affected by the phenomenon of predatory lending because aggressive mortgage brokers target specific neighborhoods within which to market these high-cost home loans, and the subsequent foreclosures in these areas have led to rows of boarded up homes being inhabited by gangs and drug dealers.⁴ While the problem of predatory lending has received widespread local, state, and federal attention over the past ten years,⁵ unfortunately, the laws enacted so far have been ineffective at substantially preventing the problem.⁶ The failure to adequately address the problem is due in large part to the unresolved and heated debate between consumer advocates and lenders over how to curb the activities of predatory mortgage brokers and lenders without adversely affecting the robust legitimate sub-prime market.⁷

This Article contends that in a free market economy where usury type limitations on interest rates, fees, and closing costs largely do not exist,⁸ the best proactive way to fight mortgage brokers and lenders who peddle predatory loans disguised as “great financial opportunities” is to require that an equally knowledgeable counter-balancing influence be available to possible victims before they close on a potentially predatory loan. The proposal presumes that when a financially knowledgeable person, *whose goal is to help the borrower*, advises the borrower on whether a proposed high-cost loan is overpriced or unaffordable, or whether there is a net economic benefit to the refinance, the borrower will be in a position to move away from the predatory loan and enter into a loan that is better

He indicated that few borrowers take the broker up on the offer to shop around. “The keys are to build a relationship, build trust, create ‘yes’ momentum, tell the client their situation is unique, and that the loan you’ve presented is perfectly tailored to their situation.” (Comments of Jim Voigt in e-mail to author dated Feb. 3, 2005.).

2. A “predatory loan” contains one of four features described in Part II *infra*. Briefly stated, these features are: an “overpriced loan” (a loan containing interest rates, fees or closing costs that are higher than they should be in light of the borrower’s credit and net income), an “unaffordable loan,” a refinance of a mortgage loan providing no net economic benefit to the borrower, or a loan containing a myriad of other exploitive terms that the borrower does not comprehend.
3. See Office of the Comptroller of the Currency, *Economic Issues in Predatory Lending* (July 30, 2003) (working paper) [hereinafter OCC Working Paper].
4. See note 17 *infra*.
5. See note 18 *infra*.
6. See Part II *infra* for an explanation of why local, state and federal initiatives have been ineffective at preventing predatory lending.
7. See the discussion of this debate and its impact on enacted laws in Part II *infra*. The distinction between a predatory loan and a legitimate sub-prime loan is discussed in Part II *infra*.
8. See Davenport, note 18 *infra*.

priced or otherwise better suits the borrower's needs. This Article argues that requiring a trained mortgage counselor to advise a borrower contemplating entering into a high-cost home loan can effectively prevent a great number of predatory lending without impinging upon the legitimate sub-prime market. This Article contains a model mortgage counseling law that would accomplish this objective and recommends that responsible lender and consumer advocates join together to make it the law of the land.

The Article begins with a brief explanation of predatory lending, why it began approximately ten years ago, and why it continues to thrive today notwithstanding the enactment of local, state, and federal laws to address the problem. The Article then details the kind of counseling and intervention that would take place under the proposed counseling intervention law, including how mortgage counseling can prevent predatory lending and how mortgage counselors can be trained and compensated. The Article then argues that the mortgage counseling intervention law proposed would be an important reform that lenders and consumer advocates should embrace because it will create a comprehensive, aggressive, and proactive approach to preventing predatory lending without impeding the legitimate sub-prime market. In making this argument, the Article responds to the claim of consumer advocates that counseling puts the burden of the problem on the victim, and that counseling would be ineffective for many borrowers. The Article also responds to lender advocates who have not embraced mandatory counseling due to their concern that it would add significant delays and costs to the mortgage loan process. The Article then evaluates how this proposed counseling law harmonizes with, but is also distinctive from, other reform proposals, and whether the proposed mortgage counseling law should be enacted on the federal level or on a state-by-state basis. The Article concludes with the text of the proposed federal counseling law.

II. THE DEVELOPMENT OF PREDATORY LENDING AND THE DIFFICULTIES WITH TRYING TO PREVENT IT

Owning your own home, with the accompanying security and dignity that ownership is expected to bring, has long been a part of the "American dream" and many governmental programs and laws were enacted following World War II to make this dream a reality for more Americans.⁹ In the past, families would spend years saving for a down payment and improving their credit and income so that they would be approved for a home mortgage loan. Lenders were very prudent and risk-averse.¹⁰ A

9. For a full history of the development the Federal Housing Administration (FHA) since its inception in 1934, see <http://www.hud.gov/offices/hsg/fhahistory.cfm>, and for a timeline of The Department of Housing and Urban Development Act of 1965, which created HUD, see <http://www.hud.gov/library/bookshelf18/hudhistory.cfm>.

10. Mortgage lending standards following the Great Depression and the Second World War required that the borrower have saved twenty percent of the purchase price to put down in equity for the loan which would not exceed eighty percent of the appraised value of the home. In addition, it was common to require that the borrower's housing expense (in the form of principal and interest on the mortgage debt and taxes and insurance) not exceed twenty-five percent of the borrower's gross income

popular cultural reflection of this appears in the movie “It’s A Wonderful Life”¹¹ when the good-hearted banker George Bailey battles it out with the hard-hearted Mr. Potter over the prudence of Mr. Bailey’s home mortgage loans to former tenants of Mr. Potter’s slums.

Although lending standards loosened somewhat in the 1980s and 1990s (for example, it became common to loan up to 90% or more of the appraised value of the home compared with the prior requirement of a 20% down payment),¹² there was still only one prevalent type of home mortgage loan—those to low-risk and creditworthy borrowers with adequate incomes. This situation started to change approximately ten years ago, when lenders began to market home mortgage loans to higher risk borrowers.¹³ These higher risk loans, however, were higher priced as well. The loans were labeled “sub-prime,” and borrowers who entered into these loans were charged far higher interest rates and fees than borrowers who entered into a regular “prime” loan. For example, if based on current interest rates a prime loan would be made at 6% per annum interest, the lowest grade sub-prime loan made at the same time would be made at

GERALD KORNGOLD ET AL., REAL ESTATE TRANSACTIONS: CASES AND MATERIALS ON LAND TRANSFER, DEVELOPMENT AND FINANCE 369–70 (4th ed. 2002); *see also* Household Debt Service Burden, Federal Reserve Statistical Release Statistical Release, The Federal Reserve Board, Household Debt Service and Financial Obligations Ratios (July 19, 2004), at <http://www.federalreserve.gov/releases/housedebt/default.htm> (defining the term “debt service ratio”). In addition, the borrower had to have a good credit history (even though there were no computerized credit scores back then).

11. IT’S A WONDERFUL LIFE (Liberty Films 1946).

12. KORNGOLD, *supra* note 10, at 358–62.

13. One reason why lenders began to market loans to “higher risk” borrowers is the Community Reinvestment Act, which was enacted by the Congress in 1977. *See* Press Release, The Federal Reserve Board, *Community Reinvestment Act* (Oct. 22, 2003), at <http://www.federalreserve.gov/dcca/cra/> (explaining Community Reinvestment Act, 12 U.S.C. 2901 (1995) [hereinafter CRA]) (The Community Reinvestment Act is intended to encourage lending institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. The CRA requires that each insured depository institution’s record in helping meet the credit needs of its entire community be evaluated periodically. That record is taken into account in considering an institution’s application for deposit facilities, including mergers and acquisitions). *See Office of Policy Development, CRA’s Impact in Changing Financial Market* (May/June 2002), available at http://www.huduser.org/periodicals/urm/urm_06_2002/urm1.html. For an explanation of other factors that played a role in the development of the sub-prime market, see Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1280–87 (2002) (explaining the rise of the sub-prime market may well be attributable to the incentive structure of the lenders and the brokers and the market power that the larger lenders utilized to pressure individuals into acceptance of unfavorable terms). *See also* Margot Saunders & Alys Cohen, Joint Center for Housing Studies, Harvard University, *Federal Regulation of Consumer Credit: The Cause or Cure for Predatory Lending?* (Mar. 2004), available at http://www.jchs.harvard.edu/publications/finance/babc/babc_04-21.pdf (noting that many people are lured into converting credit card debt to home equity loans for the lower interests rates and the tax deductions available, but they fail to realize that by extending the loan period the loan is more expensive over time even with the tax deductions).

12%.¹⁴ In 1994, only \$34 billion of sub-prime loans were made; by 2002 that figure increased to \$213 billion.¹⁵

Since homeownership is considered an integral part of the “American dream,” one might argue that the unprecedented availability of money for more Americans to reach that dream, even those Americans with blemishes to their credit, was a positive development.¹⁶ However, accompanying this extraordinary growth in sub-prime loans has been the rising phenomenon of “predatory loans,” which for far too many people has caused the American dream to become a financial nightmare, leading to, in the worst cases, homelessness and ravaged communities.¹⁷ Congress and numerous states attempted to address this pernicious outgrowth of the legitimate sub-prime market by enacting complicated laws and regulations.¹⁸

14. A July 2003 working paper by the Office of the Comptroller of the Currency provides a useful overview of the economic issues. See OCC Working Paper, *supra* note 3, at 10.

15. *Id.*

16. See Engel & McCoy, *supra* note 13, at 1258–59 (describing the legitimate sub-prime market); A. Mechele Dickerson, *Banking and Mortgage Lending: The Homeowner Dilemma*, 38 J. MARSHALL L. REV. 19 (2004). But see ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO INCOME TRAP: WHY MIDDLE CLASS MOTHERS AND FATHERS ARE GOING BROKE* (Basic Books 2003), where the authors argue that when families purchase homes or convert credit card debt into equity with a high-cost home loan they are economically worse off than if they delayed becoming a homeowner or purchased a more modest home with a lower cost home loan that they could truly afford. One commentator has argued that “mortgage” status should not be recognized with loans that convert credit card debt into a home equity loan in a bankruptcy setting to discourage lenders from making these type of loans.

17. See comments of Chicago Mayor Richard Daley in James T. Berger, *Sub-prime Lending Produces Dangerous Side-Effects*, CHI. SUN-TIMES, June 9, 2000 at 16N. See, e.g., Engel & McCoy, *supra* note 13 at 1261; *supra* note 1 (containing data on the unprecedented rise in foreclosures); Kurt Eggert, *Held Up In Due Course: Predatory Lending, Securitization, and the Holder In Due Course Doctrine*, 35 CREIGHTON L. REV. 503 at 512–13 (2002); Saunders & Cohen, *supra* note 13, at 2.

