Comment

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Predatory Lending in Oregon: Does Oregon Need an Anti-Predatory Lending Law, or Do Current Laws and Remedies Suffice?

Predatory lending has recently emerged as a significant social issue throughout the United States.[1] Specifically in Oregon, certain homeowners risk losing their homes and financial security because of manipulative lending practices that entice unsophisticated borrowers to obtain high-cost loans.[2] Most of these practices, while unethical and clearly abusive, unfortunately are not illegal. In response, consumer groups have supported legislation that would tighten the interest rate and fee triggers that define high-cost loans, improve protections for borrowers receiving such loans by prohibiting the financing of exorbitant fees, and protect consumers' rights to seek redress by prohibiting mandatory arbitration.[3]

In 2001, Oregon State Representative Carolyn Tomei sponsored a similar bill for Oregon.[4] That bill failed to pass, most

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[1] *See generally* Eric Stein, *Quantifying the Economic Cost of Predatory Lending* 23, *at* http://www.responsiblelending.org/pdfs/Quant10-01.pdf (July 25, 2001) (explaining the cost of predatory lending on American homeowners).

[2] *Hearing on H.B. 3088 Before the House Comm. on Bus., Lab. and Consumer Aff.*, 2003 Leg., 72nd Sess. (Or. 2003) [hereinafter *Hearing on H.B. 3088*] (statement of Peg Malloy, Executive Dir., Portland Hous. Ctr.).

[3] *See id.* (statement of Pegge McGuire, Executive Dir., Fair Hous. Council of Oregon).

[4] *Id.* (statement of Rep. Carolyn Tomei).

likely because of the uncertain effects its restrictions would have had on the credit market.[5] A realistic solution, therefore, must be proposed to protect vulnerable Oregonians from abusive loans. The current debate focuses on how to prohibit predatory lenders from using abusive tactics, like excessive loan fees, large "balloon" payments, high interest rates, and frequent refinances, without severely impeding legitimate lenders' efforts to extend credit to those in need.[6]

Supporters of statutes that would forbid misleading lending practices believe the government should protect cash-poor, equity-rich senior citizens and low-income minorities because these borrowers are commonly targeted and generally disconnected from the credit market.[7] Opponents of such legislation argue that existing remedies suffice and question the actual number of predatory lending occurences.[8] Opponents also assert that unnecessary legislation will force legitimate lenders out of certain jurisdictions because of the increased costs and the risk of the penalties involved in ensuring compliance with more legislation.[9]

This Comment continues in four parts. Part I defines "predatory lending" and gives an overview of the problems associated with predatory lending practices. Part II provides an assessment of the current notable federal and state laws and discusses the possibility and impact of federal preemption. Part III analyzes the existing Oregon laws aimed at limiting unethical lending practices and contends that these laws are insufficient. Finally, Part IV argues that a remedy that does not include additional legislation is inadequate, and advocates for a system of reasonable, clear, and comprehensible rules that could afford significant and necessary protection to all borrowers.

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[5] *Id.* (statement of Jim Markee, Or. Mortgage Lenders Ass'n).

[6] *See* Deborah Goldstein, *Protecting Consumers From Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 226-28 & 232-34 (2000).

[7] Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1281-82 (2002).

[8] *See Hearing on H.B. 3088*, *supra* note 2 (statement of Jim Markee, Or. Mortgage Lenders Ass'n)

[9] Patricia E. Obara, *Predatory Lending*, 118 BANKING L.J. 541, 541-42 (2001).

I

OVERVIEW OF PREDATORY LENDING

A. The Difference Between Subprime Lending and Predatory Lending

Subprime lending is the extension of credit to higher-risk borrowers who do not qualify for traditional, prime loans made at the prevailing interest rates.[10] Subprime lenders convince borrowers to take out home equity or home refinance loans to consolidate consumer debts by using the tax advantage associated with home loans.[11] For legitimate reasons, these loans have higher interest rates to compensate for the potentially greater risk that the borrowers represent.[12] However, these loans are not necessarily predatory. Predatory loans, those addressed in this Comment, make up a subset of subprime loans, and only result when lenders exploit unsophisticated and vulnerable borrowers with unquestionably predatory practices.[13]

Predatory lending, theoretically, may be a component in any loan where the borrower's fees are not justified when compared to the lender's additional cost and risk.[14] These loans have one or more of the following features: (1) they charge more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections; (2) they contain abusive terms and conditions that trap borrowers and lead to increased indebtedness; (3) they fail to take into account the borrower's ability to repay the loan; or (4) they require borrowers to waive meaningful legal redress.[15] Therefore, predatory lending has been defined as "a catalogue of onerous lending practices, which are often targeted at vulnerable populations and result in devastating personal losses, including bankruptcy, poverty, and foreclosure."[16]

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[10] *Predatory Mortgage Lending: Hearing Before the House Comm. on Banking and Fin. Servs.*, 106th Cong. 308-19 (2000) (testimony of Donna Tanoue, Chairman, Fed. Deposit Ins. Corp.).

[11] *See* Engel & McCoy, *supra* note 7, at 1263-65.

[12] *Id*. at 1261.

[13] *Id*.

[14] *See* Obara, *supra* note 9, at 544-45.

[15] Engel & McCoy, *supra* note 7, at 1260.

[16] *Id*.

B. Who is at Risk?

The victims of predatory lending are susceptible to these tactics because they are disconnected from the credit market and uneducated about their options.[17] They are often lower- to middle-income elderly or minorities who, because of credit rationing, discrimination, and other social forces, have not had experience with legitimate lenders.[18] When many of these elderly homeowners are confronted with large and unexpected emergency bills, their only option is to access the home equity that they have spent their lives accumulating.[19] Their limited knowledge about financing alternatives makes them easy prey for predatory lenders.[20] One study found that borrowers sixty-five years of age or older were three times more likely to hold a subprime mortgage than borrowers under thirty-five years of age.[21]

Many minority homeowners are left out of the home-mortgage market because of discrimination and credit rationing.[22] Subprime lenders are involved in 51% of all refinance loans made in predominantly African-American neighborhoods, compared to just 9% in predominantly white neighborhoods.[23] Minorities need credit, but are often unaware of or uneducated about the less expensive alternatives and unable to comprehend the lender's loan documents.[24] Predatory lenders take advantage of such information disparities and convince borrowers from the targeted groups to commit to loans with unsavory terms.[25]

Predatory lenders can easily identify and target cash-poor elderly and lower income minorities.[26] For example, lenders can go to the local tax office to find out which homeowners have out-

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17 *Id*. at 1279-80.

18 *See Hearing on H.B. 3088*, *supra* note 2 (statement of Rep. Carolyn Tomei).

19 *Id*.

20 *Id*.

21 NEAL WALTERS & SHARON HERMANSON, AARP PUB. POLICY INST., SUBPRIME MORTGAGE LENDING AND OLDER BORROWERS (2001), (Pub. No. DD57), *available at* http://research.aarp.org/consume/dd57_lending.html (last visited Mar. 10, 2005).

22 Engel & McCoy, *supra* note 7, at 1280.

23 U.S. DEP'T OF THE TREASURY & U.S. DEP'T OF HOUSING AND URBAN DEV., CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 23 (2000), *available at* http://www.hud.gov/library/bookshelf18/pressrel/treasrpt.pdf (last visited Mar. 10, 2005) [hereinafter HUD-TREASURY REPORT].

