State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending

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I. INTRODUCTION

"Homeownership is the American dream. It is the opportunity for all Americans to put down roots and start creating equity for themselves and their families."[1] To finance that dream, Americans turn to mortgage brokers and lenders. Because homeownership represents the single most complicated and expensive investment for most Americans, individuals commonly place significant trust in their brokers and lenders to represent their best interests. Although most individuals in the mortgage industry work hard to obtain fair and reasonable financing for consumers, there are a number of predatory brokers and lenders who abuse their positions of trust and superior bargaining position by taking unfair advantage of the financial constraints and time pressures that often face borrowers.

Unscrupulous brokers and lenders sometimes employ tactics that deceive borrowers yet result in profitable business for the mortgage industry.[2] These practices, including partial disclosure or nondisclosure of material terms, or changing the loan type or interest rate as closing approaches, are commonly referred to as "predatory lending practices." Many of these practices, through which certain players in the mortgage industry take advantage of borrowers, are on the margins of legality.

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1. *Predatory Mortgage Lending: The Problem, Impact, and Response: Hearing Before the U.S. S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 1 (2001) [hereinafter *Predatory Mortgage Lending Hearing*] (opening statement of Senator Paul S. Sarbanes, Chairman, S. Comm. on Banking, Hous., and Urban Affairs).

2. *See id.* at 2 (opening statement of Senator Paul S. Sarbanes, Chairman, S. Comm. on Banking, Hous., and Urban Affairs).

Although federal statutes regulating the lending industry are supported by strong policy statements that appear to provide significant protection for borrowers,[3] ambiguous contract terms, weak enforcement provisions, and numerous statutory exceptions undermine the protective purposes of such statutes. In response to these federal loopholes and the recent increase in predatory lending practices, many states and municipalities have enacted more stringent regulations.[4] Despite the protective purpose of these regulations, however, many in the mortgage industry oppose these regulations and contend that state laws complicate the mortgage process, creating higher transaction costs and reducing access to credit.[5] Federal lawmakers have reacted to the industry's concerns by exempting federal banks from many state statutes. However, this type of federal preemption hinders state enforcement efforts and creates incentives for businesses to seek a regulatory structure that guarantees the fewest consumer protections.[6]

Consequently, federal and state regulations have consistently failed to adequately protect borrowers from predatory lenders. Some state consumer protection statutes, however, provide consumers with a private right of action, an expanded statute of limitations, and attorney's fees.[7] In the context of predatory lending, federal courts have recognized that certain violations of federal lending statutes, namely the Real Estate Settlement Procedures Act ("RESPA") and the Truth in Lending Act ("TILA"), amount to unfair and deceptive practices for purposes of meeting the "unfair and deceptive act or practice" element of certain state consumer protection statutes.[8] To further the purposes and policies of RESPA and TILA, consumers should utilize state consumer protection statutes[9] when practices in the mortgage transaction industry violate

3. *See* 12 U.S.C. § 2601(a) (2000).

4. *See, e.g.*, N.C. GEN. STAT. § 24–1 (1999).

5. Donald C. Lampe, *Predatory Lending Initiatives, Legislation, and Litigation: Federal Regulation, State Law and Preemption*, 56 CONSUMER FIN. L.Q. REP. 78, 84 (2002).

6. *Predatory Lending: Are Federal Agencies Protecting Older Americans from Financial Heartbreak?: Hearing Before the Senate Special Committee on Aging*, 108th Cong. 60 (2004) [hereinafter *Committee on Aging Hearing*] (statement of Gavin Gee, Director of Idaho Department of Finance).

7. *See e.g.*, GA. CODE ANN. §§ 7–6A–1 (2003); N.J. STAT. ANN. § 46:10B (West 2004); FLA. STAT. ANN. § 494.0078 (West 2003); OHIO REV. CODE ANN. § 1349.25 (West 2003); 63 PA. CONS. STAT. § 456.503 (2003).

8. *See, e.g.*, Brazier v. Sec. Pac. Mortgage, 245 F. Supp. 2d 1136, 1142 (W.D. Wash. 2003); Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143, 1147–1148 (W.D. Wash. 2003).

9. The state consumer protection statutes discussed in this article are used interchangeably with unfair and deceptive acts or practices ("UDAP") statutes.

these federal lending statutes, thereby constituting unfair and deceptive conduct.

This article continues in Part II by defining predatory lending practices, identifying borrowers who are likely to face predatory lenders, and discussing the consequences of predatory lending. Next, Part III provides a background for existing federal regulation, again in reference to RESPA and TILA. Part IV discusses state legislative efforts to curb predatory lending and identifies the problems of inconsistency and federal exemptions that undermine these state statutes. Part V examines the elements of state consumer protection acts and unfair and deceptive acts or practices ("UDAP") statutes and their application to predatory practices. Part VI argues that, because consumer protection statutes have nearly uniform elements in all states, such statutes provide significant protection for borrowers and have a considerable effect on curbing abuses in the mortgage industry. Thus, consumer protection statutes represent an effective alternative to weakened federal and state predatory lending statutes. Part VII concludes this article with the recommendation that predatory lending victims utilize the protection afforded by state consumer protection and UDAP statutes to hold predatory brokers and lenders responsible for engaging in predatory practices.

II. PREDATORY LENDING PRACTICES

A. Predatory Lending in the Prime and Subprime Markets

A mortgage represents a transfer of a property interest by a borrower to a lender as security for payment of a debt.[10] Because a lender wants to guarantee repayment of the debt, it will usually perceive a borrower with a high credit rating to be a low risk investment; consequently, the lender will usually approve mortgages for such borrowers and provide them with favorable interest rates.[11] This market is primarily referred to as the prime market.[12] Although predatory lending does occur in the prime market,[13] such practices are often deterred by competition

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10. MARGARET C. JASPER, HOME MORTGAGE LAW PRIMER 5 (2nd ed. Oceana Publications 2000) (1995).

11. *See Predatory Mortgage Lending Hearing*, *supra* note 1, at 56 (prepared statement of the Honorable Thomas J. Miller, Attorney General of the State of Iowa).

12. The prime market primarily serves borrowers who have higher credit ratings, borrow greater loan amounts, select longer repayment periods, and accordingly, represent lower risks to the lender. *See* U.S. DEP'T OF TREASURY & U.S. DEP'T OF HOUS. & URBAN DEV., CURBING PREDATORY HOME MORTGAGE LENDING 27 (2000) [hereinafter *Treasury/HUD Report*].

13. *Id.* at 2.

among lenders, greater homogeneity in loan terms, and prime borrowers' greater familiarity with complex financial transactions.[14]

Borrowers with lower credit ratings, however, purportedly represent higher risk investments.[15] Because many prime lenders are unwilling to take such investment risks, borrowers with low credit ratings tend to borrow from subprime lenders.[16] A subprime lender denotes a lender who provides loans to high risk consumers.[17] Although subprime lenders play an important role in financing home loans for those who likely would not qualify for prime rates, some lenders take advantage of subprime borrowers by charging higher rates than the increased risk justifies.[18]

In recent years, the subprime lending market has witnessed dramatic growth. In 2003, more than $332 billion in mortgage loans originated from subprime lenders, compared to $125 billion in 1997.[19] Compared with prime lending, subprime lending generally has the characteristics of higher risk, lower loan amounts, higher origination costs, and faster repayments.[20] Subprime lending is not, in itself, predatory lending.[21] The subprime market often provides an important source of credit for many borrowers who struggle to obtain economic opportunities.[22]

However, subprime lending becomes predatory when material terms are not timely and accurately disclosed, excessive fees are packed into the loan, large prepayment penalties lock the borrower into high rates, or monthly payments are much higher than the borrower can afford.[23] Predatory lending commonly occurs in markets where unscrupulous lenders prey on certain identifiable groups, such as the elderly, ethnic minorities, and individuals with lower incomes and less education.[24] These individuals may not be sufficiently experienced or knowledgeable about complex financial transactions to understand the potentially devastating implications of such transactions, or may not be offered the range

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14. *Id.*

15. *See id.* at 27.

16. *Id.*

17. *See id.*

18. *See id.* at 72.

19. *Committee on Aging Hearing*, *supra* note 6, at 37 (statement of Howard Beales, Director of the Bureau of Consumer Protection of the Federal Trade Commission).

20. *Treasury/HUD Report*, *supra* note 12, at 27–28.

21. *Predatory Mortgage Lending Hearing*, *supra* note 1, at 5 (Sen. Johnson, Member, Comm. on Banking, Hous., and Urban Affairs).

22. *Id.*

23. *See id.* at 1–2 (opening statement of Senator Paul S. Sarbanes, Chairman, S. Comm. on Banking, Hous., and Urban Affairs).

24. *Treasury/HUD Report*, *supra* note 12, at 22.

of financial products available to other borrowers.[25] Even educated and financially savvy individuals facing financial pressures have become victims of predatory loan practices.