18. In 1994, Congress enacted the Home Ownership Equity Preservation Act, 15 U.S.C. § 1639 (1994) [hereinafter HOEPA], to combat predatory lending. For a look at some of the issues that HOEPA attempts to address, see a letter from Donald S. Clark Secretary, Federal Trade Commission, to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Mar. 9, 2001), available at <http://www.ftc.gov/be/v010004.htm>. However, HOEPA, even as amended, contains triggers so high that lenders simply make loans just under the triggers rather than try to comply with the prohibitions contained in the law (such as a prohibition on equity stripping or repeated refinancing with no economic benefit to the borrower). The interest rate trigger under HOEPA is 8% greater than U.S. Treasury securities with a comparable maturity for first mortgage loans and 10% greater for junior mortgage lien loans and the fees and points trigger is 8% of the loan amount (with certain fees and costs excluded) or \$400, whichever is greater. It is estimated that as much as 95% of sub-prime loans made do not fall within these triggers. See Engel & McCoy, *supra* note 13, at 1348. A variety of states have also enacted predatory lending laws substantially similar to HOEPA, but in some instances containing greater protections and lower cost thresholds. See, e.g., ARK. CODE ANN. tit. 23, § 53 (2003):

The total points and fees payable by the borrower at or before the closing exceed: (i) Five percent (5%) of the total loan amount if the loan amount is seventy-five thousand dollars (\$ 75,000) or more; (ii) Six percent (6%) of the total loan amount if the total loan amount is more than twenty thousand dollars (\$ 20,000), but less than seventy-five thousand dollars (\$ 75,000); or (iii) Eight percent (8%)

Part of the complexity associated with addressing predatory lending is the fact that it can take many forms and is therefore difficult to define consistently.¹⁹ Put simply, predatory lending is the situation where a mortgage broker or mortgage lender engages in fraudulent, deceptive or sharp practices to induce borrowers (often the elderly or minorities) to enter into “bad” loans. The loans are “bad” because they contain one or more of the following features: (i) the loan is overpriced (i.e., containing interest rates, fees, and closing costs that are higher than they should be in light of the borrower’s credit and net income); (ii) there is no net economic benefit to the refinance (commonly referred to as “loan flipping”); (iii) the borrower cannot afford to make the payments on the loan and the lender is counting on the borrower’s equity in the property to become whole after the borrower defaults (commonly referred to as “equity stripping”); and (iv) the loan contains a myriad of other exploitive terms that the borrower does not comprehend (for example, a large prepayment charge or paying for credit life insurance in one lump sum when the loan is likely to be refinanced soon).

Oddly enough, in the current debate over predatory lending, consumer advocates would argue that today’s Mr. Potter would be eager to lend money to the people he would have previously denied loans. Unrestricted by usury laws,²⁰ he can now charge borrowers—not only high risk borrowers, but also unsophisticated borrowers who do have good credit—high interest rates and fees to close the loan. If the borrower defaults, Mr. Potter (or more likely, the ultimate assignee of the loan from a large pool of residential mortgage loans) can foreclose and take over the borrower’s home. Mr. Potter might also be a leading advertiser to encourage homeowners to convert their higher interest rate credit card debt into a lower

of the total loan amount if the total loan amount is twenty thousand dollars (\$ 20,000) or less.

Id.; see also GA. CODE ANN. tit. 7, § 6a(2) (2004); N.C. GEN. STAT. § 24-1 (2004) (contains a 5% trigger on fees and points for loans greater than \$20,000); N.M. STAT. ANN. § 58-21a(5) (2004). See Tania Davenport, *An American Nightmare: Predatory Lending in the Subprime Home Mortgage Industry*, 36 SUFFOLK U. L. REV. 531, 547–57 (2003) (discussing the state and federal initiatives to reduce predatory lending and increase consumer awareness, but noting the failure of these attempts as evidenced by the elimination of state usury ceilings through preemption and that lenders were able to bypass the restrictions of HOEPA by granting loans just below the maximum allowances).

19. See, e.g., Davenport, *supra* note 18, at 533–34; Donita Judge, Note, *Predatory Lending: Legalized Theft of Home Equity*, 5 RUTGERS RACE & L. REV. 293, 299–300 (2003); Leetre Harris & Brian Nichols, *Banking and Finance: Credit or Loan Discrimination*, 19 GA. ST. U.L. REV. 14, 16 (2002); C. Bailey King, Jr., *Notes & Comments: V. Consumer Protections Issues: Preemption and the North Carolina Predatory Lending Law*, 8 N.C. BANKING INST. 377, 378–79 (2004); Abraham B. Putney, *Rules Standards, and Suitability: Finding the Correct Approach to Predatory Lending*, 71 FORDHAM L. REV. 2101, 2103–05 (2003); Christopher R. Childs, *International Law And Religion Symposium: Comment: So You’ve Been Preempted—What Are You Going to Do Now?: Solutions for States Following Federal Preemption of State Predatory Lending Statutes*, 2004 BYU. L. REV. 701, 705–08 (2004).
20. See Pub. L. No. 96-221, 94 Stat. 161 (1980), codified throughout Title 12 of the U.S. Code (creating a federal preemption on imposing usury limitations on home mortgage loans, with only a few states opting out).

interest rate home mortgage loan, without warning the borrowers that now if they default they can lose their home.

After battling the problem of predatory lending for the past ten years, has the federal government or the states made substantial headway? The answer is clearly no.²¹ Perhaps one reason for this failure is that lender advocates and consumer advocates have been battling each other over this issue for the past ten years, rather than cooperating to stop the problem. Lending groups and mortgage broker associations routinely reject the myriad of proposed and enacted reforms by claiming that these reforms will dry up the supply of funds to higher risk borrowers and/or needlessly increase the costs of making mortgage loans.²² Advocates for mortgage lenders and brokers also claim that the problem of predatory lending is overblown,²³ that the term "predatory loan" is too imprecise and difficult to tackle with legislation,²⁴ and that the best way to address the few bad mortgage brokers and lenders is through tougher licensing laws.²⁵

In response, consumer advocates have expended their energies in trying to prove that predatory lending is indeed a widespread problem capable of being remedied through legislation, and that self-policing by the brokers and lenders does not and has not worked. Consumer advocates did an outstanding job at first publicizing the problem and creating the acknowledged perception that there is indeed a widespread problem with

21. See *supra* note 18 (discussing the flaws with the federal and state laws enacted to date).

22. See, e.g., Georgia Bankers Association, *Georgia Fair Lending Act: The Unintended Consequences: Real-World Experiences Effects on Credit Availability Reaction by the Secondary Market Legislative Solutions* (Jan. 2003), at http://www.namb.org/government_affairs/fair_lending/GBAissuespredatorylendingwhitepaper.pdf ("Federal high-cost mortgage lending laws restrict that liability only to those purchasers of high-cost mortgage loans, and there is only a limited national market where those loans are securitized. However, with GAFLA [The Georgia Fair Lending Act] extending this liability to every home loan originated in Georgia, this increased liability risk has sent shockwaves throughout the secondary market."); see also Michael J. Pyle, *Policy Comment: A Flip in Predatory Lending: Will the Fed's Revised Regulation Z End Abusive Refinancing Practices?*, 112 YALE L.J. 1919, 1924–25 (2003) (commenting on lender objections to one of the amendments to Regulation Z that aimed at ending the practice of "flipping," imposing a standard that prohibits making new loans to borrowers if it is not "in the borrower's interest," with lenders arguing that this standard is vague and will impede sub-prime lending). See also Richard F. DeMong, *The Impact of the New Jersey Home Ownership Security Act of 2004* (Mar. 26, 2004), at <http://www.nhema.org/press.asp?bid=596>. See also The Mortgage Bankers Ass'n, *New Jersey Lender Study Finds Significant Drop In Mortgage Availability After State Implements Predatory Lending Law—MBA Calls For Uniform National Standard of Laws* (Mar. 31, 2004), at <http://www.mortgagebankers.org/news/2004/pr0331.html> (demonstrating through a survey sent to 98 sub-prime lenders that sub-prime lending had decreased, with many offices closing). However, this author contends that this is not evidence of a problem if the loss of business was due to borrowers now obtaining prime loans rather than sub-prime loans.

23. Pyle, *supra* note 22.

24. DeMong, *supra* note 22.

25. The Mortgage Bankers Ass'n, *supra* note 22.

predatory lending.²⁶ But advocates for mortgage brokers and lenders have been equally successful at creating the perception that reforms aimed at reducing the incidence of predatory lending will also reduce the legitimate sub-prime market or needlessly increase the costs associated with these loans.²⁷ Indeed, even some academics who have written on this topic seem very attentive to and respectful of the notion that reforms like reinstating usury limitations on what a lender can charge²⁸ would do more harm than good.

After ten years of fighting, rather than calling a truce and trying to forge a consensus on a sensible way to prevent more predatory loans, consumer advocates and lender advocates are now arguing over whether various recently enacted state reforms are preempted by federal laws.²⁹ The preemption debate is largely a technical question, but lender advocates also argue that a “patchwork” of different state laws on predatory lending makes it more difficult for lenders to comply with the law and, consequently, more expensive for them to make these high-cost home loans.³⁰ Consumer advocates are fearful of creating a federal “field preemption”³¹ relating to predatory lending laws because they do not believe that the current majority in the House and Senate would enact nor would the current President sign a federal law that provides for effective protections against predatory lending.³²

26. Putney, *supra* note 19, at 2114–22 (discussing the development, restrictions, and criticisms of HOEPA, and the state reactions with the development of state laws in response to HOEPA).

27. *See supra* note 22.

28. *See Engel & McCoy, supra* note 13, at 1312–20. The authors point to studies on past usury restrictions that found that price controls have a directly negative effect on the availability of credit and that “usury limits disproportionately hurt the poor.” *Id.* at 1313. The authors contend that the “best avenue for redressing predatory lending would be a direct approach that focuses on abusive loan terms and practices, without imposing usury limits.” *Id.* at 1259. *But see* Cathy Lesser Mansfield, *The Usury Law Debate: 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, 574–75 (2000) (suggesting that there should be a floating (tied to interest rates) maximum usury limit on sub-prime home equity loans, and that the regulation should be on a federal level).

29. *See King, supra* note 19, at 384–97 (addressing the debate and vulnerability of state regulations to a claim of preemption by the Office of the Comptroller of the Currency with respect to national banks. Several cases have been decided in various jurisdictions on the preemption issue.). *See, e.g.,* McCarthy v. Option One Mortg. Corp., 362 F.3d 1008 (7th Cir. 2004); Wachovia Bank, N.A. v. Watters, 334 F. Supp. 2d 957 (W.D. Mich. 2004); Boursiquot v. Citibank F.S.B., 323 F. Supp. 2d 350 (D. Conn. 2004); Howell v. Grant Holding, Inc., 03-CV-5059 (JMR/FLN), 2004 U.S. Dist. LEXIS 9400 (D. Minn. May 12, 2004); Ill. Ass’n of Mortg. Brokers v. Office of Banks & Real Estate, 308 F.3d 762 (7th Cir. 2002).