24 Engel & McCoy, *supra* note 7, at 1280-81.

25 *Id*. at 1281.

26 *Id*. at 1282.

standing taxes and are in need of money.[27] Predatory lenders can also discover which homeowners have been cited for housing-code violations and are in need of home-repair loans.[28] When a naïve borrower is identified, predatory lenders often coerce their victim to commit to loans under the false belief that this will be the victim's one and only chance to borrow.[29] In the end, the victims of predatory lending sign complex mortgages without having a clear understanding of the terms or the risks they have acquired.

C. What Lending Practices Cause Problems?

Predatory lending is particularly devastating because subprime borrowers typically seek home equity loans at a time of great financial need, when they are in the weakest bargaining position and most susceptible to practices that can strip them of substantial sums of money and, ultimately, their homes.[30] Four main problems arise from predatory loans: (1) abusive tactics, like "asset-based lending," "loan flipping," and attaching "balloon" payments, that seriously harm uneducated borrowers; (2) harmful rent-seeking; (3) fraudulent loans and loans involving omissions; and (4) loans that bar the plaintiff from seeking judicial redress.[31]

The first predatory lending problem involves lenders who use abusive, unconventional tactics that harm vulnerable borrowers. One example is when lenders make unaffordable loans based on the assets of the borrower instead of the borrower's ability to repay the obligation (a practice known as "asset-based lending").[32] Such loans are intended to fail. They often cause borrowers to lose their home through foreclosure or by signing over

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27 *Id*.

28 *Id*. at 1282-83.

29 *Id*. at 1283.

30 *See, e.g.*, Fred R. Bleakley, *A 125% Solution to Card Debt Stirs Worry: Second-Mortgage Trend May Signal Economic Trouble*, WALL ST. J., Nov. 17, 1997, at A2 (discussing a family that encumbered its home for more than its value to pay off credit card debt).

31 Lynne F. Riley, *The Bankruptcy Perspective: Predatory Lending in the Home Mortgage Market*, *at* http://www.abiworld.org/Template.cfm?section =200336&template=/TaggedPage/TaggedPageDisplay.cfm&TPUD=5&contentID=1848 (last visited Mar. 17, 2005).

32 MORTGAGE BANKERS ASSOCIATION OF AMERICA, BEST PRACTICES/LEGISLATIVE GUIDELINES: SUBPRIME LENDING, LEGISLATIVE GUIDELINES 6 (advising against lending without regard to repayment ability), *available at* http://www.mbaa.org/resident/ lib2000/0525b.html (last visited July 29, 2004).

the deed to the lender in lieu of foreclosure.[33] The lender can then make a profit by reselling the property.

Asset-based lending often results in another unethical practice known as "loan flipping."[34] Loan flipping occurs when a lender induces a cash-poor homeowner to refinance a mortgage with a new, larger loan designed to both pay off the previous loan and finance the fees and costs of the new loan.[35] Initially, this procedure is attractive to borrowers because it offers temporary relief in the form of lower monthly payments by extending the loan maturities.[36] But, in the end, unattainable payments will cause the borrower to owe a higher total principal and interest to the lenders.[37] The owners' home equity will decline as a result of each refinancing[38] and as their equity is stripped and total loan balances rise, the borrowers' ability to refinance with legitimate lenders plummets. Ultimately, the borrowers give away their equity and default.[39]

Another abusive tactic involves lenders who persuade homeowners to refinance no-interest or low-interest mortgages at higher interest rates.[40] Because high interest rates entail large monthly payments to lower the loan principal,[41] predatory lenders often design these loans with lower monthly payments, but attach a large "balloon" payment that is due at the end of the loan term.[42] It is certainly possible that the balloon payment that is required at the end of the loan term could exceed the price of the original loan. For example, a borrower who originally enters into a loan of $33,800 at an interest rate of 16.46% could be paying monthly payments of $462 per month for 180 months. Thus, the total amount of the repayments is $83,160, which includes a balloon payment of $35,000 (more than the original loan).

The second predatory lending problem arises when subprime lenders abuse their market power by charging rates and fees that

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33 *See* Engle & McCoy, *supra* note 7, at 1264.

34 *See* Truth in Lending, 12 C.F.R. § 226.34(a)(3) (2005).

35 *Id*.

36 *See* HUD-TREASURY REPORT, *supra* note 24, at 91-92. **R**

37 *Id*.

38 *Id*.

39 *See generally* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489 (1991) (reviewing the costs associated with foreclosure).

40 Riley, *supra* note 32. **R**

41 Hillary B. Miller, *Payday Loans and Predatory Lending*, 1242 PRACTISING L. INST. 113, 126-27 (2001).

42 *Id*.

are far higher than those in a competitive market, a practice known as "rent-seeking."[43] Rent-seeking has two common characteristics: (1) the fees are significantly higher than those charged on conventional loans; and (2) the fees are financed as part of the loan.[44] When these fees are combined with prepayment penalties, for example, a homeowner's equity will likely be ruined.[45] Consider a family that wishes to borrow $40,000 against its $75,000 house. A predatory lender presents a home equity loan that includes fees of $10,000. If the family cannot pay the $10,000 up-front, the fee is added to the loan balance, which increases it to $50,000. Assume also that the loan contains a $5,000 prepayment penalty. Immediately after the loan closes, it calls for $55,000 to pay off the $40,000 loan. The family's equity is lost.

The third form of predatory lending involves fraud and misleading omissions. Predatory lenders might use fraud or deception to hide the reality of the loan obligation from an unsuspecting borrower.[46] Although all fraudulent practices are violations of existing laws, such as state fraud statutes and the federal Truth in Lending Act (TILA),[47] lenders still attempt to deceive borrowers by including fraudulent disclosures, failing to disclose required information, and using bait-and-switch tactics in the loans.[48] In 2000, *The Oregonian* published a story regarding the fraud issues in the sale of manufactured housing in Oregon.[49] It found that lenders regularly avoid paying the minimum 5% down payment for manufactured home loans.[50] The Oregon Attorney General, in response, encouraged the development of new fraud deterrents in the state law, and recommended standardized itemization of all costs, a "cooling off" period, and better information so consumers could get a second opinion regarding their loan.[51]

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[43] 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 315-22 (Peter Newman ed., 1998) (commenting that "[r]ent seeking is unproductive; it destroys value by wasting valuable resources").

[44] Engel & McCoy, *supra* note 7, at 1265-66.

[45] *See id*.

[46] *Id*. at 1267.

[47] 15 U.S.C. §§ 1601-1693r (2000).

[48] Engel & McCoy, *supra* note 7, at 1267.

[49] Kathy Mitchell, *In Over Our Heads: Predatory Lending and Fraud in Manufactured Housing*, CONSUMERS UNION SOUTHWEST REGIONAL OFFICE PUB. POL'Y SERIES, Feb. 2002, Vol. 5, No. 1, at 15, *available at* http://www.consumersunion.org/pdf/mh/over/ report.pdf (last visited Mar. 10, 2005).

[50] *Id*.

[51] *Id*.