B. What Constitutes a Predatory Lending Practice

Although the term "predatory lending" does not have a precise definition, the most significant indicators of predatory practices are inaccurate disclosures, changes in loan types and interest rates, and disproportionately high fees[26] and points[27] financed by the borrower.[28] Most predatory practices are essentially a means by which to increase the fees and points for a loan.[29] As the fees and points increase, the likelihood that a borrower will not be able to afford the loan increases.[30] Brokers and lenders often have an incentive to lend without regard to the borrower's ability to repay because such nonperforming loans[31] usually result in refinancing, which increases the profit for the lender.[32]

In testimony before the Senate Committee on Banking, Housing, and Urban Affairs, Iowa's Attorney General characterized predatory lending as a mindset with the following operative principle: "Take as much as you think you can get away with, however you can, from whoever you think is a likely mark."[33] Although the prime market remains highly competitive, the subprime market has little competition, virtually no advertisements or other publicity about the price of loans, and limited access to information about the loans.[34]

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25. *Id.*

26. *See* JASPER, *supra* note 10, at 89–90. Fees represent the closing costs associated with mortgage loans. *Id.* Such fees typically include the following: an application fee, an appraisal fee, a credit report fee, escrow fees (insurance and taxes), a flood certification fee, flood insurance, a funding fee, a home inspection, homeowner's insurance, legal fees, mortgage taxes, prepaid interest, private mortgage insurance recording fees, a survey fee, title insurance, and a title search. *Id.*

27. *See* JASPER, *supra* note 10, at 26. Points are charges for making the loan and are payable at the time of closing; each point equals one percent of the loan. *Id.*

28. Margot Sanders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. BANKING INST. 111, 121 (2002).

29. *Id.*

30. *Id.*

31. A nonperforming loan is a loan financed at a rate that the borrower cannot afford. Because the borrower cannot afford the loan, he or she is forced to refinance. By compelling the borrower to refinance, the lender makes a higher profit from the fees required to refinance and the borrower loses the equity he or she has earned in the home. *See id.*

32. *Id.*

33. *Predatory Mortgage Lending Hearing*, *supra* note 1, at 55 (statement of Hon. Thomas J. Miller, Attorney General of the State of Iowa).

34. *Id.*

Broad language and illustrative acts or practices are more effective in defining predatory practices than is a bright line definition "because the human imagination is a wondrous thing, and its capacity to invent new scams, new permutations on old scams, and new ways to sell those scams is infinite."[35] Similarly, the Washington State Department of Financial Institutions broadly defines predatory lending as "the use of deceptive or fraudulent sales practices in the origination of a loan secured by real estate."[36] Additionally, the Department of Housing and Urban Development ("HUD") stated that predatory lending—whether undertaken by creditors, brokers, or even home improvement contractors—involves engaging in deception or fraud,[37] manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding about loan terms.[38] These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices.[39] The results are loans, loaded with onerous terms and conditions, that the borrower often cannot repay, leading to refinancing, foreclosure, or bankruptcy.[40]

Predatory lending practices can be divided into two broad categories: predatory terms and predatory procedures. Where the *terms* of a mortgage are excessive, unfair, or unreasonable based on the credit risk of the borrower, they are considered predatory.[41] Common examples of predatory terms include the following: unreasonably high interest rates, excessive fees, and prepayment penalties.[42] Unreasonably high interest rates are problematic because borrowers often do not realize that they qualify for rates lower than those secured by their brokers.[43] Excessive

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35. *Id.* at 58.

36. *Id.* (citing comments from John Bley, Director of Financial Institutions, State of Washington, on responsible alternative mortgage lending to Office of Thrift Supervision (July 3, 2000)).

37. Although in some cases, predatory practices are sufficient to meet the elements of fraud, this article refers to fraudulent practices as defined by state consumer protection statutes. *See e.g.*, Dwyer v. J.I. Kislak Mortgage Corp., 103 Wash. App. 542, 546, 13 P.3d 240 (Wash. App. 2000).

38. *Treasury/HUD Report*, *supra* note 12 at 1.

39. *Id.*

40. *Id.* at 17. Borrowers may attempt to refinance a predatory loan; however, the fees required to refinance are often prohibitive, and consequently, lead some borrowers into bankruptcy.

41. *Id.* at 17–24.

42. *Id.* at 18–22.

43. *Id.* at 2. This is especially prevalent in subprime lending markets because brokers may assure unwary borrowers that this is the best rate they can secure and that they must quickly agree in order to lock in the rate. *Id.* at 1. The complicated and time-consuming process to obtain a quote for an interest rate also contributes to unreasonably high rates because borrowers often do not have the time or the resources to obtain several brokers and lenders, complete the necessary paperwork, compare several quotes, and then make an informed decision on the best interest rate. *Id.* Additionally,

fees that exceed the amount expected or justified based on the economic position of the borrower include high origination fees (which may be in excess of ten percent of the principal amount of the loan) and other settlement costs, such as loan processing fees, credit reporting fees, and underwriting fees.[44] Moreover, a broker or lender's failure to accurately or timely disclose these fees prevents borrowers from making informed credit decisions. Similarly, prepayment penalties, which are fees assessed against the borrower for paying off the loan amount prior to the due date, represent a predatory practice because they severely inhibit a borrower's ability to refinance a predatory loan.[45] Subprime loans are disproportionately more likely to require penalties for prepayment, making them expensive to refinance, and sometimes trapping the borrower in an overly expensive loan.[46] In 2001, 76% of subprime loans had prepayment penalties, but only 2% of prime loans included these penalties.[47]

In addition to predatory *terms*, loans can be predatory where the *procedures* by which the broker originates the loan or the lender funds the loan place the borrower in an unfair or coercive position to accept a harmful loan.[48] Examples of procedural predatory lending include the following: loan flipping, nondisclosure of material terms, and the misuse of yield spread premiums.[49]

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the quoted interest rate does not always show the actual amount the borrower will be paying because other fees, such as yield spread premiums, may cause the borrower to pay a higher amount throughout the life of the loan. *Id.*

44. *Id.* at 39–40, 80. This represents a particularly egregious practice because borrowers often do not realize that their settlement costs differ significantly from a non-predatory loan. Additionally, these fees are often higher than those represented on the good faith estimates, but not to the degree that would violate RESPA's requirement that they be made in good faith and bear a reasonable relationship to the amount the borrower is required to pay. *Id.* at 1. As a consequence, this practice of packing excessive fees often goes unnoticed by borrowers and unregulated by federal statutes. *Id.*

45. *Id.* at 94. Prepayment penalties are not problematic for borrowers who have too much money and want to pay off the entire loan amount; rather, it is when borrowers with high interest loans want to refinance at a lower interest rate. *Id.* The fee assessed against the borrower as a prepayment penalty effectively prohibits the ability to refinance because the benefit of refinancing at a lower rate will be outweighed by the high fee that must be paid for paying off the original loan. *Id.* This particularly affects borrowers who are assured by their brokers not to worry about the high interest rate because they can refinance later. *Id.* Although the inclusion of a prepayment penalty in this situation renders that promise fraudulent, borrowers usually do not have sufficient evidence to prove this promise to refinance the loan. *Id.*

46. *See Predatory Mortgage Lending Hearing*, *supra* note 1, at 56 (prepared statement of the Honorable Thomas J. Miller, Attorney General of the State of Iowa).

47. *Id.*

48. *See Treasury/HUD Report*, *supra* note 12, at 79.

49. *See id.* at 73–80. A yield spread premium represents a fee paid by the lender to the broker for securing a higher interest rate. *See id.* Although the Department of Housing and Urban Development has stated that yield spread premiums are not per se illegal because they can provide a mean-

Fraudulent and deceptive practices are manifested by loan flipping, a situation where borrowers are encouraged to refinance repeatedly over a short period of time.[50] Loan flipping is a damaging predatory practice because borrowers are usually refinancing to obtain needed money to pay other debts or to attempt to secure a more favorable interest rate.[51] However, with each successive refinancing, the originators charge high fees and consequently strip borrowers' equity in their homes.[52]

In addition to loan flipping, a broker's or lender's failure to provide timely and accurate disclosures of a loan's material terms is a harmful predatory practice because the borrower is not able to make a reasoned, informed decision to enter into the loan.[53] Often, when material terms are not disclosed to the potential borrower until or near closing, the borrower is not in a position to reject the terms of the loan or to shop around for a more favorable mortgage.[54]

Another common procedural predatory practice is the misuse of yield spread premiums. The payment of yield spread premium occurs when the lender pays the broker an indirect compensation for securing a mortgage at an interest rate higher than that which the lender would have been willing to agree for the particular mortgage.[55] Yield spread premiums, which are paid by the lender, are considered indirect fees for borrowers because the payment of premiums typically results in a higher interest rate to the borrower.[56] HUD maintains that indirect fees, such as yield spread premiums, give consumers who are unable to pay direct fees the ability to obtain home loans.[57] Arguably, if the broker or lender properly discloses the yield spread premium to the borrower and provides the option of paying these fees directly in lieu of increasing the interest rate,

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ingful choice for borrowers who want to defer closing costs by paying a higher interest rate for the life of the loan, they must be disclosed to the borrower. *See id.*

50. *Id.* at 73.

51. *Id.* at 73.

52. *Id.*

53. *See id.* at 24.

54. *Id.* at 65–66.