30. *See supra* note 22.

31. A federal “field preemption” is a requirement that no state law can be made relating to the field preempted by the federal law. By contrast, a more narrow preemption would only arise if the state law contradicted the terms of the federal law. *See, e.g.,* United States v. Causby, 328 U.S. 256, 266–67 (1948).

32. This information was obtained by the author in conversations with consumer advocates at the Symposium on Market Failures and Predatory Lending: Setting the Foundation for Reform, held at the John Marshall Law School (May 17–18, 2003).

III. HOW THE PROPOSED MORTGAGE COUNSELING INTERVENTION CAN PREVENT PREDATORY LOANS

An important issue to review before detailing the reform proposal is how mortgage counseling can prevent predatory lending. In the introduction to this Article, predatory lending was defined as when a mortgage broker or lender induces a borrower to enter into a "bad" loan. A bad loan is defined as a loan that contains one or more of four common features. This Article will now briefly address how mortgage counseling could prevent each of these four features.³³

The problem which is perhaps easiest to address with mortgage counseling is preventing a borrower from entering into an "overpriced" loan (i.e., one where the interest rate, fees, and closing costs are higher than market rates for a borrower with the same credit score and net income). It has been estimated that as many as 40% of high-cost sub-prime loans were made to borrowers who would have qualified for a prime loan.³⁴ For this reason, mortgage counseling can prove particularly useful in preventing the most common form of predatory lending without depriving high credit-risk borrowers of the benefits of the sub-prime market.

The mortgage counselor should review the following documents to determine if the borrower will be overcharged: the "APR" figure (a combination of the interest rate, fees, and some of the closing costs for the loan) reflected in the Truth In Lending Act disclosure and the estimated closing costs reflected in the Good Faith Estimate of Closing Costs, and the borrower's credit score. The mortgage counselor can go online to websites like <http://www.myfico.com> to determine the borrower's credit score and to find out what a market APR figure would be for a borrower with that credit score. The counselor can then compare what the lender is offering with the market APR figure. Collecting this information on the borrower's credit score and on market APRs for various credit scores should take less than fifteen minutes and should only cost between \$10 and \$15 (or perhaps cost nothing at all).³⁵ The mortgage counselor should be knowledgeable of the typical closing cost items and what the customary charges are for these items.³⁶ The counselor can then let the borrower know if the good faith estimate reflects market or above market figures.

It is possible that the APR figure quoted by the lender is higher than the market figure for reasons other than overcharging, if the borrower's

33. See generally Debra Pogrud Stark, *Become a Hero to a Family in Need: Predatory Lenders Beware*, 18 PROB & PROP. 9 (2004) (detailing the kind of mortgage counseling that should take place to prevent various forms of predatory lending, and exhorting attorneys to provide this counseling on a pro bono basis to help their communities and to engender themselves a deeper satisfaction with their practice of the law).

34. See WARREN & TYAGI, *supra* note 16, at 135.

35. If the lender provides the borrower with the credit score, as required by the mortgage counseling intervention proposal, then there would be no charge. Here, the lender can go online and find out the market rates of APR's for different credit scores for free. If the score seems suspect, then it would make sense to verify the score independently and determine why it seems too low.

36. See Stark, *supra* note 33, at 12 (identifying a potential online source that provides a survey of average closing costs figures in different parts of the United States).

debt service ratio³⁷ is greater than 25%, for example. (The affordability issue will be addressed later in this Part.) For this reason, it would also be advantageous to determine the borrower's net income. However, determining net income can be time consuming and invasive, and one can get a good idea of the overpricing issue from the simple method described above.

If the borrower could qualify for a better priced loan, the counselor should advise the borrower of this fact and provide the borrower with information on other lenders the borrower can contact to secure a better priced loan. The counselor should also guide the borrower to obtain the APR and the closing costs figures additional lenders would charge. Such counseling would level the playing field between the borrower and sophisticated lender thus allowing the borrower to find the best market rate. If, on the other hand, the borrower does not qualify for a better priced loan (i.e., the pricing on the loan is high but it matches the borrower's credit score), then the counselor can advise the borrower on how to improve her credit score and financial situation³⁸ and recommend that the borrower delay obtaining the mortgage loan for a better rate once her financial condition has improved (unless she is refinancing an even higher priced loan—and even then the counselor would need to check if there are prepayment charges that would make entering into the new loan an unsound decision at this time). If the borrower needs the loan now, the counselor should recommend that the borrower insist on a loan with the right to prepayment without any substantial penalty and try to avoid other problematic provisions such as balloon payments (a lump sum payment due at maturity of the loan), negative amortization (a loan with a payment schedule where the principal amount increases rather than decreases over the term of the loan), and the charging of unnecessary items such as credit life insurance.

A particularly devastating predatory loan occurs when a mortgage broker induces a borrower to enter into a loan that the borrower cannot afford to pay. This phenomenon of "equity stripping" was mentioned in the introduction.³⁹

What can a mortgage counselor do to avoid this situation? The counselor would need to review the borrower's current financial situation and income to debt ratio under the proposed loan. This sort of analysis will

37. See Federal Reserve *supra* note 13 (defining "household debt service ratio").

38. See Stark, *supra* note 33, at 11–12 (discussing how to improve the borrower's credit score).

39. See Engel & McCoy, *supra* note 13, at 1261–65; Eggert, *supra*, note 17, at 509, 552 (discussing why a lender would make a loan to a borrower who will not be able to afford making the payments on the loan). The answer relates to the "atomization" of loans over the past ten years. Most loans today are arranged by mortgage brokers who earn their fees when the loans close. The mortgage brokers are not affected when the borrower defaults on some date after the loan has closed, and so they will continue to market unaffordable loans as long as they keep making money from such borrowers. The lender who initially makes the loan usually sells the loan to a mortgage loan pool and will not face the consequences of a likely future default. Even the ultimate assignee of the loan pool is protected, since the loan was given to a borrower with sufficient equity in the property so that when the assignee forecloses it can recover the principal paid and retain all of the higher interest paid prior to the default.

take more time than the one to determine if the loan is overpriced and will be more invasive since it requires the borrower to disclose personal information, such as income and expenses, to assist in determining the borrower's net income. Counselors should work with the borrower to complete financial forms that identify his major sources of income and expenses.⁴⁰ After reviewing the form with the borrower, the counselor should advise the borrower that he is in grave danger of defaulting on the loan if the monthly payments on this and any other mortgages on his home (plus taxes, insurance, and any assessments) are greater than 50% of the borrower's monthly gross income. The counselor should advise the borrower that a conservative debt service ratio is 25%, and that anything over that amount is imprudent.

Ultimately, the decision on whether to go ahead with the imprudent loan remains the borrower's, but at least he can be warned of the risks and counseled to consider other options. Considering other options is especially useful if this loan is converting credit card debt into a home equity loan. In this case, bankruptcy could be a good option as a means to liquidate the unsecured debt if a consolidation loan would still be unaffordable. Another circumstance where other options could be helpful is when the unaffordable loan is an acquisition loan. In this circumstance, the borrower could be counseled to purchase a more affordable home or delay the purchase until the borrower's credit score has improved, allowing for a future lower cost loan that would be more affordable.⁴¹

A third common predatory loan feature is "loan flipping" (numerous refinancing of a mortgage loan where the costs exceed the savings and there is no net economic benefit to the borrower), and this problem not only affects sub-prime loans, but can also occur in the context of a prime loan. For example, a borrower may be refinancing a loan at 8% with a new loan at 7%. On the surface, this appears to be an economically beneficial refinancing, however, the borrower may not have taken into account any points, fees, and closing costs for the new loan. Nor has the borrower likely taken into account whether the loan being refinanced has a prepayment charge and the amount of the prepayment charge. The anticipated length of the new loan is also important to know in order to analyze its economic benefit. For example, if the borrower is planning to sell the home in a short period (like two or three years), then a new 7% loan with points and closing costs may not be worthwhile because the interest rate savings over the short period may not exceed the overall closing costs for the new loan. A mortgage counselor should ascertain all of this

40. See Stark, *supra* note 33, at 10, for a discussion of the Illinois predatory lending law that contains an example of one such form that can be used.

41. Indeed, borrowers are not the only party in need of better counseling. Home buyers have also been induced by unscrupulous developers to purchase homes that are in defective condition and that are overpriced. This phenomenon is sometimes referred to as "predatory selling." See Michael Moss & Andrew Jacobs, *Blue Skies and Green Yards, All Lost to Red Ink*, N.Y. TIMES, Apr. 11, 2004, at 1. It is this author's opinion that if more home buyers were represented by well trained attorneys, then both the phenomenon of predatory selling and predatory lending would be significantly reduced. See DEBRA POGRUND STARK, RESIDENTIAL REAL ESTATE LAW: A TRANSACTIONAL SKILLS ANALYSIS 3-5 (2004).

information when she counsels the borrower on whether the refinance provides a net economic benefit to the borrower.

The problem of fraud and deception permeates on some level every predatory loan, because it is this fraud and deception that induces borrowers to enter into the bad loan. To combat the problem of fraud, the mortgage counselor should ask the borrower what the mortgage broker or lender has promised the borrower relating to the terms of the loan, and then make sure that the initial set of loan application documents (the loan commitment—if any is given—, the Truth In Lending Statement, and the Good Faith Estimate of Closing Costs) conform with what the borrower was promised. Examples of terms to check include whether the loan has a fixed or floating interest rate, the APR, the amortization schedule and whether there are any required escrows. The mortgage counselor should also inspect for problematic provisions that can be buried in the loan documents, such as prepayment fees, lump sum credit life insurance, “call provisions” (provisions permitting the lender, in its sole discretion, to accelerate the indebtedness), etc. Finally, before refinance closes the mortgage counselor should review the HUD-1 Settlement Statement (which reflects all of the closing costs for an acquisition or finance) and the closing loan documents to make sure that the deal that closes is the same as the deal that was documented at the loan application stage.

