STATE ANTI-PREDATORY LENDING UPDATE &

PREDICTIONS FOR FUTURE STATE ACTION

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PRESENTED AT THE "FAIR LENDING TODAY" CONFERENCE, FAIRMONT HOTEL, WASHINGTON DC (APRIL 23, 2009)

MORTGAGE LENDING IS HIGHLY REGULATED AND MANY OF THE SPEAKERS TODAY HAVE DISCUSSED THE EXTENSIVE MENU OF LAWS AND RULES APPLICABLE TO MORTGAGE LENDING. AGAINST THAT BACKGROUND, IT IS STILL FAIR TO ASK: "IF THERE ARE SO MANY FEDERAL AND STATE ANTI-PREDATORY LENDING (APL) LAWS AND CONSUMER PROTECTION LAWS, WHY DOES PREDATORY LENDING (PL) CONTINUE? WHY AREN'T 10-20 YEARS WORTH OF LAWS MORE EFFECTIVE IN PREVENTING ABUSES AND REDUCING THE INCIDENCE OF FORECLOSURES FACING SUBPRIME BORROWERS? AND IN KEEPING WITH TODAY'S "FAIR LENDING" FOCUS, WHY ARE NON-WHITE SUBPRIME (SP) BORROWERS SO MUCH MORE IMPACTED BY THE MORTGAGE CRISIS THAN THEIR WHITE COUNTERPARTS WHEN STATISTICS SHOW THAT THE MAJORITY OF SP LOANS ARE MADE TO WHITE BORROWERS?[1]

TO ANSWER THESE QUESTIONS IS IN PART TO INDICT THE STATES FOR THE ROLE THEY HAVE PLAYED IN ADDRESSING SP OR SO-CALLED HIGH-RATE LENDING. STATES HAVE, FOR THE MOST PART, ADOPTED A "TEMPLATE" APL LAW, TYPICALLY BASED ON NORTH CAROLINA'S 1999 ACT, WITHOUT MUCH REGARD

[1] "Politics and the Subprime Mortgage Meltdown," by Maurice Jourdain-Earl, ComplianceTech, Executive Summary, p. 1. "Non-Hispanic whites have more subprime rate loans than all the minority groups combined." (2006 data). (Hereafter, "Jourdain-Earl.")

TO ITS BENEFITS TO SP BORROWERS, AND WITHOUT MUCH APPARENT ANALYSIS OF THE EFFECTS OF THESE LAWS.

MOREOVER, THE STATES DO NOT HAVE AUTHORITY OR RESOURCES TO ENFORCE THEIR APL LAWS IN MANY CASES. FINALLY, NO AMOUNT OF LAW HAS EVER PROVEN COMPLETELY EFFECTIVE IN PREVENTING FRAUD AND DECEPTION, ROOT CAUSES OF MANY PREDATORY PRACTICES.

35 STATES HAVE ADOPTED APL LAWS IN THE LAST DECADE. MANY AGs HAVE ADOPTED APL REGULATIONS. ALMOST ALL THE STATE BANKING DEPARTMENTS HAVE SUPPLEMENTED THEIR APL STATUTES WITH RULES AND REGULATIONS AND SOME HAVE DRAFTED APPROVED FORMS OF DISCLOSURE FOR SUBPRIME BORROWERS.

WHILE NOT UNIFORM FROM STATE TO STATE, MOST OF THESE APL LAWS HAVE A LOT IN COMMON. THEY USUALLY PROHIBIT OR RESTRICT CERTAIN LOAN TERMS IF THE LOAN INTEREST RATE OR COSTS EXCEED SPECIFIED THRESHOLDS. OFTEN, HOEPA HIGH-COST RATE AND FEE THRESHOLDS ARE USED IN THE STATE LAWS, BUT SOME STATES HAVE LOWER THRESHOLDS. THE LOAN TERMS MOST LIKELY TO BE RESTRICTED ARE PREPAYMENT PENALTIES, POST-DEFAULT INTEREST RATE INCREASES, FINANCING SINGLE PREMIUM CREDIT INSURANCE, AND BALLOON PAYMENTS AND NEGATIVE AMORTIZATION. SOMETIMES, REFINANCING WITHIN A CERTAIN TIME PERIOD IS PROHIBITED UNLESS THERE IS A TANGIBLE BENEFIT TO THE BORROWER.

IN THEIR RUSH TO ADOPT APL LAWS, STATE LEGISLATORS HAVE NOT DIGESTED SOME WELL PUBLICIZED FACTS. TAKE TWO EXAMPLES FROM THE 2004 REPORT OF THE GENERAL ACCOUNTING OFFICE (GAO) CALLED "FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING."[2] THE 2004 GAO REPORT NOTES THAT THE FORECLOSURE RATE FOR SUBPRIME LOANS WAS MORE THAN 10 TIMES THE FORECLOSURE RATE FOR PRIME RATE LOANS IN 1998 AND 1999. AND THIS WAS **BEFORE** THE REAL UPSWING IN SUBPRIME LENDING, WHICH TOOK OFF AFTER FANNIE MAE STARTED BUYING SUBPRIME LOANS IN 1999!