In an attempt to mislead borrowers, lenders will also purposely omit two key figures: the cost of credit as a dollar amount (the "finance charge"), and the cost as an annual percentage rate (APR).[52] The finance charge measures the total cost of credit in dollars, including interest payments, points, and origination fees.[53] The APR provides another measure of total credit costs by converting the lump-sum finance charge into an effective interest rate per year.[54] Lenders have also failed to provide consumers with adequate disclosures about closing costs for mortgages and prepayment penalties.[55] In traditional prime markets, competitive forces are generally sufficient to force lenders to disclose most lending terms.[56] However, in the predatory lending market, disclosures are usually incomprehensible, and market forces do not provide adequate constraints.[57]

The fourth problem of predatory lending occurs when a loan contains a mandatory arbitration clause, which prohibits the borrower from seeking judicial redress.[58] The current trend of lenders to impose binding predispute arbitration seems to be an effort to prevent class action litigation and relief.[59] According to Sternlight, "If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy."[60]

D. The Predatory Lending Aftermath

United States borrowers lose $9.1 billion annually to predatory lending practices.[61] These outrageous losses result from lenders stripping equity and charging borrowers higher interest rates

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52 Engel & McCoy, *supra* note 7, at 1268.

53 *Id.*

54 *Id.* *See generally* U.S. DEP'T OF HOUS. & URBAN DEV. & FED. RESERVE BD., JOINT REPORT TO THE CONGRESS CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT PROCEDURES ACT I (1998) [hereinafter HUD-FED JOINT REPORT], *available at* http://www.federalreserve.gov/boarddocs/rptcongress/tila.pdf. (last visited Mar. 10, 2005).

55 Engel & McCoy, *supra* note 7, at 1269-70.

56 *Id.* at 1270.

57 *Id.*

58 *See* Shelly Smith, *Mandatory Arbitration Clauses in Consumer Contracts: Consumer Protection and the Circumvention of the Judicial System,* 50 DEPAUL L. REV. 1191, 1191-92 (2001).

59 *See* Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 59 (2000).

60 *Id.*

61 Stein, *supra* note 1, at 2.

than their credit histories would indicate is justified.[62] As a result, residential foreclosure rates have dramatically increased.[63] In Chicago, for example, the number of foreclosures of high cost mortgages increased almost 500% from 1993 to 2001.[64]

Predatory lending practices are also tormenting Oregonians. Between 1999 and 2002, 287 complaints alleging mortgage lending abuses were filed with the Department of Consumer and Business Services.[65] Although some opponents of more legislation have argued that the number of predatory lending incidents is still insignificant,[66] a recent settlement indicates that predatory lending practices thrive in Oregon.[67] In October 2002, Household International, Inc. entered into a settlement of various claims involving alleged unfair and deceptive lending practices with a number of states, including Oregon.[68] The total amount of the settlement was $484 million.[69] More than 5000 Oregon consumers, who took out loans with Household during the period from January 1999 through September 2002, are eligible to recover a portion of Oregon's share, which is at least $7 million.[70]

The foreclosure data described above demonstrates the devastating economic consequences that predatory loans have for individual borrowers and their families. Most homeowners lose both their homes and the equity they have built up over the years. Even if borrowers keep up with their loan payments, the loans continually strip them of their accrued equity and reduce their household budget for other essential needs. Homeowners are then left with a substantial debt that they cannot afford. The impact of predatory lending extends beyond those individuals and families who have been victimized. Studies show that entire neighborhoods are harmed by predatory lending practices.[71] Eq-

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62 *Id.*

63 *See* NAT'L TRAINING & INFO. CTR, OUTSIDE THE LAW: HOW LENDERS DODGE COMMUNITY REINVESTMENT 7 (2003), *available at* http://www.ntic-us.org/issues/cra/outsidethelaw/Report.pdf (last visited Mar. 10, 2005).

64 *See id.* at 8.

65 *Hearing on H.B. 3088*, *supra* note 2 (statement of Rep. Carolyn Tomei).

66 *Id.* (statement of Jim Markee, Or. Mortgage Lenders Ass'n).

67 Press Release, Or. Dep't of Justice, AG Myers Announces $484 Million Settlement with Household International (Oct. 11, 2002), *at* http://www.doj.state. or.us/releases/rel101102.htm (last visited Mar. 10, 2005).

68 *Id.*

69 *Id.*

70 *Id.*

71 *See* James H. Carr & Jenny Schuetz, *Framing the Issue, Finding Solutions*, *in* FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 5

uity-stripping and foreclosures take cash out of neighborhoods and shake the confidence of homeowners.[72] Foreclosed homes frequently remain vacant for a prolonged period of time, leading to neighborhood instability, depressed property values, and increased crime.[73]

II

Background Law

The desire to do something to stop the abuses in the lending industry has led to federal legislation, regulatory proposals, and a number of state bills.[74] Legislation against predatory lending takes a fairly consistent approach. For example, most state legislation contains prohibitions against certain activities by the lender, disclosure requirements, and a condition that the lender believe that the borrower can afford the loan.[75] However, if these state anti-predatory lending laws become too harsh or overbearing on the credit market, a federal act could be passed that preempts all state and local predatory legislation.

A. Federal Law

The main existing federal law on predatory lending is the Home Ownership and Equity Protection Act (HOEPA).[76] In 1994, Congress passed HOEPA as an addendum to TILA.[77] TILA's purpose is to promote disclosures in consumer credit transactions.[78] Under TILA, lenders must make known the cost of credit as both the finance charge and the APR.[79] If the loan is secured by a consumer's home, then TILA, as a result of the Federal Reserve Board's Regulation Z, includes additional disclo-

(2001), *available at* http://www.fanniemaefoundation.org/programs/financial.pdf (last visited Mar. 10, 2005).

72 *Id*.

73 *See* HUD-Treasury Report, *supra* note 24, at 25. **R**

74 Donald C. Lampe, *Predatory Lending Initiatives, Legislation and Litigation: Federal Regulation, State Law and Preemption*, 56 Consumer Fin. L.Q. Rep. 78 (2002).

75 *See id*. at 82-84.

76 Home Ownership and Equity Protection Act, 15 U.S.C. §§ 1602(aa)-1639 (2000). Regulations promulgated under HOEPA are found in Regulation Z, 12 C.F.R. § 226.31-.32 (2004).

77 Truth in Lending Act, 15 U.S.C. §§ 1601-1693r (2000).

78 *Id*.; Truth in Lending, 12 C.F.R. § 226.1(b).

79 12 C.F.R. § 226.31-.32.

sures and provides for a three-day right of rescission.[80]

The purpose of HOEPA was to set out a system of "triggers," which activate disclosures and possible restrictions on loans that exceed certain conditions.[81] For high-cost, closed-end home mortgages (other than purchase-money mortgages),[82] HOEPA requires additional disclosures three days before closing.[83] Under these provisions, the lender must notify the borrower of the APR, the dollar amount of the periodic payments, the size of any balloon payments, the amount borrowed, and any charges for optional credit insurance or debt-cancellation coverage.[84] HOEPA lenders must also warn borrowers that they could lose their homes.[85] For adjustable-rate mortgages under HOEPA, lenders must reveal that the interest rate, monthly payment, and amount of the single maximum monthly payment could very likely increase.[86]

Unfortunately for targeted borrowers, TILA and HOEPA have weaknesses in the activities they prohibit and the relief they provide.[87] TILA was intended to standardize disclosures on the total cost of credit, but a long list of closing costs is currently excluded when computing finance charges and APRs.[88] These omissions are made worse because predatory lenders can pad closing fees and add on expensive insurance without the customer's knowledge.[89]