IV. DETAILS AND OPTIONS FOR THE PROPOSED MORTGAGE COUNSELING INTERVENTION LAW

A complete model mortgage counseling law is appended to this Article. This Part of the Article will explain the main features of the proposed law. The mortgage counseling intervention that is proposed in this Article would apply to all “high-cost home loans.” A “high-cost home loan” would be defined as any mortgage loan on a person’s primary residence where either (i) the APR on the loan is greater than the yield on U.S. Treasury securities with a comparable maturity by 4% or more for first mortgage loans and by 6% or more for junior liens,⁴² or (ii) all of the loan clos-

42. For example, on September 8, 2004, there was a spread of only 1.23% between 10-year treasury note rates (as reported in the *Wall Street Journal*, Sept. 8, 2004, at C13) and the APR quote of 5.5% that this author received from a mortgage broker for a 30-year fixed rate first mortgage loan to a hypothetical high credit borrower on a conventional sized loan with normal closing costs (the 10-year treasury note rate was 4.25% (with a 4.27% yield according to the United States “Recent Treasury Note and Bond Auction Results” on the Dept. of Treasury website)). Department of Treasury, Bureau of the Public Debt, at <http://www.publicdebt.treas.gov/AI/OFNtebnd> (last visited Apr. 22, 2005). HOEPA, however, requires for first mortgage loans, a spread of 8% points from the yield on U.S. treasury notes, and 10% for junior mortgage loans to be considered “high-cost.” The highest grade sub-prime loan will be approximately 1% higher than a prime loan and the lowest grade sub-prime loan can be double the prime interest rate. See OCC Working Paper, *supra* note 3, at 10. To ensure that not every sub-prime loan would be covered (since this could lead to more loans being made than trained mortgage counselors could timely respond to) the mortgage counseling intervention law would initially be triggered when the loan is approximately 3% or more than a prime loan rate would be. This figure is still substantially lower than HOEPA levels or any state law threshold levels. See *supra* note 18 for a sampling of state law threshold levels. See *infra* note 49 for a discussion of how the

ing costs (including yield spread premiums and prepayment penalties and all other items included under HOEPA, but excluding any bona fide discount points) is 4% or more of the loan amount, or, if the loan amount is less than \$20,000, if all of the loan closing costs exceed \$1,000.

The APR and closing costs triggers under the proposed counseling requirement are purposefully set at far lower levels than the triggers under HOEPA and various state laws. The intent is to cast a wider net with the mortgage counseling requirement than under these other laws, because unlike HOEPA and the state anti-predatory lending laws, the counseling requirement does not prohibit any specific loan term and should not impede the legitimate sub-prime market. This wider net would provide protection to more homeowners.⁴³

When a lender offers a borrower a “high-cost home loan,” the lender would be forced to notify the borrower that he needs to obtain a “certificate of counseling” (defined and discussed below) from an “approved mortgage counselor” (defined and discussed below) before the borrower could incur any un-reimbursable loan application costs. The mortgage loan will not be enforceable by the mortgage lender—even after a funding of the loan—and the borrower will be able to obtain rescission and restitution if the lender does not receive at closing the certificate of counseling from the approved mortgage counselor certifying that the borrower has received the mandatory counseling.

The mortgage counseling intervention would occur in two potential stages: at the loan application stage and on the day before the closing of the loan. At the loan application stage, the mortgage counselor would review with the borrower whether the loan is overpriced. As previously discussed, this initial review should only take a few minutes, and the charge for this limited review (plus the review of the loan documents the day before the closing) would be regulated and limited to a nominal amount, taking into account regional variations in the cost of living, such as \$50. An important question is who would pay for this initial review and the review of the loan documents on the day before the closing? Perhaps two more important questions are who will train the “approved mortgage counselors” and who will pay for this training? This author recommends that the training be organized and funded by the United States Department of Housing and Urban Development (“HUD”) (if the proposal is enacted as a federal law) or by the equivalent state or local housing agency (if the proposal is enacted on a state or local level), perhaps with the assistance of legal clinics at various interested law schools.⁴⁴ Since this

interest-rate threshold and fees-and-costs threshold could eventually be lowered to capture the entire sub-prime market.

43. As counseling leads to fewer over-priced loans, this rate trigger may eventually be lowered without causing more loans to be subject to the counseling requirement than available mortgage counselors to handle. See Part V *infra* for a fuller discussion of this point.
44. The John Marshall Law School, through the efforts of its Fair Housing Legal Support Center, currently offers a course on predatory lending that includes teaching students how to counsel borrowers to avoid predatory loans. During the course, the students have provided counseling to at-risk borrowers with the assistance of community non-profit organizations and with financial assistance from the federal government funded through the Fannie Mae Foundation and the Department of Hous-

aspect of the counseling law is mandatory and cannot be waived by the borrower,⁴⁵ it is proposed that this small fee not be charged to the borrower, but instead be paid for by HUD or the equivalent state or local housing authority. Indeed, it is hoped that this brief counseling session is one that the approved mortgage counselor would undertake at no charge—especially if the counselor is an attorney, since this would be an excellent way to provide pro bono service to the community.⁴⁶ Another possibility for funding the training of the counselors and the limited review of the pricing of the loan and closing documents is to increase the licensing fees that banks and other mortgage lenders pay, with the increase being earmarked for the counseling project.

The approved mortgage counselor would also be trained to analyze for the borrower whether the proposed high-cost home loan is “affordable” and whether it makes economic sense for the borrower to enter into the high-cost loan when it is a refinancing.⁴⁷ As previously explained, this sort of review would take considerable time and is invasive in terms of securing information from the borrower. For these reasons, this proposal would not require that the borrower receive counseling on these two issues. The counselor would inform the borrower that they can receive counseling on these two additional issues if the borrower so desires, but the borrower would pay for the costs of this additional counseling. Like the counseling on pricing, the counseling on affordability and economic benefit would be regulated and kept at a low amount. It is estimated that counseling on these two additional issues would take between one and three hours (depending on the record keeping abilities and communica-

ing of the City of Chicago through its Community Development Block Grant Funds, which come from HUD. E-mail from Professor Michael Seng, Professor and Co-Executive Director of The John Marshall Law School Fair Housing Legal Support Center and Fair Housing Legal Clinic, to Debra Poggrund Stark (Sept. 7, 2004, 12:32 p.m. CST) (on file with author). The counseling is currently focused on homeowners in the southwest side of Chicago, traditionally a middle-class working area that is undergoing tremendous socio-economic change and hard hit with foreclosures and boarded up homes. Greater Southwest Development Corporation links the borrowers seeking counseling to the student counselors who interview the clients, review the existing or proposed loan documents, and counsel the borrowers as to their rights, obligations, and options. See Report by Michael Seng, *Predatory Home Lending—Education and Outlook*, 2004 (on file with author). In the report, Seng states that students are most effective at helping the borrowers when they can speak with them before they have entered into a bad loan, or before they have dug themselves even deeper with a second or third bad loan. When the counseling intervention occurs early on, the borrowers are counseled to perform price comparisons to get the best economic deal. Even when counseling occurs after the first bad loan, the borrowers still are sometimes able to refinance on more advantageous terms and keep their homes. *Id.* at 6. Seng concludes that some of the students who have volunteered are now seeking jobs where they can continue to put the information and skills they have learned to use. *Id.* at 7.

45. As contrasted with the Illinois predatory lending law, which permits the borrower to waive the protection of counseling. 815 ILL. COMP. STAT. 137/110 (2004).
46. See Stark, *supra* note 33, at 14 (quoting one attorney who claimed that some of the greatest satisfaction that attorneys get from the practice of law is not from the multi-million-dollar deals in which they are involved, but rather returning home and telling your spouse or partner that you helped a person solve a problem that was very important to that person—that you helped repair that person’s broken world).
47. See Part II, *supra*, for in-depth discussion of these two topics.

tion skills of the borrower) and should be limited to a reasonable figure like \$50 per hour, taking into account regional variations in the cost of living, leading in most cases to a charge that is less than what borrowers now commonly pay for an appraisal of the home.

If the borrower has applied for a high-cost home loan, then in addition to notifying the borrower to obtain the certificate of counseling (which would be on a statutory form and include information on how to contact an approved mortgage counselor), the lender must either deliver or telefax to the mortgage counselor chosen by the borrower the following: the TILA Statement reflecting the APR for the loan, the Good Faith Estimate of Closing Costs for the loan, the credit report, if any, that the lender received (or if only verbal the score reported verbally), and the loan commitment, if any. These documents are necessary for the counselor to determine whether the loan is overpriced and to prevent fraud. If the borrower decides to go ahead with the loan after receiving this counseling, the mortgage counselor will advise the lender that the loan application or commitment has been approved by the borrower after consultation with the mortgage counselor and to send a copy of the closing loan documents to the mortgage counselor the day before the closing of the loan. If the borrower decides not to proceed with the loan, then the mortgage counselor shall so advise the lender, and, if the loan is determined to be overpriced, the lender shall refund to the borrower any fees or costs that the borrower has paid to the lender in connection with the application for the loan (excluding the costs of the credit report).

On the day before the closing of the loan, the mortgage counselor would compare the closing loan documents that the lender sends to the mortgage counselor (including the HUD-1 Settlement Statement) with the TILA Statement, Good Faith Estimate of Closing Costs, and the loan commitment that the mortgage counselor had previously reviewed to make sure that the terms of the loan as previously disclosed to the borrower are the terms reflected in the closing loan documents. If they do conform, the mortgage counselor will send a notice to the closing officer that they conform and to proceed with the closing.⁴⁸ If the terms do not conform, then the mortgage counselor will inform the lender of any discrepancies and attempt to work with the lender to revise the documents to conform. If the closing documents sent to the mortgage counselor substantially conform,⁴⁹ then the mortgage counselor will not receive any further payment

48. One way to ensure that the mortgage counselor's review of the loan closing documents takes place would be for the counseling law to provide that the loan is voidable at the borrower's election if the required review of the loan documents is not performed. This will cause title insurance companies, who are normally the closing officers for new purchases or a refinance, to make sure to get an acknowledgement from the approved counselor that this review has been performed at the closing. In addition, this author recommends that if the requirements of the mortgage counseling intervention are not met, then the borrower should be able to obtain rescission of the loan and attorney's fees.

49. The proposed law would require the APR to be the same or lower, and any fees or costs imposed by the lender to be the same or lower, but would allow a deviation for items not charged directly by the lender. A major criticism of the federal Real Estate Settlement Procedures Act ("RESPA") is that the closing costs do not have to be the same or even substantially the same as what the lender said they would be in the

for the review of these documents. If, however, the documents do not substantially conform, then the lender will be required to pay the mortgage counselor a regulated rate per hour for the counselor's time in contacting the lender and attempting to modify the documents to conform, or for the time it takes the mortgage counselor (or an attorney, if one has to be hired) to obtain a rescission of the loan and obtain reimbursement to the borrower of any and all costs the borrower has incurred in connection with obtaining the loan (and for the added cost to the extent the borrower will now be charged a higher interest rate from another lender due to interest rates rising since the loan application was made).