55. *See id.* at 85, 89. These payments usually range from one to two percent of the principal loan amount, although they may be as high as three to five percent. The most significant problem with yield spread premiums is that they are perceived by the borrower as a separate payment not connected to his or her loan because the payment is not coming directly from borrower. They do not realize that the payment of the yield spread premium will have a dramatic effect on the amount paid throughout the life of the loan, as reflected in the higher interest rate.

56. *See id.* at 89.

57. *See* Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999–1 Regarding Lender Payments to Mortgage brokers, 64 Fed. Reg. 10,080 (March 1, 1999) [hereinafter *RESPA Statement of Policy*] (codified at 24 C.F.R. § 3500).

the payment of the yield spread premium is not predatory.[58] In practice, mortgage brokers receive both direct fees from the borrower and indirect yield spread premiums from the lender without reducing direct closing fees paid by the borrower; meanwhile the lender increases the interest rate for the consumer to cover the cost of the yield spread premium without disclosing to the consumer that he or she is paying the extra cost.[59]

Thus, yield spread premiums are problematic for two reasons. First, the purpose of a yield spread premium and its relationship with the interest rate are often not disclosed to the borrower. Second, rather than defraying the closing costs, the yield spread premium often constitutes an unearned fee, a bonus payment to the broker for which the broker has provided no additional services to the borrower.[60]

With respect to the first problem, although lender payments to mortgage brokers must be revealed on government mandated disclosure statements, the form of the disclosure is cryptic and does not reveal the relationship between the interest rate charged on the borrower's mortgage and the magnitude of the yield spread premium.[61] For example, the disclosure of a $4000 yield spread premium on a good faith estimate is typically listed among numerous other charges and identified as "YSP of $4000 POC."[62] For the typical borrower in either the prime or subprime market, this cryptic form of disclosure is not sufficient to enable the borrower to make an informed credit decision. Some brokers and lenders actually fail to provide any disclosure of the yield spread premium until the point at which the borrower signs the closing documents.[63]

The second problem is that yield spread premiums often constitute an unearned fee to the broker, rather than a benefit to borrowers. Despite the industry's assertion that the yield spread premium increases access to loans for individuals who cannot afford the up-front costs, at least one study examines the use of yield spread premiums and indicates that

58. *See* Taiesha L. Cantwell, *Yield Spread Premiums: Who's Working for the Borrower? HUD's Erroneous Regulation and its Bar on Plaintiffs*, 21 LAW & INEQ. 367, 372 (2003).

59. *Id.* When combined with an origination fee of two to three percent of the principal amount of the loan, yield spread premiums of two to three percent amount to a very substantial payment to the broker. *Id.*

60. *See* Predatory Mortgage Lending Practices: Abusive Use of Yield Spread Premiums: Hearing Before the S. Comm. on Banking, Hous., and Urban Dev., 107th Cong. 2 (2002) [hereinafter *Yield Spread Premiums Hearing*] (opening statement of Senator Paul S. Sarbanes, Chairman, S. Comm. on Banking, Hous., and Urban Dev.).

61. *Id.* at 160 (citing Howell E. Jackson & Jerome Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 95 (January 8, 2002)).

62. "Yield spread premium of $4,000 paid outside of closing."

63. *See, e.g.*, Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143, 1143 (W.D. Wash. 2003).

mortgage brokers earn substantially more on loans when yield spread premiums are paid.[64] Furthermore, the study argues that "yield spread premiums are not simply another form of mortgage broker compensation, but rather ... constitute a deceptive device that the mortgage broker industry employs to extract unnecessary and excessive payments from unsuspecting borrowers."[65] Yield spread premiums are often paid to brokers using only a rate sheet[66] provided by the lender and as a result, services are not likely to be provided in exchange for that premium.[67] These payments represent a particularly egregious form of predatory lending when they are used as a payment from the lender to the broker in exchange for convincing the borrower to agree to a higher interest rate and are not disclosed or explained to the borrower.

C. Predatory Loan Example

To understand these predatory practices in context of a mortgage transaction, an analysis of Sabrina Harris's experience obtaining a loan demonstrates a few of the subtle tactics employed by some individuals in the mortgage industry.[68] Ms. Harris negotiated for the purchase of a home through a real estate agent, placed a $10,000 deposit on the home, and agreed to purchase within three months. Shortly after finding a residence, Ms. Harris contacted a mortgage broker to secure financing and complete the purchase of the home. The broker obtained a copy of Ms. Harris's credit report and began the application process. The broker then provided Ms. Harris with a "good faith" estimate of fees and a truth-in-lending disclosure statement, both of which quoted a 30-year fixed rate[69] with an interest rate of 7% for a $200,000 loan. These documents also

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64. Howell E. Jackson & Jerome Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 95 (January 8, 2002), available at http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf (last visited Nov. 16, 2004).

65. *Id.* at 9.

66. Mortgage brokers obtain several rate sheets from the lenders with whom they work to fund their loans. Rate sheets denote the prices at which lenders are willing to fund mortgages. When the broker is ready to lock in the financing terms for a particular customer, the broker usually uses the rate sheets to pick among the terms that corresponding lending institutions offer. *Id.* at 61–62.

67. Cantwell, *supra* note 58, at 372.

68. This character is fictional and her loan circumstances are based on a collaboration of numerous accounts of predatory lending practices.

69. A fixed rate mortgage loan generally bears interest at a fixed percentage rate per year. JASPER, *supra* note 10, at 17. This means that the loan amount does not change and there is a set monthly payment over the entire term of the loan. *Id.* In the first few years of the loan, the interest is usually the larger share of the payment; during the last few years of the loan, the principal payment makes up the larger share of the payment. By the end of the loan period, the borrower will have repaid the entire principal and interest debt. *Id.*

listed a number of additional fees. Ms. Harris was satisfied with the rate and fees disclosed on the good faith estimate.

Three months later at closing, however, Ms. Harris was presented with the final preprinted closing documents. The escrow agent who presented her with the documents informed her that she could not make any changes to these forms. In contrast to the previous good faith estimate and the truth-in-lending disclosure statements, the closing documents stated the loan type as a one-year adjustable rate mortgage ("ARM")[70] with an interest rate of nine percent. In addition to the rate change by two percentage points, the nine-percent ARM actually represented a much higher rate because the loan's rate is designed to fluctuate substantially after the first year. Despite the fact that the broker initially disclosed a lower rate, the federal lending statutes consider this merely an estimate and provide little protection for a borrower who is promised one rate, but receives a different rate.

In addition to the rate change, the closing documents also included additional fees. For example, the loan included a two-percent origination fee ($4000); however, there was an additional fee stated as a $4500 P.O.C. When Ms. Harris noticed the fee, the agent told her not to worry because the fee would be paid by the lender. However, Ms. Harris was not informed that this fee was a yield spread premium, the device through which the broker collected the payment of $4500 from the lender in exchange for Ms. Harris' agreeing to a higher interest rate. She was also unaware that she would consequently be paying a higher interest rate for the life of the loan in exchange for the lender's payment of the yield spread premium to the broker. In total, the broker was collecting more than four percent of the loan as commission.

Although Ms. Harris could have theoretically rejected this mortgage because of the change in terms and fees, she faced losing her opportunity to purchase the home and the $10,000 deposit she paid to secure it. The broker capitalized on the time and financial pressures facing Ms. Harris. Because she did not have the bargaining power to negotiate for more favorable terms, Ms. Harris was left to accept the mortgage agreement, despite the unnecessarily high interest rate and unfavorable terms. By failing to disclose the yield spread premium and changing the loan type and interest rate as closing approached, this broker engaged in an unscrupulous and manipulative practice. Although Ms. Harris was not

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70. An adjustable rate mortgage does not have a fixed payment. The interest rate is subject to periodic adjustment up or down at various intervals during the loan term. "The interest rate is gauged by the movement of a specific standard, such as the existing prime rate at the time of adjustment." *Id.* at 18. The rate only fluctuates after the X-year ARM period, which is one year in this example.

necessarily a victim of outright fraud, she was deceived and taken advantage of during the closing process because she was not provided with material information about her loan. These predatory tactics employed by some brokers and lenders result in deception for the borrower and profitable business for the mortgage industry.[71] Although many actors in the mortgage industry provide timely and truthful disclosures and educate borrowers, the numerous actors who engage in predatory practices strongly oppose regulation of the mortgage industry.

III. BACKGROUND OF MORTGAGE LENDING LEGISLATION: FEDERAL STATUTES

A. The Real Estate Settlement Procedures Act (RESPA)

In 1974, Congress enacted the Real Estate Settlement Procedures Act ("RESPA") to protect consumers from unnecessarily high settlement costs and certain abusive practices that were developing in the residential real estate industry.[72] The purpose of RESPA, as stated by Congress, was, in part, (1) to result in more effective advance disclosure to home buyers and sellers of settlement costs, and (2) to eliminate kickbacks or referral fees that unnecessarily increased settlement costs.[73] By controlling the manner in which settlement services are provided and compensated and requiring advanced disclosure of settlement costs, RESPA requirements enable the borrower to make an informed determination of whether the offered terms are reasonable and acceptable.[74]

RESPA and Regulation X[75] attempt to fulfill RESPA's first purpose by requiring that certain disclosures be made during application and closing, including disclosure of charges the borrower will have to pay for settlement services.[76] At the time of application, the lender must provide

71. *See Predatory Mortgage Lending Hearing*, *supra* note 1, at 2 (opening statement of Senator Paul S. Sarbanes, Chairman, S. Comm. on Banking, Hous., and Urban Affairs).