Even though HOEPA fills some of TILA's loopholes, its coverage is too narrow. HOEPA does not apply to purchase-money mortgages, reverse mortgages, or open-end credit lines of any kind.[90] For home mortgages within its coverage, HOEPA only applies if at least one of the following triggers is satisfied: the APR at consummation exceeds the yield on Treasury securities of comparable maturity plus 8% for first-lien loans (or 10% for subordinate-lien loans); or the total points and fees exceed 8% of the total loan amount or $400 (subject to annual indexing),

[80] 15 U.S.C. § 1635 (2000); 12 C.F.R. § 226.32.
[81] *See* 15 U.S.C. § 1602(aa)(1)-(4) (2000).
[82] Truth in Lending, 66 Fed. Reg. 65, 605 (Dec. 20, 2001).
[83] 15 U.S.C. §§ 1601, 1602(aa), 1639(a)-(b) (2000).
[84] 12 C.F.R. § 226.32(c).
[85] *Id*.
[86] *Id*.
[87] *See* HUD-FED JOINT REPORT, *supra* note 55, at II. **R**
[88] *See id*. at VII-XI.
[89] *See id*. at XI & XIX.
[90] *See* 15 U.S.C. § 1602(i), (w), (bb) (2000).

whichever is greater.[91] To evade HOEPA, a lender can simply create a loan as an open-end extension of credit or keep the interest and fees below the triggers.[92] HOEPA's triggers are so high that most lenders, including predatory lenders, have no trouble pricing their loans below the triggers.[93] In 2000, about 1% of all subprime mortgage loans were estimated to fall under HOEPA.[94] By contrast, estimates of predatory lending and actual settlements entered into by large subprime lenders suggest the true incidence may be considerably higher.[95]

On August 5, 2003, the Office of the Comptroller of the Currency published a notice of proposed rulemaking.[96] The proposal added a new paragraph that prohibited a national bank from making a loan "based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources."[97] Unfortunately, the proposal does not influence a financial company's ability to make unethical loans. It also allows national banks to escape state contract laws[98] and make real estate loans without adhering to state laws limiting the "terms of credit."[99] Therefore, state legislation has developed as a supplement to perceived deficiencies in the federal law on predatory lending.

B. State Law

More than half of the states have either recently passed or have currently pending laws dealing with predatory lending.[100]

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91 *See* 15 U.S.C. § 1602(aa)(1)-(4) (2000); 12 C.F.R. § 226.32(a)(1) (2004).

92 *See* Truth in Lending, 12 C.F.R. § 226.32(d).

93 *See, e.g.*, HUD-TREASURY REPORT, *supra* note 24, at 85. **R**

94 Governor Edward M. Gramlich, Remarks at the Community and Consumer Affairs Department Conference on Predatory Lending (December 6, 2000), *at* http://www.federalreserve.gov/boarddocs/speeches/2000/20001206.htm (last visited Mar. 8, 2005).

95 *See generally* Christopher A. Richardson, *Predatory Lending and Housing Disinvestment* (2003), *available at* http://www-cpr.maxwell.syr.edu/seminar/spring03/richardson.pdf (last visited Mar. 10, 2005).

96 Bank Activities and Operations, Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1905 (Jan. 13, 2004) (to be codified at 12 C.F.R. pts. 7, 34).

97 *Id*. II.A.

98 *Id*. III.

99 MICHAEL MADISON ET AL., THE LAW OF REAL ESTATE FINANCING § 5:34 (rev. ed. Supp. 2004).

100 Lampe, *supra* note 75, at 82. **R**

Several of these states have enacted HOEPA-like regulations that force lenders to consider the borrowers' ability to repay and prohibit financing fees in high cost loans, balloon payments, direct home-improvement disbursements, negative or non-amortizing loans, and prepayment penalties.[101] Although it is beyond the scope of this Comment to review all state and local legislation on the issue of predatory lending, certain developments are worth mentioning.

North Carolina was the first state to specifically address the issue of predatory lending in its 1999 Anti-Predatory Lending Law.[102] The law defines general regulations for all loans,[103] develops a new class of high-cost loans,[104] provides additional restrictions for those loans,[105] and then establishes a way to enforce the regulations.[106] It prohibits the refinancing of home loans if there is no tangible net benefit to the borrower, the financing of single premium credit insurance, and prepayment penalties on first-lien mortgages of less than $150,000.[107] The law also contains a flipping prohibition, which forces the lender to assess the borrower's need for the refinancing and decide if the refinancing would benefit the borrower.[108]

Florida's Fair Lending Act creates a category of "[h]igh-cost home loan[s]"[109] and subjects those loans to certain restrictions.[110] The statute places restrictions on prepayment fees,[111] increased interest rates in the event of a default,[112] balloon payments,[113] negative amortization,[114] including the first payments in the loan,[115] encouraging default,[116] and has anti-flipping provi-

[101] Anna Beth Ferguson, *Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers*, 48 CLEV. ST. L. REV. 607, 627-32 (2000).

[102] Richard R. Daugherty, Note, *Will North Carolina's Predatory Home Lending Act Protect Borrowers from the Vulnerability Caused by the Inadequacy of Federal Law?*, 4 N.C. BANKING INST. 569, 592 (2000).

[103] *See generally* N.C. GEN. STAT. § 24-1.1A (2001) (creating primarily disclosure-based protections).

[104] *Id*. § 24-1.1E(a)(4)-(7).

[105] *Id*. § 24-1.1E(b)-(d).

[106] *Id*. § 24-1.1E(e).

[107] *Id*. § 24-1.1A.

[108] *Id*. § 24-10.2(c).

[109] FLA. STAT. ANN. § 494.0079(6) (West Supp. 2004).

[110] *Id*. § 494.00791.

[111] *Id*. § 494.00791(1).

[112] *Id*. § 494.00791(2).

[113] *Id*. § 494.00791(3).

[114] *Id*. § 494.00791(4).

[115] *Id*. § 494.00791(5).

sions.[117] But, there is an uncommon provision in the statute. The provision states that:

> A lender making a high-cost home loan shall not engage in any pattern or practice of extending high-cost home loans to borrowers based upon the borrowers' collateral without regard to the borrowers' ability to repay the loan, including the borrowers' current and expected income, current obligations, and employment.[118]

Although there is a condition requiring lenders to consider the borrower's ability to repay the loan, the statute does not contain the usual rebuttable presumption.[119] Therefore, lenders in Florida who take a chance on a borrower must question whether a court will find that their loan was made "without regard" to the borrower's ability to repay.

New York's most recent anti-predatory law is also worth analyzing because Oregon's House Bill 3088, which failed to pass in 2003, was modeled after the New York statute.[120] New York's rule regarding the repayment ability clause tracks the opposite approach from Florida. New York's statute allows the lender to use a rebuttable presumption because reasonableness is a judgment to be made in each loan.[121] But, it has a higher standard of proof than other state statutes for proving the borrower's ability to repay the loan before the lender gains this presumption.[122]

The New York statute applies to high-cost loans. For example, residential mortgages that have either an APR that is more than 8% above the interest rate for a comparable length Treasury Bill or where points and fees exceed 5% of the total loan amount are high cost loans.[123] If the loan qualifies as a high-cost loan, the New York statute prohibits call provisions,[124] balloon payments

116 *Id*. § 494.00791(11).