V. THE PROPOSED MORTGAGE COUNSELING INTERVENTION LAW SHOULD BE EMBRACED BY BOTH CONSUMER ADVOCATES AND RESPONSIBLE MORTGAGE LENDERS AND BROKERS

The proposed mortgage counseling intervention offers a more comprehensive, effective, and proactive means to reduce the incidence of predatory lending without impinging upon the legitimate sub-prime market than the other enacted and proposed reforms. Consequently, the proposal should be embraced by both consumer and lender advocates.

The only more comprehensive and potentially effective approach this author has seen proposed would be to re-institute usury laws that would impose a maximum lawful interest rate and maximum fees and costs (in which the cap on rates would float based on United States Treasury notes to avoid the problem of inflation making the usury limitations too low).⁵⁰ A problem with this proposal, however, is how low to set the rates and fees and costs. If set too low, it would impede the legitimate sub-prime market; if set too high, many overpriced loans would not be prevented. For these reasons, this proposal has been rejected by many academics and the lending industry.⁵¹

As previously noted, HOEPA does not effectively prevent predatory lending. HOEPA does not prohibit the charging of high interest rates, fees, or costs; rather, if a lender makes a high-cost home loan, then various additional disclosures are required, and certain specific loan terms are prohibited.⁵² HOEPA has been soundly criticized by consumer advocates and many academics on two basic grounds: (i) the triggers for the Act's protections are so high that sub-prime lenders simply avoid the Act's requirements by making loans that fall just below the triggers, and (ii) the main protections themselves are inadequate (e.g., requiring numerous disclosures that borrowers fail to understand or even read, and the prohibition of specific problematic loan terms while not prohibiting the overpricing of the loan—the most important loan term).⁵³ In contrast, the pro-

Good Faith Estimate of Closing Costs. Due to preemption issues, this aspect of the counseling reform proposal would have to be a federal law that would reverse this aspect of RESPA to be enforceable. See Part VI, *infra*, for a discussion of whether the proposal should be a federal or state law.

50. Mansfield, *supra* note 28, at 574–75.

51. See *supra* note 28.

52. See *supra* note 18.

53. *Id.*

posed mortgage counseling intervention would be triggered at far lower interest rates and lender fees and costs, so it will become a requirement that lenders will have to comply with if they want to make sub-prime loans. Through this counseling, borrowers will be able to avoid an overpriced loan and reduce the incidence of fraud. In addition, borrowers can choose to get counseling to avoid entering into high-cost loans that are unaffordable or have no net economic benefit.

Counseling the borrower on issues relating to the affordability of the loan and certain other potentially problematic provisions in the loan rather than prohibiting lenders and borrowers from entering into such loans has the advantage of allowing the borrower to make an informed decision in light of his special circumstances. For example, assume that a borrower is borrowing more money than is typically prudent in light of his income (at say a 60% debt to income ratio), but he is doing so not to pay off some credit card debt for various consumer goods, but instead, to pay for a major operation or a child's college tuition.⁵⁴ If the loan is a high-cost loan, under the proposal he will receive counseling on whether he is being overcharged, and if he elects, he can also receive counseling on the affordability issue. After being warned that he can lose his home if he defaults, and that a much lower debt to income ratio is considered prudent, it is ultimately the borrower's decision what to do.

Similarly, there are various terms under HOEPA and various state predatory lending laws that are prohibited from being present in a high-cost home loan (as defined in those laws) that certain borrowers might still accept. An example of this is balloon payments or negative amortization, which are prohibited under HOEPA and various state predatory lending laws for high-cost home loans. These features can be very problematic when a borrower is unaware of their presence, making it more likely that the borrower will go into default when the loan matures. However, if the borrower is made aware of these terms and the consequences of these terms before entering into the loan, the borrower can decline the loan if these terms are not acceptable, and accept the loan if the terms are in harmony with the borrower's circumstances and plans. For example, if the borrower is planning to move and sell the home in three years, then a loan with a balloon payment due in five years should not be problematic. If the borrower is taking classes at night and working during the day but expects to graduate and has a high-paying job waiting for her in a year, then a loan that accrues interest at a higher rate than it is payable at for a one-year period (causing negative amortization) would not be problematic and may best suit that particular borrower's needs. Other provisions are ones the borrower would always like to avoid such as high prepayment charges, especially if the charges are in a high-cost home loan that the borrower hopes to refinance in the near future when her credit or income has improved.

As previously mentioned, several states have enacted laws aimed at predatory lending, but these laws mirror HOEPA's approach of only prohibiting certain loan terms (excluding, as HOEPA does, prohibiting over-

54. The possibility of enacting laws to provide all Americans with comprehensive health coverage and a college education goes beyond the scope of this Article.

priced loans) when a very high interest rate trigger or a relatively high cost trigger is reached. Consequently, these state laws, like HOEPA, are laws that lenders avoid rather than comply with.⁵⁵ Although five states have enacted mortgage counseling requirements for high-cost home loans, because the triggers for this protection are set at such high levels, they have become another reform to avoid rather than comply with.⁵⁶ Consequently, existing state law protections, including those that provide for mortgage loan counseling, are not as comprehensively available as the proposed mortgage counseling intervention would be.

Perhaps the two most important reform proposals this author has seen are the imposition of a “suitability” requirement on mortgage brokers and lenders⁵⁷ and the elimination of the “holder in due course” defense to assignees of the predatory loan.⁵⁸ The suitability requirement, however, focuses primarily upon whether the loan is one that the borrower can afford to pay, and focuses less on the equally important issue of whether the loan is overpriced.⁵⁹ Consequently, even if it operates as intended, it will not provide as comprehensive an approach to the multifaceted predatory loan problem as would the mortgage counseling proposal. In addition, the suitability approach places the burden on borrowers to bring a cause of action after they are harmed by the “unsuitable” loan, while the mandatory mortgage counseling intervention would actually prevent the borrower from entering into a harmful loan. It will likely be far more difficult and costly to litigate a “suitability” case on behalf of a borrower than it will be to counsel the borrower before they close on their high-cost home loan. In addition, some borrowers may not even know that they have a cause of action based on “suitability” and are likely only to learn of this if they are in default and facing a foreclosure action. Since only a relatively small percentage of predatory loans become delinquent,⁶⁰ many borrowers might not enjoy any benefits of the “suitability” reform. This does not mean that the presence of a mortgage counseling intervention requirement would preempt other useful laws that could reduce the problem of predatory lending. Making mortgage brokers liable for induc-

55. See *supra* note 18 for interest rate triggers from the five states with predatory lending laws that included a counseling provision and their lower costs triggers, and note that New Mexico has enacted somewhat lower costs triggers than under HOEPA.

56. See, for example, *supra* note 18 for further information about 5 states that have enacted predatory lending laws. Illinois’s mortgage counseling law is not included in the list because borrowers can waive this right, which eviscerates its usefulness. Since borrowers currently receive a pile of loan documents that they barely read, the waiver form is just one more paper they sign at the loan application or loan closing stage without any careful consideration.

57. See Engel & McCoy, *supra* note 13, at 1321–28.

58. See Eggert, *supra* note 17, at 528–31.

59. See Engel & McCoy, *supra* note 13, at 1319–20 and 1343. (Engel and McCoy do propose under the suitability standard that mortgage lenders and mortgage brokers be prohibited from making a sub-prime loan to borrowers who would qualify for a prime loan. However, a borrower might be a proper candidate for a sub-prime loan and still be grossly overcharged, since there are various grades of sub-prime loans ranging from only about 1% more than a prime loan to double the interest rate of a prime loan. See Engel & McCoy, *supra* note 13, at 10.)

60. OCC Working Paper, *supra* note 3, at 10 (the highest credit risk borrowers were at a delinquency rate of approximately 10%).

ing borrowers to enter into loans that they cannot afford or that do not provide a net economic benefit would be an additional protection to borrowers that would complement mortgage counseling.

Eliminating the “holder in due course” defense could also lead to a significant reduction in the fraud element of predatory loans, but not the other predatory loan features, including overpriced and unaffordable loans unless these borrowers can prove that they were also defrauded (which is difficult to prove). Consequently, placing liability on assignees for the fraud of the originating lender or the mortgage broker would not be as comprehensive or as effective an approach to predatory lending as would the mortgage counseling proposal.⁶¹ It should also be noted that the lending industry has expressed strong disfavor with eliminating the holder in due course defense; in one state that enacted this type of reform (Georgia), the state legislature reversed itself in light of its concern that the secondary market would no longer purchase these loans.⁶² If, nonetheless, laws were enacted that eliminated or modified the holder in due course defense and the laws withstood a preemption challenge,⁶³ this reform would not be inconsistent with a mortgage counseling requirement which covers not only issues of fraud, but also other issues such as avoiding an overpriced loan.

Finally, neither the suitability requirement nor assignee liability is as proactive a means to prevent predatory lending compared with mortgage counseling intervention, which takes place before the borrower closes on the loan, and even before the borrower incurs any significant unreimbursable expenses.⁶⁴

There are several specific concerns that lenders and consumer advocates have raised about mortgage counseling as a means to prevent predatory lending, and the mortgage counseling intervention proposed herein has been formulated with these concerns in mind. The key concerns lenders raise are that imposing a counseling requirement will delay the closing of the loans and will be costly to administer.⁶⁵ The major concerns that

61. *Id.*

62. See Georgia Fair Lending Act, GA. CODE ANN. tit. 7, § 6(a)(3) (2004); see also OCC Working Paper, *supra* note 14, at 20 (citing the *American Banker* in stating that Ameriquest Mortgage Co., the seventh largest subprime lender in the nation decided to cease doing business in Georgia due to the increased risk of punitive damages for lenders and the imposition of a standard that prohibits making new loans to borrowers if there is not “a net tangible benefit” to the borrower if the refinancing is less than five years old).

63. See Treas. Dep’t Order, Docket No. 03-17 (July 31, 2003), at http://www.namb.org/government_affairs/front/2003_08_06_occ.pdf.

64. Of course, knowing that they could be liable for arranging an unaffordable loan should cause mortgage brokers and lenders to make sure not to arrange or make an unaffordable loan. Similarly, if assignees can have liability for the fraud of the mortgage broker or originating lender, then the assignees may require evidence of sound practices and liability of the originating lenders for such claims, which in turn can cause the originating lenders to take more care to avoid such fraud. The lending industry would argue that assignee liability will either cause the secondary market to dry up or will increase the costs of these loans.