72. 12 U.S.C. § 2601(a) (2000). RESPA was enacted to handle federally related mortgage loans, defined as loans secured by a first or subordinate lien on residential property designed for occupancy by one to four families and that are made in whole or in part by any lender whose deposits or accounts are federally insured or by a lender that is federally regulated. *Id.* § 2602.

73. 12 U.S.C. § 2601(b) (2000); Washington Mut. Bank v. Super. Ct. of Los Angeles County, 75 Cal. App. 4th 773, 779, 89 Cal. Rptr. 2d 560 (Cal. Ct. App. 1999).

74. ELIZABETH RENUART, STOP PREDATORY LENDING: A GUIDE FOR LEGAL ADVOCATES 51 (National Consumer Law Center ed., 2002).

75. 24 C.F.R. § 3500 (2003). To regulate settlement procedures for federally regulated loans, Congress authorized the Secretary of the Department of Housing and Urban Development to promulgate Regulation X pursuant to the RESPA. *See* 12 U.S.C. 2617 § (2000).

76. *Washington Mut. Bank*, 75 Cal. App. 4th at 776. Settlement services include credit reports, appraisal fees, recording fees, wire transfer fees, and other loan related services. *Id.*

the applicant with an information booklet explaining the settlement process.[77] The lender must also include a good faith estimate of the charges for particular settlement services with the booklet.[78] RESPA and Regulation X require the use of a uniform settlement statement form at closing, known as the "HUD-1" form.[79] The HUD-1 form must conspicuously and clearly itemize all charges imposed upon the borrower in connection with the settlement.[80] However, the itemization on the HUD-1 form does not require an explanation of the nature or purpose of any of the itemized costs.[81]

RESPA aims to fulfill its second purpose by prohibiting kickbacks and unearned fees. Specifically, RESPA prohibits a person from paying or receiving "a thing of value" pursuant to any written or oral "agreement or understanding" for business incidental to or a part of a real estate "settlement service" involving a "federally related mortgage loan."[82] An unearned fee is any payment to a party for which no services were provided. In the mortgage lending context, a kickback occurs when the lender pays the broker for referring the borrower to that lender.

Regulation X supplements RESPA by defining terms, explaining the requirements for the good faith estimate,[83]describing the prohibition on kickbacks and referral fees, presenting specific instructions for completing the HUD-1 form, and providing for administrative requirements.[84] Specifically, Regulation X provides the timing requirements of disclosure, which is an important factor in determining whether there is a violation of RESPA.[85] For a residential mortgage transaction, both Regulation X and RESPA require that a creditor or broker provide a good faith estimate of fees, costs, and other mortgage terms before: (1) the extension of credit; or (2) three business days after the creditor receives the consumer's written application, whichever is earlier.[86]

Despite the disclosure requirements, the provisions in neither RESPA nor Regulation X establish a private right of action by a bor-

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77. 12 U.S.C. § 2604(a) (2000).

78. *Id.* § 2604(c).

79. 12 U.S.C. § 2603 (2000); 24 C.F.R. §§ 3500.8, 3500.9 (2003).

80. 12 U.S.C. § 2603(a) (2000).

81. *See id.*

82. 12 U.S.C. § 2601(b) (2000); Washington Mut. Bank v. Super. Ct. of Los Angeles County, 75 Cal. App. 4th 773, 779, 89 Cal. Rptr. 2d 560 (Cal. Ct. App. 1999).

83. 24 C.F.R. § 3500.7(c)(2) (2003) provides: As to each charge with respect to which the lender requires a particular settlement service provider to be used, the lender shall make its estimate based upon the lender's knowledge of the amounts charged by such provider.

84. 24 C.F.R. §§ 3500.8, 3500.14 (2003).

85. 12 U.S.C. § 2604(c) (2000).

86. *Id.*

rower for inaccurate disclosures on the HUD-1 form relating to charges for settlement services.[87] Rather, administrative enforcement of the disclosure requirements of RESPA and Regulation X regarding settlement costs is the responsibility of the Secretary of the Department of Housing and Urban Development and other federal, state, and local agencies that have supervisory powers over lenders and others covered by RESPA.[88]

RESPA and Regulation X include express provisions relating to the preemption of state laws.[89] Both the statute and the regulation provisions provide that nothing in RESPA annuls, alters, affects, or exempts any persons subject to its provisions from complying with the laws of any state with respect to the settlement process, except to the extent that those laws are inconsistent with any provision of RESPA.[90] The provisions also authorize the Secretary to determine whether an inconsistency exists.[91] However, this authorization directs that the Secretary may not determine a state law to be inconsistent if the state law gives greater protection to the consumer.[92]

Courts have interpreted these preemption provisions to mean that Congress intended for consumers to receive maximum protection not only in the form of federal legislation, but also in the form of state laws.[93] Additionally, Congress did not intend any preemption of state laws to occur if those laws resulted in more protections for the consumer, so long as the state law did not interfere with the operation of the federal law, and it was possible to comply with both the state and federal regulations relating to mortgage lending.[94] States have the right and responsibility to provide heightened levels of consumer protection, depending on the local environments. The mortgage industry, however, maintains that inconsistent and restrictive state laws render it impossible for the industry to successfully comply with the disclosure requirements of both state and federal anti-predatory lending statutes.[95]

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87. RESPA does, however, provide for a private right of action for violation of its provisions relating to kickbacks and referral fees. *Id.* § 2607(d). For more discussion about kickbacks and referral fees, *see RESPA Statement of Policy*, *supra* note 57.

88. 24 C.F.R. § 3500.19(a) (2003).

89. 12 U.S.C. § 2616 (2000); 24 C.F.R. § 3500.13(a) (2003).

90. 12 U.S.C. § 2616 (2000).

91. *Id.*

92. *Id.*

93. Washington Mut. Bank v. Super. Ct. of Los Angeles County, 75 Cal. App. 4th 773, 785, 89 Cal. Rptr. 2d 560 (Cal. Ct. App. 1999).

94. *Id.*

95. *See* Lampe, *supra* note 5, at 84.

B. The Truth in Lending Act (TILA)

"TILA is primarily a disclosure statute."[96] Congress enacted TILA under Title I of the Consumer Credit Protection Act to promote informed borrowing by requiring lenders to fully disclose to borrowers the terms of credit being extended to them.[97] Congress charged the Federal Reserve Board with the responsibility of implementing TILA.[98] In response, the Federal Reserve Board implemented Regulation Z, which has the force and effect of law.[99] In addition, in order to strengthen the disclosure regulations, Congress also enacted an amendment to TILA in 1994 called the Home Ownership Equity Protection Act.[100]

TILA and Regulation Z require lenders to provide consumers with a written statement containing information about the cost of extending credit.[101] In the TILA statement, creditors must disclose finance charges to ensure that the costs being charged for credit are not obscured in the price of goods sold.[102] TILA defines the finance charge as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit."[103] Some primary examples include interest, service charges, and points or origination fees.[104] Some costs which meet this definition are not considered finance charges simply because the statute, regulation, or accompanying commentary says they are not.[105]

Regulation Z also requires lenders to express the finance charge as an annual percentage rate ("APR") to allow the consumer to comprehend the actual costs of the loan.[106] The APR is intended to reflect the cost of credit expressed as an annual rate by showing the correlation between the finance charge and the amount financed, given the prescribed repayment terms.[107] However, the APR excludes certain costs and therefore does not reflect the actual cost of credit.[108] For example, Congress excluded title insurance, appraisal, and document preparation fees from the APR, and

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96. RENUART, *supra* note 74, at 85.
97. 15 U.S.C. § 1601 (2000).
98. *Id.* § 1604.
99. 12 C.F.R. § 226.1 (2003).
100. 15 U.S.C. § 1639 (2000).
101. *Id.* § 226.1.
102. *Id.* § 226.6.
103. 15 U.S.C. § 1605(a) (2000); Reg. Z, 12 C.F.R. § 226.4(a) (2003).
104. RENUART, *supra* note 74, at 85.
105. *Id.*
106. *See* 12 C.F.R. § 226.5(2) (2003).
107. RENUART, *supra* note 74, at 86.
108. *Treasury/HUD Report*, *supra* note 12, at 66.

the Federal Reserve Board excluded application fees.[109] Even if the APR included all fees, it would have limitations because it is not designed to assist consumers in determining whether they should pay points up front or bear the costs of credit over the life of the loan.[110] Additionally, the APR does not provide information on the financial impact of the amount of the monthly payment or the down payment.[111]

The TILA finance charge and annual percentage rate disclosure requirements were designed to protect consumers in lending situations from becoming unknowingly obligated to pay hidden and unreasonable charges imposed by lenders.[112] These disclosure requirements were meant to allow borrowers to compare the terms of credit extended by different lenders in a meaningful fashion.[113] However, TILA and Regulation Z provide exceptions to the broad definition of finance charges, substantially narrowing the charges required to be disclosed under TILA.[114] In addition to these exceptions, the one-year statute of limitations provided for violation of TILA's disclosure requirements undermines TILA's effectiveness. Borrowers often do not realize that material terms have not been disclosed until they consult an attorney, often after the expiration of the statute of limitations.[115]

To strengthen disclosure regulations, Congress enacted the Home Ownership Equity Protection Act ("HOEPA") to amend TILA.[116] HOEPA creates a special class of regulated closed-end loans[117] that are made at higher rates or with excessive costs and fees. These loans are not only subject to special disclosure requirements but, more critically, they are also subject to restrictions on terms commonly used by predatory

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109. *Id.*

110. *Id.*

111. *Id.*

112. Nussbaum v. Mortgage Serv. Am. Co., 913 F. Supp. 1548, 1553 (S.D. Fla. 1995) (citing Johnson v. McCrackin-Sturman Ford, 527 F.2d 257, 262 (3rd Cir. 1975)).