117 *Id*. § 494.00791(9).

118 *Id*. § 494.00791(6).

119 *See, e.g.*, GA. CODE ANN. § 7-6A-5(8) (2003) (explaining that there is a rebuttable presumption that the borrower is able to repay the obligation if the borrower's total monthly debts, including the loan, do not exceed 50% of the borrower's monthly gross income).

120 *Hearing on H.B. 3088*, *supra* note 2 (statement of Rep. Carolyn Tomei).

121 N.Y. BANKING LAW § 6-l(2)(k) (McKinney Supp. 2002).

122 *Compare* CAL. FIN. CODE § 4973(f)(1) (West Supp. 2005) (permitting "any . . . reasonable means"), *with* N.Y. BANKING LAW § 6-l(2)(k) (allowing reliance only on verified "detailed documentation of all sources of income and corroborated by independent verification").

123 *Id*. § 6-l(d), (g).

124 *Id*. § 6-l(2)(a).

(fifteen years or sooner),[125] negative amortization,[126] higher default interest rates,[127] modification and deferral fees (except under certain circumstances),[128] "oppressive" mandatory arbitration clauses,[129] loans made "without due regard to repayment ability" or without the borrower having received specified counseling disclosures,[130] the financing of single premium credit insurance or debt cancellation benefits,[131] the financing of points and fees in excess of 3% of the principal amount of the loan,[132] and the charging of points and fees when the loan refinances a lender's own or an affiliate's high-cost home loan.[133] The New York statute also prohibits "loan flipping," that is, "refinanc[ing] an existing home loan [with a high-cost home loan] when the new loan does not have a tangible net benefit to the borrower considering all of the circumstances."[134]

With its extensive list of requirements, the New York statute places a substantial burden upon lenders engaged in the subprime industry to ensure compliance. Only time will tell whether the prediction of the mortgage banking industry will come true and lenders will flee the subprime market rather than be subject to these new restrictions.

C. Assessment of the State Laws

Because North Carolina's statute was the first to specifically prohibit predatory practices, it has been the subject of many examinations that assess the consequences of anti-predatory lending legislation.[135] The central question of these studies was whether the law would eliminate consumers' access to the very credit they need to improve their economic situation.[136]

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[125] *Id*. § 6-l(2)(b).
[126] *Id*. § 6-l(2)(c).
[127] *Id*. § 6-l(2)(d).
[128] *Id*. § 6-l(2)(f).
[129] *Id*. § 6-l(2)(g).
[130] *Id*. § 6-l(2)(k), (l).
[131] *Id*. § 6-l(2)(h).
[132] *Id*. § 6-l(2)(m).
[133] *Id*. § 6-l(2)(q).
[134] *Id*. § 6-l(2)(i).
[135] Lew Sichelman, *Predatory Lending Law Slowed Borrowing, Studies Say*, CHI. TRIB., Nov. 3, 2002, at F7.
[136] Roberto G. Quercia, et al., The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment 21-22 (June 25, 2003) (unpublished manuscript, on file with the Texas Law Review), *available at* http://www.kenan-flagler.unc.edu/ assets/documents/CC_NC_Anti_Predatory_Law_Impact.pdf (last

A study that reviewed 3.3 million subprime loans found that there was a reduction in subprime originations from 1999 to 2000, but that the reduction was due to a decline in the number of refinance originations which contain predatory terms.[137] Specifically, the number of loans with prepayment penalties extending for three years or more dropped 72% in North Carolina, while rising in neighboring states—by more than 260% in South Carolina.[138] Subprime refinance loans with balloon payments dropped 53% in North Carolina, compared with a national decline of only 15%.[139]

The study also found that the total volume of loans to North Carolina borrowers with impaired credit (credit scores below 580) actually increased 31% after the law was fully implemented, and subprime home purchase loans increased 43%.[140] These figures were comparable to those in surrounding states, which did not have anti-predatory lending laws.[141] Overall, the study concluded that, after the North Carolina law was fully implemented, the subprime market in North Carolina behaved essentially as the law intended.[142] There was a reduction of loans with predatory terms without restriction in access to or increase in the cost of loans to borrowers with blemished credit.[143]

D. *Federal Preemption?*

However, a state statute with expanding triggers and prohibitions, vague standards, and onerous penalties could make emergency credit more scarce and costly to those homeowners who need it most. It is possible that if a state's anti-predatory law is so harsh that it results in a drastic curtailment of lending in that state, the federal government could adopt an anti-predatory lending law that preempts state regulation.[144] Congress' power to preempt state law is derived from the Supremacy Clause of the

visited Jan. 15, 2005) (finding that the North Carolina Anti-Predatory Lending Law reduced the number of loans with predatory terms without inhibiting borrowers with blemished credit from obtaining loans).

137 *Id*. at 21.

138 *Id*. at 20.

139 *Id*.

140 *Id*. at 20.

141 *Id*. at 17-19.

142 *Id*. at 21-22.

143 *Id*.

144 Lampe, *supra* note 75, at 84-86. R

United States Constitution.[145] Congress may choose to take all regulatory authority over a certain subject matter, or it may share the field with the states.[146]

In 2003, United States Representative Bob Ney introduced the Responsible Lending Act (H.R. 833) that, if passed, "shall preempt any law" of any state or political subdivision that regulates any type of mortgage (not just "high-cost mortgages"), "irrespective of whether such law affords greater protection."[147] But, there is obvious opposition to such a preemption provision that would infringe on state's rights, restrict a state's choice to opt out, and possibly weaken existing federal law.[148]

The future of federal legislation is unclear, but it is evident that the actions of some states and municipalities in creating unrealistic laws that impact the availability of credit are viewed as an invitation to federal preemption.[149] Therefore, any new state legislation should be patterned after HOEPA with clear, realistic, and objective standards that do not unduly constrain mortgage lending.

III

Existing Lending Legislation in Oregon

As of January 16, 2004, Oregon had passed two laws that sought to protect consumers from making bad loans with unethical lenders.[150] In 2001, the Oregon Legislature enacted House Bill 2764, which established educational requirements that lenders must meet before dealing with borrowers who desire mortgage financing.[151] This law provided an exemption from education requirements for individuals who were licensed insur-

145 Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 152 (1982).

146 Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

147 Responsible Lending Act, H.R. 833, 108th Cong. § 104(a) (2003), *available at* http://www.butera-andrews.com/legislative-updates/directory/Federal/Congress/Bills/HR%20833.pdf (last visited Jan. 15, 2005).

148 *See, e.g*., Press Release, National Community Reinvestment Coalition, NCRC Opposes Ney's "Responsible Lending Act" as Providing Few Consumer Protections (Feb. 25, 2003), *at* http://www.ncrc.org/pressandpubs/press_releases/ Oppose_Ney/php (last visited Mar. 10, 2005).

149 *See* Lampe, *supra* note 75, at 84-86. **R**

150 2003 State and Local Predatory Lending Bill Score Card, *available at* http://www.butera-andrews.com/legislative-updates/directory/State/Legislature/ Bills/sbc/2003%20State%20Predatory%20Lending%20Bill%20Score%20Card.pdf (last visited Mar. 10, 2005).