65. Engel & McCoy, *supra* note 13, at 1309–11; Robert E. Litan, *Unintended Consequences: The Risks of Premature State Regulation of Predatory Lending*, at <http://www.aba.com/NR/>

consumer advocates raise are that counseling puts the burden of preventing predatory lending on borrowers, that there is an inadequate number of trained counselors, and that counseling will be ineffective for many borrowers.⁶⁶

The issue of possible delays and costs from the mortgage counseling intervention has already been addressed in Part IV. The key to minimizing delays is to have an adequate number of trained mortgage counselors ready to perform the mortgage counseling intervention. If it is assumed that an adequate number of counselors exist, then the actual counseling provided at the loan application stage should cause no significant delay, since the counseling itself will take only between approximately fifteen minutes (to counsel on if the loan appears to be overpriced) and three hours (to obtain the information necessary to determine if the loan is affordable and if there is a net economic benefit). With an adequate number of mortgage counselors ready to provide this service, the intervention could delay the process by only one day. When one considers that loans can be rescinded within three days of application, there may in fact be no real delay in the process. Requiring the lender to send the loan closing documents to the mortgage loan counselor the day before the closing to prevent fraud would not delay the closing but would add extra copying costs. If this requirement turns out to be objectionable, then another way to allow the mortgage counselor to perform the fraud check is to have the closing officer at the title company (if the loan closes there) make those papers available to the mortgage counselor to review before the deal closes. This would cause a delay of only an hour or so for the counselor to review the papers against what the borrower originally received when making loan application. In light of this analysis, there should be no significant delays caused by requiring mortgage counseling intervention—provided there are an adequate number of trained counselors.

As for costs, the key cost would be training an adequate number of mortgage counselors rather than the fees charged by the mortgage counselors. Determining how many counselors will be needed requires a calculation of how many loans will be picked up under the lower threshold triggers. That number should gradually decrease as the requirement goes into effect and more lenders who currently attempt to overcharge (e.g., try to slip a sub-prime loan to a person who would qualify for a prime loan) will be deterred from continuing the practice by the realization that a mortgage counselor will surely discourage the recipient from accepting these unattractive loan terms. The question of who pays for this training is a sensitive one. This proposal recommends a combination of state or federal (depending on the level at which the mortgage counseling intervention law is enacted) housing funds be earmarked for this training plus an increase in licensing fees for home mortgage lenders to also contribute to the costs for this training. The fees of the mortgage counselor would be regulated and kept very low. As previously discussed, one could envision a \$50 fee to assess whether the loan is overpriced, which the government

rdonlyres/D881716A-1C75-11D5-AB7B-00508B95258D/28871/PredReport200991.pdf
(last visited Apr. 22, 2005).

66. Engel & McCoy, *supra* note 13, at 1309–11.

would fund (perhaps through the increased licensing fees), with any additional optional counseling paid for by the borrower at a regulated hourly fee. Once again, it is hoped that attorneys would be encouraged to perform this mortgage counseling intervention pro bono, in which case the fees would be zero. Indeed, this counseling would likely appeal to transactional attorneys that practice in states that already require pro bono service from their attorneys.⁶⁷ It is also recommended that the government encourage law schools to provide this training to introduce future lawyers to this opportunity, as has occurred successfully at The John Marshall Law School.⁶⁸

Consumer advocate concerns with counseling as a solution have also been considered in the formulation of this proposed mortgage counseling intervention. First, consumer advocates noted that there are an inadequate number of trained counselors to do the job. This is currently true. For the proposal to work, resources have to be committed under the law for the mortgage counseling intervention to be effective. Indeed, the law should provide for a training period before the counseling requirement begins. In addition, under the proposal, the burden to obtain counseling is no longer on the borrower. Counseling will be required for high-cost home loans to close. Consumer advocates should not confuse a mortgage counseling *intervention* with general education on mortgage loans. It is true that individuals do not retain a large percentage of the information that has been presented to them in a classroom setting.⁶⁹ For this reason, relying solely on the general education of consumers is an inadequate response to the predatory lending problem. Warnings about predatory loans are likely to be best understood when the borrower is in the midst of the lending situation.⁷⁰ If a mortgage counselor determines that the borrower could get the same loan at a better price, and so counsels the borrower, that borrower (no matter how sophisticated or intelligent—unless severely mentally impaired) will act rationally to decline the loan and seek a better termed loan, especially if a counselor assists with the process of obtaining a better priced loan. The proposal has left as optional if the borrower will receive counseling on whether the loan is affordable and provides a net economic benefit, but has done so out of concern for the borrower's privacy and the added costs that this type of analysis could

67. Having practiced as a transactional attorney, I experienced first-hand that there are more pro bono opportunities to represent lower income individuals in need in the context of a litigation rather than a transaction. In addition, transactional attorneys are particularly well equipped to provide the type of counseling proposed herein after proper training.

68. See *supra* note 42.

69. Barbara O'Neill, *Avoiding Predatory Loans: Is Financial Education the Solution?*, Speech at The John Marshall Law School Symposium, *supra* note 32 (outline on file with the author) (emphasizing that the best learning is not in the classroom but at "teachable moments," such as when a person is in financial distress, through "active" learning [learning by doing], learning from experience, and one on one learning. All of these most effective styles of learning are employed in the context of the proposed mortgage counseling intervention. Of course, if an individual does not speak English, a translator would have to be provided. In addition, mortgage counselors should be trained to be sensitive when counseling borrowers since many borrowers feel ashamed to be in their situation and may not be forthcoming with details.).

70. See Engel & McCoy, *supra* note 13, at 1309–11; Childs, *supra* note 19, at 722–24.

require. The mortgage counselor should reinforce the importance of determining whether the loan is affordable and provides a net economic benefit. However, since the borrower would be paying for this additional counseling, it is proposed that the borrower be able to decide whether to obtain it or not. Under the mortgage counseling intervention proposal, the burden of paying to train the counselors and to answer the initial question if the loan is overpriced has been placed on the government and subprime lenders rather than on the borrower. However, more expansive counseling would be provided at the option and expense of the borrower, but at low, regulated rates.

VI. SHOULD THE MORTGAGE COUNSELING INTERVENTION BE ENACTED AS A FEDERAL LAW THAT PREEMPTS STATE LAW ON COUNSELING OR ENACTED ON A STATE-BY-STATE BASIS?

The final issue that should be addressed with the mortgage counseling intervention is whether it makes more sense for it to be enacted as a federal law or on a state-by-state basis. Although this is a difficult question, one aspect is perfectly clear: Under no circumstances should mortgage counseling create a “field preemption” of the general issue of predatory lending (i.e., that the only law that any state could ever enact on any aspect of predatory lending is a law requiring mortgage counseling consistent with the federal mortgage counseling law). As previously explained, it is not contemplated or necessary for this proposal to be the only method to prevent predatory lending.⁷¹ A more difficult question is whether, as a federal law, it should preempt all state mortgage counseling laws that are inconsistent with the federal law.

Lenders would prefer a uniform approach (and hence a federal law), because with a uniform law, multi-state lenders will have only one set of rules to comply with, making compliance with the law easier and cheaper to administer. If the mortgage counseling intervention is enacted by various states, it is likely that there would be significant differences in the procedures and requirements imposed by each state, making compliance by multi-state lenders more costly (costs that will be passed along to consumers of the affected loans in terms of higher fees or interest rates). For efficiency reasons, it makes sense for the proposal to be enacted as a uniform federal law. From the consumers’ standpoint, it also ensures that in every state some type of mortgage counseling will be available. In addition, since the proposed requirement that lenders charge no more than the amounts reflected in the Good Faith Estimate of Closing Costs would work as a revision to the federal Truth in Lending Act (“TILA”), this aspect of the proposal could only be enforced as a federal law amending this aspect of TILA.

There are several reasons in favor of enacting the mortgage counseling intervention on a state-by-state basis. First, consumer advocates fear that in light of the current holders of national office, it is unlikely that as effective a law will be enacted as might be enacted by certain states. Second, the advantage of allowing each state to establish its own specific re-

71. See Part IV, *supra*, for the discussion of other options.

quirements and procedures is that as each state experiments with different procedures and requirements, the most effective forms of the law will be revealed and a uniform law based upon these empirical findings can be created.

In light of the efficiency advantages of a uniform law, and the important change to federal law on closing costs that is embodied in the counseling intervention law, this proposal calls for a federal law in substantially the same form as appended hereto. If the proposed federal law removes the key ingredients necessary for mortgage counseling to be effective (such as allowing the counseling to be waived by the borrower or increasing the triggers to HOEPA levels), then consumer advocates can withdraw support from it and work to have a stronger law enacted at the state level. An allowance for local variations to account for local conditions or initiatives can still be accomplished within the proposed procedures through variation in the substance of the counseling on the key issues previously identified. As such, one can retain the efficiencies of a uniform federal law without stifling individual states' creativity.

VII. CONCLUSION

The mortgage counseling intervention law proposed in this Article is a reform of the law that responsible mortgage lenders and consumer advocates should enthusiastically embrace, because it will prevent a great deal of predatory lending without interfering with the legitimate sub-prime market. It would provide meaningful protections to borrowers from highly persuasive and unscrupulous mortgage brokers and lenders without limiting any of the borrower's choices. With an adequate number of trained and available mortgage counselors to perform the relatively straightforward counseling, then the counseling intervention requirement should not create significant delays or costs to the closing of non-prime mortgage loans and will ensure that borrowers who would have qualified for a prime loan will not be entering into a high-cost sub-prime loan. It will also prevent borrowers from closing on loans that are disadvantageous to the loans they were promised at the loan application stage. Preventing fraud and preventing borrowers from being overcharged is something that responsible lenders and mortgage brokers should embrace. Failing to do so would perpetuate the negative image inflicted upon all mortgage lenders and brokers due to the continuing problem of predatory lending.

Consumer advocates also need to support this proposed law. Their input is especially necessary for the drafting of training materials for the mortgage loan counselors and placing pressure on Congress to fund the training of an adequate number of mortgage counselors (including authorizing the imposition of an increase on the licensing fees of lenders who engage in sub-prime lending).

It is hoped that consumer advocates and advocates for mortgage lenders and brokers will pause in their battle over predatory lending long enough to take a serious look at the mortgage counseling intervention proposed herein. It is a reform that some victims of predatory lending have

wished existed before they entered into a predatory loan.⁷² The mortgage counseling intervention is a proposal that both sides of the debate can work on together, and it therefore can serve as an important bridge across the current divide and debate. Responsible borrowing and responsible lending are critical to successful home ownership remaining an integral part of the American dream. Mortgage counseling intervention is perhaps the best means available to achieve this goal.