113. *Johnson*, 527 F.2d at 262.

114. Examples of such exceptions include charges by third parties provided certain conditions are met, closing agent fees in certain circumstances, application fees, late fees, certain real estate fees, but only if bona fide and reasonable, certain life, accident, health, or loss-of-income insurance, credit property insurance premiums, debt cancellation coverage if certain conditions are met, certain security interest charges, overdraft charges in certain circumstances, annual fees or fees periodically imposed for participation in a credit plan, seller's points, and interest reductions in time deposits. 15 U.S.C. § 1605(d)–(e) (2000); 12 C.F.R. §§ 226.4(c) (2003).

115. *See, e.g.*, Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143, 1148 (W.D. Wash. 2003).

116. 15 U.S.C. § 1639 (2000).

117. A closed-end loan has a fixed term. RENUART, *supra* note 74, at 86. In contrast, an open-end loan has no fixed term and allows the borrower to repay as much or as little as he or she decides. *Id.* Examples of open-end loans include credit card transactions and lines of credit. Most mortgages are closed-end loans. *Id.*

lenders to manipulate the cost of these transactions.[118] Although HOEPA provides significant protections for high-risk borrowers who obtain high-cost loans, HOEPA'S built-in system of triggers undermines its effectiveness.[119] Specifically, the HOEPA protective provisions apply to a loan only where the APR exceeds comparable treasury securities by ten percentage points.[120] Because predatory lenders often ensure that the HOEPA provisions do not apply to their loans, only a very small percentage of mortgages exceed the HOEPA threshold.[121] For example, a $200,000 loan can have fees of $14,000 and an interest rate of 12% and still not violate HOEPA. Because most predatory mortgages fall just below this minimum threshold and are not subject to HOEPA regulations, HOEPA protections are in effect illusory in addressing the problem of predatory lending.

IV. BACKGROUND OF MORTGAGE LENDING LEGISLATION: STATE STATUTES

The weak enforcement provisions of federal lending statutes undermine these statutes' effectiveness. The absence of a private right of action under RESPA, exceptions to disclosure requirements for certain finance charges, and the limited one-year statute of limitations under TILA all contribute to this ineffectiveness. The recent increase in state legislation aimed at eradicating predatory lending illustrates the increasing awareness of the inadequacies of federal regulation of the home mortgage industry.[122] As of January 2004, twenty-five states had passed laws restricting predatory lending.[123] State anti-predatory lending statutes generally have the following characteristics: limiting the interest rates and fees that a lender may charge; precluding lending to borrowers without regard to their ability to repay; requiring refinance loans to provide a net tangible financial benefit to the borrower; prohibiting excessive prepayment penalties; requiring disclosure to the borrower of various loan

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118. *Id.*

119. *Treasury/HUD Report, supra* note 12, at 85.

120. *Id.* at 87.

121. *Id.* at 85.

122. *See, e.g.,* Anne-Marie Motto, *Skirting the Law: How Predatory Mortgage Lenders are Destroying the American Dream*, 18 GA. ST. U. L. REV. 859, 890–895 (2002).

123. *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, GAO Report to the Chairman and Ranking Minority Member, Special Comm. on Aging, U.S. Senate, GAO–04–280 at 5 (2004) [hereinafter *GAO Consumer Protection Report*].

provisions; and requiring counseling for borrowers who are planning to take out certain loans that are governed by these laws.[124]

In 1999, North Carolina became the first state to enact such predatory lending legislation.[125] This legislation included the aforementioned elements of typical anti-predatory lending statutes and provided specific requirements for high-cost loans.[126] Although the mortgage industry has argued that state intervention would result in higher costs and reduced access to credit for borrowers,[127] two recent studies on the effectiveness of North Carolina's predatory lending reform have demonstrated the opposite.[128] The studies indicate that while subprime lending continued to thrive in North Carolina, the statute prevented predatory terms on 31,500 subprime loans that were made in 2000 and saved borrowers at least $100 million.[129] The studies conclude that because subprime lenders in North Carolina continue to offer a wide range of loan options that provide borrowers with access to credit on fair terms, the reform legislation is beginning to have its intended effect of reducing predatory lending while increasing access to fair credit.[130] Following North Carolina's lead, a number of states and localities have enacted legislation aimed at curbing predatory lending.[131]

Despite the demonstrated success of anti-predatory lending legislation in North Carolina, the federal government is increasingly preempting the states' power to regulate lending, which has reduced the impact

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124. *Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit Abusive Mortgage Lending and Access to Credit: Hearing Before the Subcomm. of Capital Mkt., Ins. and Gov't Sponsored Enters., House Fin. Servs. Comm.*, 108th Cong. 228–229 (2003) (prepared statement of Frank Raiter, Managing Dir. of Standard & Poor's Credit Market Services).

125. Keith Ernst, John Farris & Eric Stein, *North Carolina's Subprime Home Loan Market after Predatory Lending Reform*, A Report From the Center for Responsible Lending iii (August 13, 2002) [hereinafter *North Carolina Study*], *available at* http://www.responsiblelending.org/pdfs/HMDA_Study_on_NC_Market.pdf (last visited Nov. 10, 2004).

126. N.C. GEN. STAT. § 24.1–1.1.A (2003).

127. *See, e.g.*, Dona DeZure, *Predatory Pandemonium*, MORTGAGE BANKING, Apr. 2003, at 26–33; Neil J. Morse, *The Predatory Lending Obstacle Course*, MORTGAGE BANKING, Apr. 2002, at 53–59; Marion Lee, *A Due Diligence Nightmare*, MORTGAGE BANKING, Sept. 2001, at 28–36.

128. *North Carolina Study, supra* note 125; Roberto Quercia, Michael A. Stegman & Walter R. Davis, *The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment*, Center for Community Capitalism, University of North Carolina at Chapel Hill (June 25, 2003), *available at* http://www.predatorylending.org/pdfs/PredLendingStudy.pdf (last visited Nov. 10, 2004).

129. *North Carolina Study, supra* note 125, at iii.

130. *Id.* at 12.

131. *See, e.g.*, GA. CODE ANN. §§ 7–6A–1 (2003); N.J. STAT. ANN. § 46:10B (West 2004); FLA. STAT. ANN. § 494.0078 (West 2003); OHIO REV. CODE ANN. § 1349.25 (West 2003); 63 PA. CONS. STAT. § 456.503 (2003).

of state legislation on predatory lending practices.[132] The Office of Comptroller of Currency ("OCC"), which charters, regulates, and supervises national banks, recently finalized rules designed to clarify its exclusive authority over national banks.[133] The preemption rule declares that state laws that obstruct, impair, or condition a national bank's ability to exercise the power granted to it under federal law are preempted.[134] The preemption rule does not, however, immunize national banks from complying with state laws that affect the business of banking, such as contract law, tort law, public safety law and general criminal law.[135] Although the OCC preemption rule applies to exempt national banks, even non-exempt national banks are often able to obtain protection from liability. Non-bank lenders have the ability to become subsidiaries of national banks, and consequently, the significant preemption of state anti-predatory lending laws often undermines the effectiveness of the state statutes.[136]

States worry that, given the sweeping exemptions of the OCC's recent regulations, new consumer protection laws explicitly governing mortgage lending will have to originate at the federal level, without the benefit of continued experimentation at the state level.[137] This is because federal exemptions hinder state enforcement efforts and create incentives for businesses to seek the regulatory structure with the fewest consumer protections.[138] Nevertheless, states argue that their systems are better equipped to respond quickly and to tailor solutions to the specific needs of various communities and industry sectors. Although state anti-predatory legislation is often exempted by federal law, states are still better able to respond to state-specific predatory lending challenges.[139] Borrowers should consider using their state consumer protection statutes in cases of predatory lending.

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132. *See Office of the Comptroller of Currency Preemption: Hearing Before the Oversight and Operations Subcomm. House Fin. Serv. Comm.*, 108th Cong. 59–60 (2004) [hereinafter *OCC Hearing*] (statement of Karen Thomas, Independent Community Bankers of America).