151 2001 Or. Laws Ch. 952 § 4 (2001).

ance agents.[152] The exemption was included to deal with the insurance agents who may only write a small number of loans as part of their insurance business and, therefore, do not need the educational skills of a full time mortgage loan officer.[153] But after that law went into effect in January 2002, several instances arose in which people who were full-time loan originators avoided the Act's education requirements because they also had an insurance agent license.[154]

In 2003, House Bill 2682 was passed to enhance HB 2764, close the loophole, and protect consumers in two additional ways: (1) it compels full-time mortgage originators, who are also insurance agents, to abide by the education requirements of all other loan originators;[155] and (2) it requires mortgage loan originators to pass a criminal background check.[156] A criminal background check is important because the loan originator has access to the most personal of financial information. The legislation also requires that mortgage bankers and brokers "conduct a criminal records check of each individual the mortgage banker or mortgage broker employs or intends to employ as a loan originator."[157] Applicants for licensure must include with their application evidence that each loan originator has completed an entry-level training course,[158] passed an examination,[159] and for certain individuals, completed continuing education.[160] Therefore, the legislation prevents a mortgage banker or broker from employing an individual who has been convicted of a crime.[161]

Although these two laws improve a consumer's chance of dealing with a law-abiding lender, they fail to address the growing problem of how to prohibit unscrupulous lenders from using unethical and clearly abusive practices to prey on vulnerable citi-

152 *Id*. § 1(4)(e).

153 *Work Session on H.B. 2682 of the House Comm. on Bus., Lab. and Consumer Aff.*, 2003 Leg., 72nd Sess. (Or. 2003) (statement of John McCulley, Or. Ass'n of Mortgage Brokers) (Mar. 14, 2003), *minutes available at* http://arcweb.sos.state.or.us/archives/legislative/legislativeminutes/03/h/bus/HBLCA03142003.htm (last visited Mar. 10, 2005).

154 *Id*.

155 2003 Or. Laws ch. 526 § 2(1)(a).

156 *Id*. § 2(2)(d).

157 *Id*. § 3(1).

158 *Id*. § 4(4)(a)(A).

159 *Id*. § 4(4)(a)(B).

160 *Id*. § 4(4)(a)(B)(b).

161 Nat'l Ass'n of Mortgage Brokers, *Word From Washington* (Sept. 2003), *available at* http://www.lioninc.com/namb/washington (last visited Mar. 10, 2005).

zens. There is no mention in either HB 2764 or HB 2682 of how to handle home mortgage loans that included abusive asset-based lending, loan flipping, misleading omissions, prepayment penalties, and mandatory arbitration clauses. Thus, the existing Oregon and federal lending laws are inadequate to end the devastating social consequences of anti-predatory lenders.

IV

Existing Remedies and Possible Future Developments in Oregon

Unfortunately, ending predatory lending in Oregon will be difficult. Identifying predatory loans can be problematic because there is no full and comprehensive standard by which loans are defined as either predatory or equitable.[162] In addition, legitimate subprime lenders will probably be harmed by, and therefore oppose, any attempt to regulate predatory lenders.[163] Making overbroad legislation, because of a desire to create a comprehensive definition of predatory lending, could cause a chilling effect on the subprime market as it shuts out the very consumers that the legislation was seeking to protect.[164] Therefore, balancing the support of ethical subprime loans against the prevention of predatory loans results in a debate as to whether or not additional laws are needed to prevent predatory lending.

A. Are There Currently Existing Alternatives to Legislation Sufficient to Curb Predatory Lending Practices?

Essentially, neither the State of Oregon nor the federal government has sufficient laws to curb predatory lending. As a result, victims of predatory loans must currently rely on an assortment of statutes and common law rules, which were not intended to address the harm caused by predatory lenders. These remedies include: (1) market solutions; (2) antifraud acts;

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162 *See* Report of the Staff to Chairman Gramm, Comm. on Banking, Hous. & Urban Affairs, Predatory Lending Practices: Staff Analysis of Regulators' Responses (Aug. 23, 2000), *available at* http://banking.senate.gov/docs/reports/ predlend/predlend.htm (last visited Mar. 10, 2005).

163 *See Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Hous. and Urban Affairs*, 107th Cong. 378-79 (2001) (statement of George J. Wallace, Counsel for American Fin. Servs. Ass'n), *available at* 2001 WL 857934.

164 *See id*.

(3) contractual rules; (4) litigation; (5) consumer education; and (6) antidiscrimination laws.

1. Market Solutions

Some industry leaders have argued that the best way to protect both borrowers and the credit supply is to avoid further legislation and allow the market forces to prevent predatory lending.[165] In their view, if predatory lending generates profits that surpass the profits made by legitimate prime and subprime lending, legitimate lenders from those markets should enter and restore equilibrium in the predatory lending market.[166] Unfortunately, the market will not correct.

Legitimate lenders have specific standards and reputational concerns that keep them from entering the subprime market.[167] For example, most legitimate lenders are accountable to shareholders and regulators who are not willing to sustain lengthy losses.[168] Many of these legitimate lenders are also reputable institutional lenders who cannot disappear and reincorporate under another name.[169] In addition, the marketing strategies that legitimate subprime lenders would have to use to contact the typical victims of predatory lending would most likely conflict with the firm's business plans and culture.[170] Predatory lenders, on the other hand, have no problem using abusive tactics and can either file for bankruptcy, dissolve, or form a new predatory lending operation after suffering a loss.[171]

2. Antifraud Acts

Some groups suggest that certain existing legal remedies could be used to punish predatory lenders.[172] Using existing legal remedies would allow a resolution of the issue without encumbering

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165 *Predatory Lending Practices: Hearing Before the House Comm. on Banking and Finance*, 106th Cong. (2000) (testimony of Neill Fendly, President-Elect, National Association of Mortgage Brokers), *available at* http://financialservices.house.gov/banking/ 52400fen.htm (last visited Mar. 10, 2005).

166 *Id.*

167 *See* Engel & McCoy, *supra* note 7, at 1361.

168 *Id.*

169 *Id.*

170 *See id.* at 1360-61.

171 *Id.*

172 Press Release, The Business Council of New York State, Inc., Council Opposes Bill that Would Fundamentally Change Loans and Lending (Apr. 19, 2002), *at* http://www.bcnys.org/whatsnew/2002/0322lend.htm (last visited Mar. 10, 2005).

the already highly regulated lending industry with further regulations. Obviously, in cases of actual fraud, either criminal or civil remedies can be pursued. Common law fraud, however, does not cover manipulation or misleading omissions.[173] Therefore, Congress, and all of the states, have passed unfair-and-deceptive-acts-and-practices (UDAP) statutes,[174] which prohibit unfair practices affecting lawful trade or commerce.[175] The federal act gives enforcement of the statute to the Federal Trade Commission (FTC), but does not offer a private right of action.[176]

Recently, the FTC has filed several enforcement actions targeting predatory lending and alleging unfair and deceptive practices under the Federal Trade Commission Act (FTCA).[177] A few of those actions against predatory lenders have provided borrowers with partial relief.[178] However, due to the absence of a private cause of action and political influences, private relief under the FTCA is unlikely for most borrowers.

3. *Contractual Rules*

Even without fraud, certain contractual rules such as unconscionability might invalidate predatory provisions in a loan, even though most contract defenses go to defects in formation of assent and not to disparities in bargaining power.[179] Accordingly, the non-English speaking consumer can point to the bargain's unfair formation and terms that occurred because the lender took advantage of the consumer's inability to comprehend the English language contract.[180] The unconscionability principle is stated in the Uniform Commercial Code (UCC):

> If the court as a matter of law finds the contract or any clause

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[173] *See, e.g.*, RESTATEMENT (SECOND) OF TORTS §§ 525, 537-45 (1977).