WITH THAT BACKGROUND, IT SHOULD NOT HAVE BEEN DIFFICULT TO PREDICT THAT EVENTUALLY, SKYROCKETING LEVELS OF SP LOANS WOULD LEAD TO SKYROCKETING FORECLOSURES. AND THAT WITH A BLACK "SUBPRIME INCIDENCE DISPARITY" OF ABOUT 3 EVEN IN THE EARLY APL-ADOPTING STATE OF NORTH CAROLINA, THE EVENTUAL FORECLOSURE RATIO OF SP LOANS MADE TO BLACK BORROWERS WOULD BE VERY HIGH INDEED.[3]

DESPITE THE PUBLISHED DATA, STATE LEGISLATORS DID NOT PREDICT THE FORECLOSURE CRISIS AND CONSEQUENTLY DID NOT INCLUDE FORECLOSURE PROTECTION PROVISIONS IN THEIR APL LAWS. THEY ARE DOING SO NOW, WHICH I WILL DISCUSS IN A MOMENT.

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[2] Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending," GAO-04-280 (January 2004) by David G. Wood.

[3] Jourdain-Earl describes the "subprime disparity index" (SDI) as the higher incidence of SP rate loans to blacks and Hispanics compared to non-Hispanic whites. (Jourdain-Earl, p. 4.) So a subprime incidence disparity of 3 means triple the frequency of subprime rate lending to a minority group than to whites. The average SDI for NC in 2006 was 2.90 (Jourdain-Earl, "Black Subprime Disparity Index by Congressional Districts," Chart, p. 9.)

SECOND, EVEN THOUGH THE GAO PL REPORT EMPHASIZES THAT CONSUMER DISCLOSURES ABOUT PL AND HIGH COST LOANS (INCLUDING DISCLOSURES ABOUT HOMEBUYER COUNSELING) ARE LARGELY INEFFECTIVE IN PREVENTING PL, THE VAST MAJORITY OF STATE APL LAWS MANDATE EXTENSIVE DISCLOSURES AND COUNSELING. APL LAWS ARE LOADED WITH DISCLOSURE AND COUNSELING REQUIREMENTS THAT INCREASE COSTS (AND NON-COMPLIANCE RISKS) FOR LENDERS DESPITE BEING OF QUESTIONABLE VALUE TO BORROWERS.

STATE APL LAWS HAVE OTHER LIMITATIONS. THEY DON'T APPLY TO SP LOANS MADE BY BANKS OR THEIR SUBSIDIAIRES BECAUSE OF FEDERAL PREEEMPTION AND THE EXCLUSIVE SUPERVISORY AUTHORITY OF THE BANKING AGENCIES. MOREOVER, MANY STATES LACK THE FINANCIAL AND HUMAN RESOURCES TO ENFORCE THEIR APL LAWS. RESOURCE CONSTRAINTS ARE INCREASING JUST AS THE NEED FOR ENFORCEMENT IS PEAKING. WITH FEWER LENDERS PAYING FEES TO STATE AGENCIES, THE AGENCIES CAN AFFORD TO PURSUE ONLY THE MOST EGREGIOUS VIOLATIONS. WHICH LEADS BACK TO THE CRIMINALS AND FRAUDSTERS. LIMITED ENFORCEMENT BUDGETS AND LACK OF TRAINED INVESTIGATORS CREATE OPPORTUNITIES FOR FRAUD, THEFT AND DECPTION. AS RECENT FINANCIAL DEVELOPMENTS DEMONSTRATE, TALENTED CON MEN CAN FLY BELOW THE RADAR FOR A LONG TIME.

PUTTING TOGETHER STATE APL LAWS WITH LIMITED VALUE TO BORROWERS, LEGISLATIVE FAILURE TO USE KNOWN DATA TO PREDICT DEFAULT AND FORECLOSURE RATES FOR MINORITY BORROWERS, FEDERAL PREEMPTION PRINCIPLES THAT MAKE STATE APL LAWS INAPPLICABLE TO MANY LENDERS,

BUDGET-CONSTRAINED ENFORCEMENT TOOLS AND A FEW DISHONEST LOAN ORIGINATORS RESULTS IN A LANDSCAPE OF UNSUCCESSFUL STATE EFFORTS TO REGULATE PL.