133. 69 Fed. Reg. 1904 (January 13, 2004).

134. *OCC Hearing*, *supra* note 132, at 19 (statement of Julie Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of Currency).

135. *Id.*

136. *Committee on Aging Hearing*, *supra* note 6, at 60 (statement of Gavin Gee, Director of Idaho Department of Finance).

137. *Id.*

138. *Id.*

139. *See, e.g.*, *GAO Consumer Protection Report*, *supra* note 123, at 6.

V. AN ALTERNATIVE TO ANTI-PREDATORY LENDING LEGISLATION: "UNFAIR OR DECEPTIVE ACTS OR PRACTICES" STATUTES

As indicated above, federal statutes do not adequately protect borrowers from predatory lending because of the weakness of the statutes' enforcement provisions.[140] Additionally, state anti-predatory legislation is inconsistent and burdensome, and is undermined by the OCC's sweeping exemptions for federal banks.[141] Unfair or deceptive acts or practices ("UDAP") statutes, however, prohibit conduct that is unfair, unconscionable, or deceptive in more general terms, but do not require proof of a seller's fraudulent intent or knowledge.[142] As a result, claims under these statutes are easier to prove than common law fraud or misrepresentation.[143] Additionally, UDAP statutes authorize private rights of action in nearly every state and provide for such special private remedies as attorney's fees for prevailing consumers in addition to punitive, treble, or minimum damage awards.[144] These provisions encourage private litigation and deter merchant misconduct.[145]

Every state has at least one UDAP statute that is construed with broad applicability to consumer transactions and aimed at preventing consumer deception and abuse in the marketplace.[146] These statutes have generally incorporated the Federal Trade Commission Act ("FTCA"),[147] which prohibits unfair and deceptive acts or practices.

Although the application of the terms "unfair and deceptive" may produce confusion about which acts or practices are covered, state legislatures and federal agencies already utilize similar standards to ensure uniformity in the determination of which practices are covered.[148] The terms "unfair" and "deceptive" are each defined separately. With respect to deceptive acts, the OCC stated in an advisory letter to the mortgage industry that a practice may be considered deceptive where there is a representation, omission, act, or practice that is likely to mislead a reasonable consumer in the targeted audience in a material way.[149] In clarifying

140. *See id.* at 54.

141. Lampe, *supra* note 5, at 78, 82.

142. JONATHAN SHELDON & CAROLYN L. CARTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES 31 (3d ed. 1991).

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. 15 U.S.C. § 45(a) (2000).

148. *See* SHELDON, *supra* note 142, at 31.

149. Office of Comptroller of Currency, Administrator of National Banks, Guidance on Unfair or Deceptive Acts or Practices, Advisory Letter, 1 (March 22, 2002) *available at*: http://www.occ.treas.gov/ftp/advisory/2002-3.doc (last visited Nov. 10, 2004).

the role of the term "deceptive" in the context of predatory lending, the OCC referred to the FTCA.[150] With respect to the first prong of the "deceptive" test, practices that can be misleading or deceptive include false oral or written representations, misleading claims about costs of services or products, use of bait and switch techniques, or failure to provide promised services or products.[151] Determining the reasonable consumer in the second prong requires an analysis of the totality of the circumstances and the net impression that is made on the consumer.[152] A material misrepresentation under the third prong is one that would have a substantial effect on the consumer's choice or conduct concerning a particular product or service.[153] On the other hand, with respect to unfair acts, "[a] practice may be found to be unfair if the following occur: (1) The practice causes substantial consumer injury such as monetary harm; (2) the injury is not outweighed by benefits to the consumer or to competition; and (3) the injury caused by the practice is one that consumers could not reasonably have avoided."[154]

Application of UDAP statutes provides significant protection for both state and private claimants.[155] Such remedies allow for widespread redress of marketplace misconduct and consumer abuse.[156] Because the state consumer protection and UDAP statutes prohibit similar conduct in each state and provide private rights of action, longer statutes of limitations, and attorney's fees, they are an effective alternative to combat predatory lending.

A. Benefits of UDAP Statutes

Unfair and deceptive practices statutes provide an important alternative to federal and state anti-predatory lending legislation because they usually provide individuals with private rights of action and attorney's fees.[157]

Every state, except Iowa and North Dakota, provides a private right of action for alleged violations of state consumer protection statutes.[158] This private right of action emerged after states realized that the state attorneys general and other administrative agencies were unable to han-

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150. *Id.* at 3.
151. *Id.*
152. *Id.*
153. *Id.* at 3–4.
154. *Id.* at 4–5.
155. SHELDON, *supra* note 142, at 31.
156. *Id.*
157. *Id.*
158. DEE PRIDGEN, CONSUMER PROTECTION AND THE LAW, § 6.2 (2003).

dle the quantity of complaints.[159] States also realized that private actions represent a random selection, are less subject to politicization than government enforcement, and are viewed as a marketplace solution to a marketplace problem.[160] Although the application of the private right of action differs among states, the ability to bring a timely private action without relying on overburdened administrative agencies is important because victims of predatory lending are likely to face foreclosure proceedings,[161] or lose their affirmative claim because of the statutes of limitations.[162]

UDAP statutes also often provide provisions for attorney's fees. Many plaintiffs seek non-monetary damages such as injunctions against foreclosure, rescission of the loans, or changes in the loan terms. Although damages in some cases of predatory lending may be severe because individuals lose substantial equity in their homes or lose their homes due to foreclosure, many potential cases of predatory lending practices will not provide significant damages from which a plaintiff will be able pay an attorney. Consequently, the UDAP statutes' provisions for attorney's fees typically provides a means through which plaintiffs can obtain representation in cases where monetary damages are marginal.

B. Application of Washington Consumer Protection Statutes to Violations of Federal Statutes (RESPA & TILA)

The following examination of cases alleging violations of the Washington Consumer Protection Act ("CPA") demonstrates how consumers can effectively use consumer protection statutes to enforce the policies and requirements of federal lending statutes. The Washington CPA is intended to prohibit individuals in trade or commerce from engaging in unfair or deceptive practices in the course of business with consumers.[163] Because the Washington Legislature passed the act to protect citizens from unfair and deceptive trade and commercial practices, persons injured in their business or property in violation of the CPA may bring a civil action to recover their actual damages sustained.[164] To prevail on a CPA claim, a plaintiff must prove each of the following five elements: (1) that the defendant engaged in an unfair or deceptive act or practice; (2) occurring in trade or commerce; (3) that affects the public

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159. *Id.*
160. *Id.*
161. *See, e.g.*, RENUART, *supra* note 74, at 26.
162. *Id.* at 53, 77.
163. Dwyer v. J.I. Kislak Mortgage Corp., 103 Wash. App. 542, 546, 13 P.3d 240, 242 (2000).
164. *Id.*

interest; and (4) caused injury (5) to plaintiff and his or her business or property.[165]

In applying the CPA to mortgage practices, courts have held that violations of the provisions of the federal lending statutes constitute unfair and deceptive practices in violation of consumer protection statutes.[166] Specifically, the failure to make accurate and timely disclosures under federal statutes such as TILA and RESPA constitutes an unfair or deceptive act or practice in violation of the CPA.[167]

In *Brazier v. Security Pacific Mortgage*, the plaintiff alleged that the mortgage broker failed to disclose in the signed good faith estimate that the broker would receive, among other payments, a 1.5% yield spread premium from the lender.[168] The plaintiff claimed that he had no knowledge that the broker would receive such a payment if the plaintiff did not pay origination fees.[169] On a summary judgment motion, the court found that inadequate disclosure of a mortgage broker fee in a signed good faith estimate violated the CPA and the Mortgage Broker Practices Act ("MBPA").[170] While a question of fact remained with regard to the timeliness of such disclosures, the court determined that as a matter of law, the failure to disclose the mortgage broker fee was a violation of RESPA and TILA.[171]

After finding that the failure to disclose a mortgage broker fee was a violation of these federal statutes, the court recognized that Washington law specifically incorporated RESPA's and TILA's disclosure requirements.[172] Because RESPA, TILA, and the MBPA each require that a mortgage broker provide the borrower with an itemization or good faith estimate of all fees and costs in connection with a residential mortgage loan,[173] and failure to make such disclosures constitutes an unfair or deceptive act or practice, the court held that the inadequate disclosures in the signed good faith estimate also violated the CPA.[174]

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165. Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co., 105 Wash. 2d 778, 780, 719 P.2d 531, 533 (1986).

166. Brazier v. Sec. Pac. Mortgage, 245 F. Supp. 2d 1136, 1142 (W.D. Wash. 2003); Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143, 1143 (W.D. Wash. 2003).

167. *Brazier*, 245 F. Supp. 2d at 1142 (discussing WASH. REV. CODE §§ 19.86, 19.146.100 (1999)).

168. *Id.* at 1139.

169. *Id.*

170. *Id.* at 1141.

171. *Id.*

172. *Id.*; WASH. REV. CODE § 19.146.030(2) (1999).

173. WASH. REV. CODE § 19.146.030 (1999).

174. *Brazier*, 245 F. Supp. 2d at 1142.