[174] *See generally* JONATHAN SHELDON & CAROLYN L. CARTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 1.1 (4th ed. 1997 & Supp. 2000).

[175] *See* Federal Trade Commission Act, 15 U.S.C. § 45(a)(2) (2000).

[176] *See* SHELDON & CARTER, *supra* note 175, § 9.1 & n.2. **R**

[177] Federal Trade Commission, List of Law Enforcement Actions, *available at* http://www.ftc.gov/opa/1999/02/chart2.htm (last visited Jan. 15, 2005).

[178] *See* In re Fleet Fin., Inc., 128 F.T.C. 479 (1999) (approving a $1.3 million settlement for consumer redress and injunctive relief, based on charges that Fleet's failure to provide accurate, timely disclosure of the costs and terms of home-equity loans to consumers and cancellation rights violated section 5 of the Federal Trade Commission Act).

[179] *See generally* E. ALLAN FARNSWORTH, CONTRACTS § 4.28, chs. 4-5, 9 (2d ed. 1990).

[180] Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027, 1040-41 (1996).

> of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause so as to avoid any unconscionable result.[181]

This section applies to "transactions in goods" and not to credit, but many courts have recognized the unconscionability doctrine in non-UCC contract situations.[182]

Unconscionability has been defined as "an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."[183] But, many courts have been unwilling to find excessive prices to be unconscionable, "without more."[184] Courts usually require a showing of both procedural and substantive unfairness.[185] Courts also have legitimate apprehensions about their ability to determine whether a particular price is reasonable. Therefore, borrowers who have alleged unconscionable lending practices have prevailed only with respect to nonprice terms.[186]

4. Litigation

Due to the recent wave of successful litigation against large institutions that may have engaged in predatory practices, the belief that current law will permit prosecution of predatory lenders has gained support.[187] Some scholars, however, suggest that more legislation is still needed because large institutions are not the main cause of the problem.[188] Rather, they blame a small number of unscrupulous lenders who are specially geared toward maximizing profits through abusive loans.[189] If a smaller group of specialists is the source of the problem, large sweeping prosecutions will not be sufficient.[190] In fact, such prosecutions might

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181 U.C.C. § 2-302(1) (1998).

182 FARNSWORTH, *supra* note 180, § 4.28. **R**

183 Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965).

184 *See* FARNSWORTH, *supra* note 180, § 4.28. **R**

185 Bender, *supra* note 181, at 1040. **R**

186 *See, e.g.*, *Williams*, 350 F.2d at 450.

187 For example, Household International Inc. recently proposed a $484 million settlement to end prosecutions from a group of states. Cassell Bryan-Low & Joseph T. Hallinan, *What's Behind the Big Charge? Take a Look at Household*, WALL ST. J., Oct. 23, 2002, at C1.

188 *See* Engel & McCoy, *supra* note 7, at 1289-96.

189 *See id*. at 1282-84.

190 A victory against predatory lending may not be helpful since these lenders are usually not sufficiently capitalized to pay their judgment. *See id*. at 1290.

actually worsen the problem by sending uneducated borrowers away from slightly abusive, legitimate institutions, and into the grasp of lenders whose total aim is to take the victims' money.[191] Therefore, even if present law has proven successful against larger lenders, it is still not clear how useful it will be in combating the problem as a whole.

5. *Consumer Education*

Consumer education is another possible solution to the problem of predatory lending. Educational initiatives attempt to control predatory lending by improving consumers' lending knowledge.[192] The initiatives are designed to help consumers gain a clearer understanding of their rights and obligations under the terms of the loan.[193] The idea behind educational initiatives is that when consumers have a better understanding of what they are signing, they can better negotiate equitable terms, or at least understand their other options, and can then walk away if the proffered terms are unfair.[194] Educational initiatives have another benefit of being less harsh on the actual loan process than rules or standards. This allows consumers to decide for themselves whether the offered terms are acceptable.[195]

Consumer education should be available for those borrowers who want to be well-informed. Education, however, is not sufficient to end predatory lending either. The initial challenge for any educational campaign is finding the potential victim.[196] But even if a victim is found, there is no guarantee that she will understand the information or be able to use it when a predatory lender comes knocking on the door.[197]

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[191] For example, a borrower might turn to a loan shark who does not act within a legal framework.

[192] One way to do this is to require counseling before a high-cost loan is made. *See* GA. CODE ANN. § 7-6A-5(7) (2003).

[193] *See, e.g.*, 15 U.S.C. § 1639 (a)(1)(A) (2000).

[194] *See* AARP, *Avoiding Predatory Lenders*, *at* http://www.aarp.org/money/consumerprotection/financinghomes/Articles/a2002-09-16-ConsumerAdvocacyHomeLoans.html (last visited Jan. 15, 2005).

[195] *Id*.

[196] *Cf*. ABDIGHANI HIRAD & PETER M. ZORN, A LITTLE KNOWLEDGE IS A GOOD THING: EMPIRICAL EVIDENCE OF THE EFFECTIVENESS OF PRE-PURCHASE HOMEOWNERSHIP COUNSELING 1, 18 (2001) (stating that "telephone counseling had no demonstrable effectiveness in reducing delinquency rates"), *available at* http://www.chicagofed.org/cedric/files/2003_conf_paper_session1_zorn.pdf (last visited Mar. 10, 2005).

[197] *Id*.

6. Antidiscrimination Laws

Other suggestions, based on civil rights themes, are novel, but typically stretch far beyond existing jurisprudence of those laws.[198] As previously discussed, predatory lenders target members of protected minority groups and the result is a disparate impact on those people.[199] Therefore, some victims of predatory lending may have claims for disparate treatment,[200] disparate impact,[201] or "pattern and practice"[202] claims under the Equal Credit Opportunity Act (ECOA) or the Fair Housing Act (FHA).[203] The ECOA forbids lenders from discriminating in mortgage and credit transactions by race, color, religion, national origin, sex, marital status, age, or receipt of public assistance.[204] The FHA prohibits discrimination in the financing of residential real estate based on race, color, religion, national origin, sex, handicap, or familial status.[205]

Even though both statutes permit private damages actions,[206] very few victims of lending discrimination have brought claims under these statutes.[207] One reason for this is that many loan applicants cannot recognize lending discrimination because they are unaware of the factors contributing to the lenders' decision.[208] Even when borrowers realize that they have been discriminated against, they may not understand that the lenders'

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198 *See* Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly*, 10 B.U. PUB. INT. L.J. 1, 28-29 (2000).

199 *See supra* Part I.B.

200 *See* Ronald K. Shuster, *Lending Discrimination: Is the Secondary Market Helping to Make the "American Dream" a Reality?*, 36 GONZ. L. REV. 153, 163-66 (2001).

201 *Id*. at 166-68.

202 *See* Peter P. Swire, *The Persistent Problem of Lending Discrimination: A Law and Economics Analysis*, 73 TEX. L. REV. 787, 832 (1995) (proposing the use of testing to detect patterns of discrimination).

203 *Cf*. Timothy C. Lambert, *Fair Marketing: Challenging Pre-Application Lending Practices*, 87 GEO. L.J. 2181, 2196-2203 (1999) (suggesting the option of bringing a marketing discrimination claim under federal law).