72. See Walter C. Jones, *The Mortgage Trap Bill Sponsored By Governor Would Help Prospective Homeowners Avoid Penalties*, AUGUSTA CHRON., Apr. 21, 2002, at D01 (reporting on Charisse McReynolds, a woman of modest means, who was persuaded by a mortgage broker to accept a federally insured loan that was one percent higher than she would normally have received, causing her to pay an extra \$40,000 over the life of the loan and garnering to the mortgage broker approximately \$7,000 in fees. Ms. McReynolds acknowledged that she did not understand the loan process and exclaimed, "Before you buy a home, you should have to take a class.").

APPENDIX A

[THE PROPOSED MORTGAGE COUNSELING INTERVENTION LAW]

AN ACT

TO IMPOSE COUNSELING REQUIREMENTS RELATING TO HIGH-COST HOME LOANS, TO PREVENT UNFAIR OR DECEPTIVE PRACTICES BY MORTGAGE BROKERS AND LENDERS, AND TO PROVIDE CIVIL REMEDIES AND CRIMINAL PENALTIES.

BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED,

Section 1. SHORT TITLE. This act may be cited as the "Mortgage Counseling Act."

Section 2. FINDINGS AND PURPOSES.

- (A) The legislature finds that because predatory loans, in which the rates or fees are excessive, despite the extra risk involved, can cause significant harm to consumers, and current disclosure and licensing requirements do not provide consumers with enough protection, a counseling requirement for high-cost home loans is necessary.
- (B) It is the purpose of this act to:
 - (1) Deter creditors from making predatory loans.
 - (2) Decrease the occurrence of predatory lending without unnecessarily interfering with the flow of credit.
 - (3) Encourage consumer awareness of the consequences of home loan terms.
 - (4) Encourage attorneys to advise consumers in connection with contemplated high-cost home loans.
- (C) This act shall be liberally construed to effectuate its purpose.

Section 3. COVERAGE.

- (A) There shall be no waiver of any provision of this act.
- (B) The requirements of this act apply to a consumer credit transaction that is secured by the consumer's principal dwelling, and in which either:
 - (1) The annual percentage rate at loan application will exceed by more than four percentage points for first-lien loans, or by more than six percentage points for subordinate-lien loans, the yield on U.S. Treasury securities having comparable periods of maturityⁱ to

i. As of February 2002, the government no longer reports a 30-year constant maturity yield for Treasury securities. Federal Reserve Board, Statistical Release, *Changes to Treasury Long-Term Rate Series* (Feb. 25, 2002), available at http://www.federalreserve.gov/releases/h15/treas_long-term_rate.htm. From February 2002 to May 2004, the

- the loan maturity as of the fifteenth day of the month immediately preceding the month in which the creditor receives the loan application; or
- (2) The total points and fees payable by the consumer at or before loan closing will exceed the greater of four percent of the total loan amount, or \$495 if the total loan amount does not exceed \$20,000.ⁱⁱ The \$495 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1.
- (C) The requirements of this act do not apply to the following:
- (1) Reverse mortgage transactionsⁱⁱⁱ in which:
- (a) A mortgage, deed of trust, or equivalent consensual security interest securing one or more advances is created in the consumer's principal dwelling; and
- (b) Any principal, interest, or shared appreciation or equity is due and payable (other than in the case of default) only after:
- (i) The consumer dies;
- (ii) The dwelling is transferred; or
- (iii) The consumer ceases to occupy the dwelling as a principal dwelling.
- (2) Open-end credit plans^{iv} in which
- (a) The creditor reasonably contemplates repeated transactions;
- (b) The creditor may periodically impose a finance charge on an outstanding balance;
- (c) The amount of credit that may be extended up to any limit set by the creditor is generally made available to the extent that any outstanding balance is repaid.

Section 4. DEFINITIONS. The following words and phrases when used in this act shall have, unless the context clearly indicates otherwise, the meanings given to them in this section:

- (A) "Administrator." The person selected to oversee the implementation of and compliance with this act.
- (B) "Annual percentage rate (APR)." The sum of the interest rate, fees, and certain loan closing costs calculated according to the provisions of the Truth-in-Lending Act (15 U.S.C. § 1601, et seq.), and the regulations promulgated by the Federal Reserve Board.

Treasury reported a yield for Treasury securities maturing in 25 years or more. U.S. Department of the Treasury, *Daily Treasury Long-Term Rates*, available at <http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/ltcompositeindex.html> (last visited Mar. 5, 2005). In January 2004, the Treasury began publishing the *Treasury 20-year Constant Maturity*. *Id.* The Treasury Department explains how to calculate the rate for a 30-year maturity period: "To use the Extrapolation Factor to determine a 30-year proxy rate, simply add the factor to the 20-year Constant Maturity Rate. For example, if on a particular day the 20-year Constant Maturity is 5.40% and the Extrapolation Factor is 0.02%, then a 30-year theoretical rate would be 5.40% + 0.02% = 5.42%." *Id.*

ii. This amount is 3% lower than the January 2005 adjusted dollar amount under HOEPA.

iii. This definition is from HOEPA. 12 C.F.R. § 226.33 (2005).

iv. This definition is from HOEPA. 12 C.F.R. § 226.2 (2005).

- (C) "Approved counselor." An individual approved by the United States Department of Housing and Urban Development to provide advice to consumers about high-cost home loans. The individual shall be unaffiliated with the lender, mortgage broker, or other service professionals involved with the loan.
- (D) "Consumer." A person to whom consumer credit is offered or extended.
- (E) "Creditor." Any lender who originates, funds, or negotiates a high-cost home loan or acts as a mortgage broker or lender, finance company, or retail installment center with respect to a high-cost home loan.
- (F) "Day." A calendar day.
- (G) "Debt-to-income ratios." Two different estimates of the ratios of debt payments to gross income.^v The first estimate is the income ratio. This is a comparison of monthly housing expenses to monthly gross income. Housing expenses consist of the principal and interest payments for the mortgage, real estate taxes, hazard and mortgage insurance premiums, homeowner's association fees, ground rents, payments on a second mortgage, and assessments. The second estimate is the long-term debt ratio. This is a comparison of all recurring expenses to monthly gross income.^{vi} Recurring expenses are those that will last more than ten months after the loan closing.^{vii} These expenses include the housing expenses listed above, in addition to credit card debt, car payments, other loans, alimony, and child support.^{viii}
- (H) "High-cost home loan." A loan covered by Section 3 of this act.
- (I) "Person." A natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit.
- (J) "Points and fees."^{ix} All compensation paid to creditors, fees charged by a mortgage broker, amounts payable under an add-on or discount system of additional charges, points, loan fees, all charges payable indirectly or directly by the consumer and imposed by the creditor as incident to or a condition of the loan, including fees charged by third parties if the creditor requires the third party, premiums or other charges for credit, life, accident, health, or loss-of-income insurance, or debt-cancellation coverage that provides for cancellation of all or part of the consumer's liability in the event of the loss of life, health, or income, or in the case of accident, written in connection with the credit transaction.

v. Illinois Office of Banks and Real Estate, *Mortgage Awareness Program (MAP) Mortgage Ratio Worksheet*, available at <http://www.obre.state.il.us/predatory/ratio.PDF> (last visited Mar. 5, 2005). The ratio is expressed as a percentage and is calculated by dividing the appropriate expenses or debts (as listed in this definition) by the total gross income. *Id.*

vi. *Id.*

vii. United States Department of Housing and Urban Development, Handbook 4155.1 REV-5, para. 2-11 (A), Oct. 2003, available at http://www.hudclips.org/sub_nonhud/cgi/pdfforms/41551r-5.doc [hereinafter *HUD Handbook*].

viii. Illinois Office of Banks and Real Estate, *supra* note v. According to HUD, the income ratio should not exceed 29% of gross income, and the long-term debt ratio should not exceed 41% of gross income. *HUD Handbook, supra* note vii, at para. 2-12 (A-B).

ix. The points and fees are identical to those included in HOEPA, 12 C.F.R. § 226.32 (2005).

- (K) "Substantially conform." Have identical or lower cost terms for direct lender charges, and a variance of terms that do not exceed a difference of five percent in the aggregate for lender-imposed third-party charges and five percent in the aggregate for third-party charges required by law to close the purchase or refinance—excluding any deviations in the charges required by law caused by a change in the law after the creditor supplies the good faith estimate of closing costs.

Section 5. REQUIRED PRACTICES AND PROVISIONS REGARDING MORTGAGE COUNSELING.

(A) Phase I: Pricing Determination

- (1) Upon applying for a high-cost home loan, a creditor shall require the consumer to receive counseling on the pricing of the loan transaction (the required "Phase I Pricing Determination") and the possibility for advice on the advisability of the loan transaction (the optional "Phase II Advisability Determination," which, at the consumer's election, the consumer can seek counseling on).
- (2) The counselor shall advise the consumer on each of the following subjects in detail at the Phase I Pricing Determination:
 - (a) Determine whether the consumer may qualify for a lower-cost loan based upon credit score.
 - (i) Check the correlation between the consumer's credit score and current interest rates and APR.^x
 - (ii) Review the Truth in Lending Act (TILA) form and check the APR.
 - (iii) Review the Good Faith Estimate of Closing Costs form and determine whether the creditor is paying a yield spread premium, which can be a sign that a loan is overpriced. Also compare the various closing cost estimates to regional average costs.^{xi}
 - (b) Determine whether the consumer is being manipulated into accepting high rates or unaffordable terms.
 - (c) Advise the consumer if he or she qualifies for a more favorable loan. If the consumer is a candidate for a prime loan, assist the consumer in identifying other prime lenders or mortgage brokers offering prime loans and obtaining quotes from such lenders or mortgage brokers.

(B) Phase II: Advisability Determination

- (1) If the consumer does not qualify for a more favorable loan, and elects to receive the Phase II Advisability Determination, advise the consumer on whether the loan is affordable:
 - (a) Determine whether the consumer will be able to make the scheduled payments to repay the loan based on the consumer's current and expected income, current debts, employment status,

x. This information is available at <http://www.myfico.com> (last visited Apr. 20, 2005).

xi. A survey of closing costs is available at <http://www.bankrate.com>. See Michael D. Larson, *A Close-Up Look at Closing Costs* (June 21, 2001), at <http://www.bankrate.com/brm/news/mtg/20010621a.asp>.