In a similar case, *Anderson v. Wells Fargo Home Mortgage*, the court held that Wells Fargo's failure to provide the RESPA-required disclosure of the payment of a yield spread premium within three days of a borrower's loan application was a deceptive act for purposes of a CPA claim.[175] Anderson alleged that her mortgage broker engaged in an unfair and deceptive act or practice when it did not properly disclose to her that the yield spread premium paid by her lender was for brokering a loan at a higher interest rate than was otherwise available to her.[176] The court determined that both RESPA and TILA unambiguously require lenders (and to the extent that they are not the lender's exclusive agent, mortgage brokers) to disclose to a loan applicant information about the proposed loan, including the fact that any yield spread premium will be paid outside closing by the lender to the broker, and the amount of such a payment.[177] RESPA requires this information to be disclosed on the good faith estimate no later than three days after the loan application is submitted, and not at closing when it may be too late for the borrower to use the information.[178]

The court specifically rejected the notion that the borrower should have detected the payment of a yield spread premium from either the disclosed interest rate, the interest rate and the disclosed finance charges, or the origination fee.[179] Because RESPA and TILA require an "up front" disclosure at the application stage—not the closing stage—of the loan process, and Wells Fargo failed to provide information required under these statutes, they engaged in a deceptive act.[180] The court deemed that the TILA claim was barred because of its one-year statute of limitations.[181] However, the court did recognize that even though the TILA claim was time-barred, the borrower was still able to assert the violation as a basis for her timely CPA claim.[182] The defendant's successful assertion of a statute of limitations does not mean that the violation did not occur; rather, it means that the claim based on it is stale.[183] Consequently,

175. 259 F. Supp. 2d 1143, 1147–1148 (W.D. Wash. 2003).

176. *Id.*

177. *Id.* at 1146 (discussing 12 U.S.C. § 2604(c) (2000)); 24 C.F.R. § 3500.7(b), (c) (2003); 12 C.F.R. § 226.18 (2003)).

178. *Anderson*, 259 F. Supp. 2d at 1147.

179. *Id.*

180. *Id.* at 1147–48.

181. *Id.* at 1148–49.

182. *Id.* at 1147, note 3.

183. *Id.*

where the actual claim asserted—the CPA—has a longer limitations period, the violation may still be used to support the timely claim.[184]

Although plaintiffs may allege violations of RESPA, TILA, and unfair and deceptive acts or practices statutes as distinct causes of action in the same complaint, the precedent established in *Brazier* and *Anderson* presents another framework for courts to recognize that the actual violation of the federal statute is sufficient to meet the unfair and deceptive act element of state consumer protection statutes.[185] The ability for borrowers to utilize the state's consumer protection act where their broker or lender has violated federal statutes is significant because borrowers acquire a private right of action and special remedies such as attorney's fees and punitive, treble, or minimum damages.[186] Additionally, because consumer protection statutes are more uniform than state anti-predatory legislation, compliance is less burdensome for the mortgage industry.

VI. HOW UDAP STATUTES ALLEVIATE PROBLEMS WITH FEDERAL & STATE LEGISLATION

A. Federal legislation does not adequately protect borrowers against predatory lending.

Despite the protective purpose of RESPA and TILA to ensure that borrowers receive accurate and timely disclosures of the material terms of their loans, RESPA and TILA do not adequately protect borrowers against predatory lending because (1) RESPA does not allow for a private right of action and (2) TILA has only a one-year statute of limitations.

The right to initiate a private action against a mortgage broker or lender under RESPA for inadequate disclosures is important for the following reasons: (1) The failure to disclose the yield spread premium increases the interest rate by circumventing the intended use of the yield spread premium—giving the borrower the option of deferring closing costs;[187] (2) the resulting higher interest rates often force borrowers into foreclosure;[188] and (3) the administrative agencies charged with the enforcement of RESPA provisions do not have the resources or the time to prosecute each alleged violation or to provide immediate relief for bor-

184. *Id.*

185. *Id.*; *Brazier*, 245 F. Supp. 2d at 1142.

186. SHELDON, *supra* note 142, at 31.

187. *See, e.g.*, *Yield Spread Premiums Hearing*, *supra* note 60, at 2.

188. *See, e.g.*, RENUART, *supra* note 74, at 26.

rowers faced with imminent foreclosure.[189] Although the inclusion of a private right of action under RESPA may help alleviate these problems, consumers have been unsuccessful in their efforts to convince Congress to provide a private right of action under RESPA.[190] Utilizing the private right of action afforded under the state UDAP statutes represents a practical, available alternative for plaintiffs seeking redress for violations of RESPA.

Unlike RESPA, TILA does provide for a private right of action; however, TILA similarly fails to provide adequate relief for borrowers because of its one-year statute of limitations.[191] In many situations, such as in *Anderson*[192] and in the Sabrina Harris example discussed above, the borrower thought that she was deceived in her mortgage transaction. However, in these situations, many borrowers do not immediately realize that this conduct violates the disclosure requirements of TILA. It is often not until the borrower seeks legal advice that she makes this realization, and by this point, her TILA claim is likely barred by the one-year statute of limitations. The limited statute of limitations does not place accountability on the mortgage industry because it provides them with nearly immediate legal protection from liability for nondisclosure after the statute of limitations has run.[193] The mortgage industry's ability to escape from liability under RESPA and TILA frustrates the Congressional intent of the disclosure requirements to assure a meaningful disclosure of credit terms so that the consumer will be able to easily compare the various credit terms available.[194]

B. Consumer protection statutes provide a uniform and efficient standard for compliance.

Although RESPA and TILA are based on strong public policy considerations, they lack the necessary enforcement mechanisms that state consumer protection statutes provide. Consumer protection statutes simply require that mortgage brokers and lenders refrain from engaging in unfair and deceptive acts or practices.[195] Such practices include false oral or written misrepresentations, misleading claims, and the failure to pro-

189. *See Committee on Aging Hearing*, *supra* note 6, at 61 (statement of Gavin Gee, Director of Idaho Department of Finance).

190. *See generally* Sanders, *supra* note 28.

191. 15 U.S.C. § 1640(e) (2000).

192. Anderson v. Wells Fargo Home Mortgage, Inc., 259 F. Supp. 2d 1143, (W.D. Wash. 2003).

193. *See id.* at 1148.

194. *See* 12 U.S.C. § 2601(a) (2000); 15 U.S.C. § 1601(a) (2000).

195. *See* SHELDON, *supra* note 142, at 183–86.

vide promised services or products discussed in the FTCA—all prime examples of predatory lending. Similarly, mortgage practices are unfair when they are coercive or cause injury that could reasonably have been avoided if the consumer had sufficient information to make the choice.[196] Therefore, when a mortgage broker or lender fails to disclose the yield spread premium before closing or changes the type or interest rate of the loan at closing when it is too late for the borrower to seek another loan, the mortgage broker or lender has engaged in a deceptive practice. Although the broad applicability of an unfair or deceptive act may initially appear too overreaching for the mortgage industry, it provides a more uniform requirement than the alleged "patchwork" of state regulation. If borrowers use their private rights of action to hold the parties engaging in predatory lending practices responsible for such deceptive practices under the state consumer protection statutes, the mortgage industry would refrain from predatory tactics that would render them liable.

C. UDAP statutes are favorable because they punish predatory actors while protecting legitimate brokers and lenders.

The mortgage industry claims that the "patchwork" of regulations resulting from the numerous state and local anti-predatory lending statutes and ordinances will dramatically increase the cost of compliance for the industry.[197] Though studies examining the impact of the North Carolina predatory lending reform indicate that the costs of obtaining a mortgage in that state remained unchanged and the incidents of predatory loans decreased,[198] the industry persistently warned that the increased costs of compliance will be passed on to consumers in the form of higher mortgage rates.[199] The mortgage industry's argument that it bears an increased cost in complying with many state and local anti-predatory lending laws that are vague, ambiguous, and have substantially different terms has some merit.[200] However, when consumers utilize consumer protection statutes to remedy predatory loans and deter predatory lending practices, the unscrupulous actors will be the ones in the mortgage industry that bear the increased costs. This alternative approach negatively affects only those brokers and lenders who engage in unfair and decep-

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196. *See Treasury/HUD Report*, *supra* note 12, at 79–81.

197. *See* Lampe, *supra* note 5 at 78 and 82.

198. *See North Carolina Study*, *supra* note 125, at 12.

199. *See id.* at 82.

200. *See, e.g.*, Morse, *supra* note 127, at 57 (discussing a county ordinance in Georgia that was struck down by a Superior Court judge on the grounds that it was unconstitutional and void because it attempted to regulate an area of law over which the state had sole jurisdiction).

tive practices. Without an effective federal statutory or state common law alternative to the increased protection afforded to borrowers by state legislation, some unscrupulous mortgage brokers and lenders will likely continue to engage in predatory lending practices.[201]

In addition to its claims about increased consumer costs, individuals in the mortgage industry warn that state government intervention "raises the cost of lending to the point that lenders will leave the market rather than make loans to people that might be marginal risks."[202] The argument that state legislation will reduce the availability of funding for mortgages addresses the important point that a borrower does not benefit from expanded credit if the credit is offered on unfair terms or involves predatory practices.[203] Because access to a predatory loan is not a benefit to a homeowner since access to destructive credit is worse than no credit,[204] regulations that prevent access to predatory loans do not prevent borrowers from accessing beneficial credit. Thus, eliminating and pushing these lenders out of the market makes the industry profitable for those lenders or brokers who do comply with federal and state laws that protect consumers. The notion that the industry should face less regulation in order to provide access to additional predatory loans is a self-serving proposition for the mortgage industry.