204 15 U.S.C. § 1691(a) (2000).

205 42 U.S.C. § 3605 (2000).

206 15 U.S.C. § 1691e (2000).

207 *See, e.g*., Stephen M. Dane, *Eliminating the Labyrinth: A Proposal to Simplify Federal Mortgage Lending Discrimination Laws*, 26 U. MICH. J.L. REFORM 527, 549 (1993) (noting that there has not yet been much private or public litigation under ECOA).

208 *See* Michele L. Johnson, Note, *Your Loan is Denied, But What About Your Lending Discrimination Suit?:* Latimore v. Citibank Federal Savings Bank, 151 F.3d 712 (7th Cir. 1998), 68 U. CIN. L. REV. 185, 215 (1999).

tactics were unlawful under the FHA or ECOA. Loan information regarding how other applicants were treated could assist victims in establishing discriminatory treatment, but such information is complicated and costly to formulate.[209]

The Department of Justice (DOJ), in 1992, brought its first "pattern or practice" lawsuit under ECOA, claiming racial discrimination against Decatur Federal Savings and Loan.[210] The action resulted in a consent decree in which Decatur agreed to pay $1 million in loans to formerly rejected black applicants.[211] As a result, the DOJ has prosecuted a number of similar cases alleging lending discrimination,[212] but its ability to prosecute more cases is "hampered by staff shortages, the costly, time-consuming nature of compiling proof of discrimination and inevitable shifts in political winds."[213] Moreover, proving every element necessary for a civil rights suit is a rather circuitous and cumbersome method of establishing that a loan was unfair.[214]

Thus, while some feel that predatory lending can be stopped without major legislative changes, others disagree and suggest that direct and effective legislation is needed. Much recent legislative activity seems to indicate that improvements in borrower protection are essential to the goal of protecting vulnerable consumers.[215] All along, however, the goal of protecting consumers, while protecting the credit infrastructure that they depend on, is still at the forefront of the debate.[216]

B. More Legislation?

An effective solution must be one that reduces predatory lend-

209 *See* Dane, *supra* note 208, at 544. **R**

210 Anthony D. Taibi, *Banking, Finance, and Community Economic Empowerment: Structural Economic Theory, Procedural Civil Rights, and Substantive Racial Justice*, 107 HARV. L. REV. 1463, 1477 & n.53 (1994).

211 *Id*.

212 *See, e.g.*, Willy E. Rice, *Race, Gender, "Redlining," and the Discriminatory Access to Loans, Credit, and Insurance: An Historical and Empirical Analysis of Consumers Who Sued Lenders and Insurers in Federal and State Courts, 1950-1995*, 33 SAN DIEGO L. REV. 583, 640-42 (1996).

213 Engel & McCoy, *supra* note 8, at 1317. **R**

214 For example, discriminatory intent or impact must be shown before a fair housing violation will be found. Arlene S. Kanter, *A Home of One's Own: The Fair Housing Amendments Act of 1988 and Housing Discrimination Against People With Mental Disabilities*, 43 AM. U. L. REV. 925, 979-80 n.325 (1994).

215 *See supra* Parts II.A-B.

216 Joseph A. Smith, Jr., *The Federal Banking Agencies' Guidance on Subprime Lending: Regulation with a Divided Mind*, 6 N.C. BANKING INST. 73, 107-09 (2002).

ing without having too great an impact on the subprime lending market. Because current Oregon and federal laws, as well any alternative remedies that do not involve more legislation, seem to fail this balancing test by insufficiently protecting the borrower, more legislation is the answer. But the additional legislation must be realistic. It needs to have objective, clear, and comprehensible rules that can afford borrowers significant protections while still preserving the credit infrastructure.

In 2003, Oregon Representative Carolyn Tomei proposed Oregon's first anti-predatory law, House Bill 3088.[217] It was based on New York's most recent anti-predatory lending law and would have made it possible for the Oregon Department of Justice to prosecute illegal predatory lending practices in all open-ended credit plans.[218] House Bill 3088 stated that: (1) lenders could not accelerate or increase payments on high-cost loans at their own discretion or increase interest rates after a high-cost loan is defaulted; (2) if the loan is a refinance loan, lenders could not schedule payments more than twice the size of the previous payments, or encourage the borrower to default on the current loan; (3) lenders could not charge fees for making changes to a high-cost loan, charge fees outside their normal fee schedule, or include fees over 3% of the principal amount; (4) predatory lenders could not mandate unfair arbitration, participate in loan flipping, or make high-cost loans without regard to the borrower's ability to repay; (5) a lender under a high-cost loan could not make direct payment to a contractor under a home improvement loan; and (6) lenders would have to disclose a high-cost loan to the borrower and provide a list of state-approved credit counselors to the borrower before a high-cost loan could be made.[219]

However, House Bill 3088 failed to pass. Oregon legislators most likely feared that their efforts to curb predatory practices would have actually restricted credit access to the high-risk borrowers that they intended to protect.[220] New York's law, after which the Oregon bill was modeled, has been considered one of the most problematic for both borrowers and lenders because it significantly exceeds the coverage of other state laws and in-

[217] *Hearing on H.B. 3088*, *supra* note 2 (statement of Rep. Carolyn Tomei).
[218] *Id.*
[219] *Id.*
[220] *Id.* (statement of Jim Markee).

cludes prohibitions and limitations on loan terms that go well beyond the federal HOEPA.[221] It was not a good model for Oregon's first anti-predatory lending law to follow.

Instead, Oregon's next legislation should take a lighter, more reasonable approach that tracks both HOEPA and Florida's Fair Lending Act, and should implement the following reforms:

> Cover home mortgage lending, reverse mortgage lending, and open-ended transactions secured by real estate.
> Create a homeowner protection unit in the Attorney General's Office and establish a new homeowner's education program in the Department of Commerce.
> Limit balloon payments, call provisions, and negative amortization in high-cost home loans.
> Limit prepayment penalties for the first three years of the loan, increased interest rates after a default, and improper payments to home improvement contractors.
> Limit fees to modify, renew, extend or amend high-cost home loans.
> Prohibit flipping of home loans, in which refinancing worsens the borrower's financial position.
> Require homeownership counseling for borrowers who seek high-cost loans.

This is not a comprehensive list. It is intended to illustrate how public policy should respond to the pervasive abuses occurring in the marketplace that cannot be addressed solely through improved disclosure or more extensive financial literacy counseling. The goal, therefore, is to create a system in which loans are appropriately and affordably priced, and meet housing needs as well as urgent consumer needs such as financing a medical emergency. Even Oregon lenders and merchants would likely support such a bill if it mirrored the reasonable Florida law and had fewer teeth than an alternate proposal.

Conclusion

Addressing predatory lending requires a balanced response. Subprime lending has many desirable aspects, and Oregon should not adopt draconian policies that extinguish or greatly curtail legitimate subprime business. At the same time, the state must propose a solution to lending abuses. Combating such abuses calls for a comprehensive, multi-dimensional strategy that employs realistic anti-predatory legislation and consumer education. Therefore, the best way to protect both subprime borrow-

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[221] *See* Lampe, *supra* note 75, at 81-82. R

ers and subprime lenders is to create a system of clear and comprehensible rules that also affords significant protections without constraining mortgage lending.