- and other financial resources (not including equity in the home that will secure payment for the loan).
- (b) If the long-term debt ratio for housing and recurring debts is 50% or greater, the counselor shall inform the consumer that he or she is at risk of losing the home as well as any equity in the home.^{xii} If the income ratio for housing expenses (including principal, interest, taxes, and insurance) is 30% or greater, the counselor should advise the consumer that the loan is beyond a level considered prudent.^{xiii}
 - (2) Determine whether it is advisable to take out the loan at the present time.
 - (3) Advise the consumer on how to improve his or her credit score and financial situation.^{xiv}
 - (4) Determine whether the loan contains unfavorable or potentially problematic terms, such as prepayment penalties, balloon payments, negative amortization, or the bundling of unnecessary charges such as life insurance.
 - (5) Determine whether there is a net economic benefit to a re-finance:
 - (a) Determine the consumer's reasons for entering into a new loan.
 - (b) Determine whether the consumer will receive a tangible, net economic benefit from refinancing the existing loan by reviewing the terms of the new and refinanced loans, the cost of the new loan, and the consumer's circumstances.^{xv}
 - (C) After the first counseling session, and within three business days after the session, if the consumer decides not to close the loan, the counselor shall inform the creditor. If the loan is overpriced, then the creditor shall refund any fees or costs the consumer has paid in connection with the loan application, including the appraisal fee, if any.
 - (D) If the consumer decides to take out the loan, the creditor shall send to the approved counselor, on the day preceding the loan closing, the package of loan documents for the consumer to sign. The counselor shall take the following steps to prevent fraud and material misrepresentation when reviewing the loan documents:
 - (1) Review the closing loan documents and ensure that they substantially conform to the terms that were previously agreed to.

xii. Credit card debt is calculated according to the required minimum monthly payment. *HUD Handbook*, *supra* note vii, at para. 2-11 (A)(1).

xiii. See Mortgage Awareness Program (MAP) Mortgage Ratio Worksheet, *supra* note v.

xiv. Training materials will explain how the consumer can improve his or her credit based on, among other things, making timely bill payments, keeping debts reasonable, and closing unnecessary accounts. See *How to Improve Your Credit Score*, at <http://www.creditinfo.com/credit-score/improve-credit-score.htm> (last visited Mar. 5, 2005); see also myFICO, FICO Deluxe, at <http://www.myfico.com/Products/FICOThree/Description.aspx?fire=11> (last visited Jan. 24, 2005).

xv. Training materials on this issue will provide a manner to calculate whether there is a net economic benefit. See, e.g., *Mortgage Refinance Calculator*, at <http://office.microsoft.com/en-us/templates/TC010566211033.aspx?CategoryID=CT062100581033> (providing an Excel template that may be downloaded to analyze the costs of refinancing a mortgage); see also Mortgage Bankers Association of Georgia, *Tangible Net Benefit Worksheet*, at <http://www.mbag.org/media/pdf/tangibleworksheet.pdf#search='tangible%20net%20benefit'> (last visited Mar. 5, 2005) (providing a worksheet to calculate economic benefits in order to prevent loan flipping).

- (2) Pay special attention to the note and HUD-1 Settlement Statement.
 - (3) If the counselor determines that the closing costs or loan terms do not substantially conform to the previously stated amounts or terms, the counselor shall contact the creditor to correct the discrepancies or reject the loan if the discrepancies cannot be corrected. The consumer shall decide whether to close the loan.
 - (4) If the consumer decides not to close the loan due to a lack of substantial conformance, the counselor shall inform the creditor, and the creditor shall refund any fees or costs the consumer has paid in connection with the loan application, including the appraisal fee, and pay the present value of the amount of the increase in interest rates from when the loan was applied for and the scheduled loan closing date, if any, over the term of the proposed loan.
- (E) After the consumer has received counseling, the counselor shall provide the creditor with certification that the consumer has received counseling on the pricing of the loan transaction and a signed acknowledgement of receipt and review of the closing documents. The certification shall have the consumer's signature as well. The creditor shall not make a high-cost home loan to any consumer unless the creditor has received a signed counseling certificate with respect to the proposed loan and the signed acknowledgement. If the counselor fails to send the required documents, then the U.S. Dept. of Housing and Urban Development shall assist the consumer in contacting a new Approved counselor to perform the necessary counseling and submit the certification and acknowledgement.

Section 6. LIMITS ON FEES. The counselor may not impose a charge or other fee on behalf of a consumer, except as permitted under this section.

- (A) The counselor may charge a fee not exceeding [insert amount^{xvi}] for the Phase I consultation. This fee will be paid by HUD from a reserve set up for this mortgage counseling program.^{xvii}
- (B) The counselor may charge a fee not exceeding [insert amount] per hour for the Phase II consultation. This fee will be paid by the consumer.
- (C) If the loan closing documents do not substantially conform to the previously disclosed terms, the counselor may charge a fee not exceeding [insert amount] per hour for the counselor's time in contacting the creditor and attempting to modify the documents or to reject the loan and obtain reimbursement. The creditor shall be responsible for payment of the said fee. In addition, the counselor can recover costs and reasonable attorney's fees from the creditor if a lawsuit must be brought to recover the fee.

xvi. A sum such as \$50 may be appropriate. The fee could be adjusted for regional variations in the cost of living, and it should increase over time. As another option, the fee may correspond to the jurisdiction's fee schedule for court-appointed attorneys for probate and guardianship matters. *See, e.g.,* Oakland County, Michigan, Court Appointed Attorney Fee Schedules, at http://www.co.oakland.mi.us/circuit/division_committee/atty-fee-sched.html.

xvii. It can be funded by an increase in the creditors' licensing fees.

- (D) If the loan closing documents substantially conform to the previous terms, the counselor will receive a fee of [insert amount] from the consumer for the review of the documents.
- (E) The counselor may not require a consumer to purchase any educational program, materials, or supplies.

Section 7. VOIDABLE LOANS.

- (A) A high-cost home loan between a creditor and consumer who has not received counseling or a review of loan closing documents as required under this act is voidable and unenforceable at the consumer's election. Obtaining a counseling certificate in the form of Schedule A attached hereto and an acknowledgement of receipt and review of loan closing documents in the form of Schedule B attached hereto is prima facie evidence of compliance with this act.
- (B) If a loan is voidable under subsection (A), a consumer may bring a civil action in a court of jurisdiction for rescission of the loan and to recover all money paid pursuant to the loan, together with costs and reasonable attorney's fees plus damages. When a consumer exercises the right to rescind, he is not liable for any finance or other charge, and any security interest given by the consumer becomes void upon rescission. Within 20 days after receipt of a notice of rescission, the creditor shall return to the consumer any money or property given by the consumer to the creditor and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. Damages shall equal the sum of any actual damages sustained by the consumer as a result of the violation; the costs of the action; and a reasonable attorney's fee as determined by the court.^{xviii}
- (C) A creditor that violates this act does not have a claim against a consumer for breach of contract and does not have a claim in restitution with respect to a loan that is voided^{xix}—except for return of the loan amount actually financed minus the damages and other sums recoverable by the consumer as set forth in Section 7 (B) of this Act.
- (D) A creditor may not divide a loan transaction in to separate parts with the intent to avoid the application or provisions of this act.

Section 8. CRIMINAL PENALTIES.

- (A) Any creditor who knowingly violates this act is subject to criminal prosecution.
- (B) On conviction for a violation of this act, a person is subject to a fine not exceeding \$1,000 for the first violation, and to a fine not exceeding \$5,000 or imprisonment not exceeding five years, or both, for each subsequent violation.^{xx}

xviii. These are the remedies available for a violation under HOEPA. *See* 15 U.S.C. §§ 1635 and 1640(a) (2004).

xix. *See* National Conference of Commissioners on Uniform State Laws, *Consumer Debt Counseling Act* (Draft for Discussion Only), § 10(c) (Nov. 14–16, 2003), available at <http://www.law.upenn.edu/bll/ulc/UCDC/nov2003mtgdraft.pdf> (explaining the consequences of voiding an agreement).

xx. This is the penalty provided in Section 28 of the Uniform Consumer Debt Counseling Act, which was created by the National Conference of Commissioners on Uniform

Section 9. ADMINISTRATIVE REMEDIES.

- (A) After notice and an opportunity for a hearing, the administrator may enforce this act by:
- (1) Ordering a violator to cease and desist from the violation and any similar violations.
 - (2) Ordering a violator to take affirmative action to correct the violation, including the restitution of money or property.
 - (3) Revoking, suspending, or denying renewal of the creditor's license or the counselor's certification.
- (B) The administrator may enforce this act by:
- (1) Commencing a civil action to obtain restitution, an injunction, or other equitable relief.
 - (2) Intervene in an action brought by the consumer.

Section 10. PREEMPTION. This act does not preempt any federal, state, or local laws addressing the predatory lending problem, except for any counseling requirements in conflict with this law.

Section 11. ATTORNEYS AS APPROVED COUNSELORS. All attorneys licensed as active attorneys are encouraged to become Approved counselors and perform at least 20 hours of counseling under this Act each year.

Section 12. EFFECTIVE DATE. This act shall take effect on [insert date].

State Laws. A recent draft that includes commentary is available at <http://www.law.upenn.edu/bll/ulc/UCDC/2005AprMtgDraft.htm>. In addition, HOEPA also provides criminal penalties for violation. See 15 U.S.C. § 1611 (2005).

APPENDIX B

SCHEDULE A—COUNSELING FORM

This certifies that [*insert consumer's name*] has received the Phase I Pricing Determination counseling for the following loan in accordance with the Mortgage Counseling Act.

<i>LOAN INFORMATION</i>	
Date of Loan Application:	Loan # (if applicable):
Creditor Name:	
Address:	Phone:

<i>COUNSELOR INFORMATION</i>	
Date of Counseling Session:	
Counselor Name:	
Address:	Phone:

Counselor's Signature: _____
 Date: _____

<i>CONSUMER INFORMATION</i>	
Consumer Name:	
Address:	Phone:

Consumer's Signature: _____
 Date: _____

SCHEDULE B—COUNSELOR’S ACKNOWLEDGEMENT

This certifies that [*insert mortgage counselor’s name*] has received and reviewed the loan closing documents for the following loan in accordance with the Mortgage Counseling Act.

<i>LOAN INFORMATION</i>	
Applicant Name:	
Applicant Address:	Applicant Phone:
Date of Loan Application:	Loan # (if applicable):
Creditor Name:	
Address:	Phone:

<i>COUNSELOR INFORMATION</i>	
Counselor Name:	Date of Document Review:
Address:	Phone:

Counselor’s Signature: _____
 Date: _____