Additionally, the argument that predatory lending legislation will harm the people it was intended to protect is tenuous and is contradicted by the evidence of the North Carolina study on the impact of that state's legislation.[205] The North Carolina study of 3.3 million loans made in the state between 1998 and 2000 found that after the legislation there was a reduction in predatory loans, but no change in the cost of subprime credit or reduction in access to credit for high risk borrowers.[206] The study reports that borrowers in North Carolina with an annual income of less than $25,000 received a higher ratio of subprime to prime loans than similarly situated borrowers in other states.[207] This suggests that the changes in the regulatory environment, like those implemented in North Carolina, would have no significant detrimental impact on the supply of subprime credit to these high-risk borrowers.[208] Despite the fact that the North Carolina Study indicates that legislation can reduce predatory

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201. *See* Sanders, *supra* note 28, at 146.
202. Morse, *supra* note 127, at 55.
203. *See* Sanders, *supra* note 28, at 141.
204. *See id.* at 141.
205. *North Carolina Study, supra* note 125.
206. *Id.* at 12.
207. *Id.* at 7.
208. *See id.*

terms without necessarily reducing access to credit, the mortgage industry maintains its position that such legislation would have a considerable negative impact on the survival of their industry.[209]

However, the industry's argument that the complex patchwork of state and local regulations increases costs for consumers should not be sufficient to shield the mortgage industry from liability for predatory practices. When there are problems with compliance and enforcement under the federal statutes, and the state statutes place the burden on brokers and lenders working in numerous jurisdictions, consumers and courts should rely on the alternative protections of state consumer protection statutes. Although additional legislation at the federal or state level may reduce predatory lending practices, UDAP statutes give consumers an existing, practical means of redress against predatory lenders. Also, the employment of state UDAP statutes to eliminate predatory lending practices will likely alleviate industry concerns because the UDAP statutes' prohibitions are uniform and efficient. The uniformity of these statutes is evidenced by their requirements that brokers and lenders refrain from making material representations that are likely to deceive consumers. Additionally, state consumer protection statutes prevent the industry from engaging in unfair and deceptive practices. When the industry complies with these statutes by disclosing material terms and sufficiently educating borrowers about changes in loan terms and interest rates, the mortgage process is likely to become more efficient for both the industry and the borrower.

UDAP statutes that reduce the prevalence of predatory lending provide a net benefit to society because the costs saved by the consumers outweigh any increased costs to those engaging in unfair and deceptive practices in the mortgage industry. They do not impose additional compliance requirements; rather, they require that the individuals in the mortgage industry simply refrain from engaging in unfair and deceptive practices. In doing so, these statutes reduce the burden on the industry by protecting brokers and lenders who refrain from unfair or deceptive acts or practices and punishing only the predatory actors.

D. Where national banks are exempted from state anti-predatory lending legislation, UDAP statutes represent a viable alternative.

Despite the potential effectiveness of state and local regulation of predatory mortgage practices, many of these statutes and ordinances may

209. *See* Lampe, *supra* note 5, at 81–82.

become preempted by new federal legislation.[210] This potential preemption is evidenced by the recent exemptions for federal banks. With respect to preemption, the present versions of RESPA and TILA emphasize the importance of the continued enactment of state law, except to the extent that state law is inconsistent with federal statutes.[211] Congress intended that the states remain free to impose greater protection for borrowers and did not intend for the federal statutes' disclosure regime to provide the maximum protection to which borrowers are entitled nationwide.[212] However, even without explicit federal preemption, the exemptions for national banks demonstrate the trend toward the weakening of state anti-predatory lending statutes.

Moreover, as federal agencies seek expansion of their regulatory jurisdiction, consumer advocates favor an expanding federal administrative system, and national creditors lobby for federal preemption of more stringent state laws, federal preemption is likely to be the next step in predatory lending legislation.[213] Although consumer advocates encourage Congress to enact more protective and enforceable federal legislation, consumers do not favor preemption of more protective state laws.[214] Preemption of protective state legislation without an adequate federal replacement rewards the mortgage industry for its successful lobbying, but does not address the problem of predatory lending.[215] The deleterious effects of potential federal preemption are evidenced by the OCC's recent exemption for national banks from state anti-predatory lending laws.[216] The effect of this decision is the preemption of state reform laws in 23 states.[217] Because of this possible federal preemption of state laws, it is important for consumers to have an alternative means through which to hold mortgage brokers and lenders liable for unfair and deceptive conduct when brokering or funding a mortgage.

While federal regulation may be successful in preempting specific state anti-predatory lending statutes, the existence of parallel federal regulation in the field of consumer protection is usually no bar to state

210. *See, e.g.*, Responsible Lending Act, H.R. 833, 108th Cong. (2003).

211. 12 U.S.C. § 2616 (2000); 24 C.F.R. § 3500.13(a) (2003); 15 U.S.C. § 1610 (2003).

212. Black v. Financial Freedom, 92 Cal. App. 4th 917, 936, 112 Cal. Rptr. 2d 445 (2001).

213. *See Predatory Mortgage Lending Hearing*, *supra* note 1, at 54 (prepared statement of the Honorable Thomas J. Miller, Attorney General of the State of Iowa).

214. *See id.* at 55.

215. *See id.*

216. *OCC Hearing*, *supra* note 132, at 58–59 (statement of Rep. Peter King, N.Y.).

217. Press Release, National Community Reinvestment Coalition, NCRC Testifies in Congress: Asserts OCC Preemption Will Hurt Housing and Community Development 1 (January 28, 2004) *available at* http://www.ncrc.org/pressandpubs/press_releases/PressRelonOCCCtest.pdf (last visited Nov. 10, 2004).

efforts.[218] In fact, the Federal Trade Commission encouraged the states to adopt "little FTC acts" during the 1960s as an attempt to broaden the reach of consumer protection regulation.[219] In analyzing the relationship between specific federal and state general consumer protection acts, courts have held that where the federal regulation encouraged concurrent state legislation and sellers could easily comply with both the federal and state consumer protection regulations simultaneously, the state consumer protection laws should not be preempted.[220] The mortgage industry, however, maintains that state anti-predatory lending specific laws should be preempted because they impose a burden so substantial that they render compliance with federal and state requirements impossible.[221] Because the industry may successfully convince Congress that these state laws should be preempted by existing or additional federal lending legislation, and state UDAP statutes are rarely preempted by federal law, UDAP statutes represent a viable, concrete, and powerful alternative to state and federal lending-specific legislation.

VII. CONCLUSION

The mortgage industry plays a critical role in allowing individuals to obtain financing to pursue the American dream of homeownership. However, predatory brokers and lenders engage in unfair and deceptive practices that are prohibited by consumer protection statutes in every state. Predatory practices harm both the borrowers and certain lenders in the mortgage industry who do follow state and federal regulations by keeping the borrower informed and properly and timely disclosing fees. The industry and consumers should work to eradicate the presence of predatory mortgage practices. Where consumers and courts hold accountable only those lenders and brokers who engage in unfair and deceptive acts, the victims of predatory loans and the honest sector of the industry will be protected. When consumers are provided with the disclosures that enable them to make educated and informed decisions about their mortgage terms, the marketplace will function fairly and properly.

The current federal regulatory structure under RESPA and TILA is undermined by ambiguous terms, numerous exemptions, and weak enforcement provisions; state legislation is complex, inconsistent, and faces

218. PRIDGIN, *supra* note 158, at 524.

219. *Id.*

220. *Id.* (discussing Nat'l Funeral Servs., Inc. v. Rockefeller, 870 F.2d 136, 138–140 (4th Cir. 1989) (holding that West Virginia's extensive regulation of the pre-need funeral contract industry was not preempted by the FTC's Funeral Rule)).

221. *See generally*, DeZure, *supra* note 127; Morse, *supra* note 127.

likely federal preemption. Accordingly, consumers should allege violations of the federal statutes as a way of meeting the unfair and deceptive practices element under state consumer protection statutes. The private right of action, the longer statutes of limitations, and the provision of attorney's fees provided for in state consumer protection statutes enable consumers to more effectively litigate claims against brokers and lenders for damages resulting from manipulation and deception in the mortgage process. Additionally, state consumer protection statutes will likely withstand the challenges of federal preemption that are lodged against state anti-predatory lending statutes. When consumers become victims of predatory lending practices, they should utilize provisions set forth in state consumer protection statutes that provide for private rights of action, longer statutes of limitations, and attorney's fees. The remedial and preventative nature of consumer protection statutes makes them an effective alternative to federal and state anti-predatory lending regulations when brokers and lenders engage in unfair and deceptive practices.