STATES ARE NOW HARD AT WORK ENHANCING THEIR APL LAWS. THE NEW LAWS VARY FROM THE OLD ONES PRIMARILY IN THAT THEY DEAL WITH FORECLOSURE RESCUE AND NOT WITH ORIGINATION FEATURES. NEW JERSEY'S 2008 MORTGAGE STABILIZATION AND RELIEF ACT IS AN EXAMPLE.[4] IT GIVES BORROWERS A 6-MONTH FORECLOSURE FORBEARANCE PERIOD, DURING WHICH THE BORROWER CAN PURSUE A LOAN MODIFICATION OR OTHER TYPE OF WORKOUT. OTHER STATES HAVE ADOPTED TEMPORARY FORECLOSURE MORATORIUMS. NEW YORK ADOPTED A SUBPRIME LENDING REFORM BILL[5] WITH SEVERAL ELEMENTS ON FORECLOSURE, INCLUDING A 90-DAY NOTICE OF INTENT TO FORECLOSE WITH AT LEAST 5 HOUSING COUNSELORS IDENTIFIED IN THE NOTICE, A MANDATORY SETTLEMENT CONFERENCE BETWEEN THE LENDER AND BORROWER WHOSE HOME IS BEING FORECLOSED, RESTRICTIONS ON OPERATORS OF FORECLOSURE RESCUE SERVICES, AND NEW STANDARDS FOR UNDERWRITING SUBPRIME LOANS.

WHETHER THESE LAWS WILL WORK REMAINS TO BE SEEN, BUT THE NEW REALITY IS THAT STATES ARE TURNING THEIR ATTENTION AWAY FROM RESTRICTIONS ON SP LOAN TERMS AND TOWARD RESTRICTIONS ON FORECLOSURE OF SB LOANS. THE SENSE SEEMS TO BE THAT IF A BAD LOAN SOMEHOW GOT MADE, PERHAPS A NEW FORECLOSURE RELIEF LAW CAN DELAY THE EVENTUAL DAY OF RECKONING.

[4] S.B. 1599, N.J. Laws 2008, Ch. 127.
[5] N.Y. Ch. 472 (Laws 2008).

THE CLIMATE IN THE STATE HOUSES AND AGENCIES SEEMS ALMOST TO SUGGEST THAT A SP LOAN IN FORECLOSURE MUST HAVE BEEN SUSPECT FROM THE START. THERE IS A SIMMERING SUSPICION, FUELED BY THE PRESS, THAT BEHIND EVERY FILED FORECLOSURE IS A PREDATORY LENDER WHOSE EXECUTIVES ARE LIVING LARGE WITH MULTI-MILLION DOLLAR BONUSES. PUBLIC AND POLITICAL UNEASE IS THE PERFECT STORM THAT WILL DRIVE THE ADOPTION OF MORE AND MORE NON-UNIFORM STATE LAWS TO REGULATE THE MORTGAGE BUSINESS.

LET ME ALSO POINT OUT HERE THAT THE TERMS OF SP LOANS SHOULD NOT HAVE COME AS A SURPRISE TO STATE BANKING EXAMINERS. EVERY STATE THAT LICENSES LENDERS CONDUCTS PERIODIC EXAMS AT WHICH LOAN FILES ARE REVIEWED. APPARENTLY THE EXAMINERS NEVER DISCOVERED THE $50K-A-MONTH HAIRDRESSERS REFERRED TO EARLIER TODAY BY BEN KLUBES, EVEN THOUGH THEY'VE HAD NUMEROUS OPPORTUNITIES TO SEE THEIR LOAN FILES.

NOT EVERYONE IS WAITING FOR STATE GOVERNMENT TO SOLVE THE SP LOAN CRISIS. BORROWERS AND THEIR COUNSEL, AND SOME STATE AGs ARE NOT WAITING FOR NEW LAWS TO RELIEVE THE SP MESS. THEY ARE FILING LAWSUITS, ALLEGING PREDATORY LENDING AS A DEFENSE TO VALIDITY OF THE LOANS, OR TO THEIR FORECLOSURE. THE MASSACHUSETTS ATTORNEY GENERAL'S FREMONT CASE WAS ALREADY DISCUSSED TODAY. FREMONT'S SUBPRIME LOANS IN MASSACHUSETTS ACCOUNTED FOR BETWEEN 50-60% OF ITS LOANS AND THE FORECLOSURE RATE ON THESE LOANS WAS ABOUT 20%. THE COURTS DETERMINED THAT THE FREMONT LOANS WERE "DOOMED TO FAIL" BECAUSE THEY CONTAINED 4 FEATURES THAT, TAKEN TOGETHER, SHOULD HAVE MADE IT

APPARENT TO THE LENDER THAT THERE WAS NO LIKELIHOOD OF REPAYMENT. THESE FEATURES INCLUDE LOW INTRODUCTORY TEASER RATES, FAILURE TO CALCULATE WHETHER THE PAYMENT WAS MORE THAN 50% OF THE BORROWER'S INCOME BASED ON THE FULLY INDEXED RATE, A LOAN TO VALUE RATIO OF 100%, OR A SUBSTANTIAL PREPAYMENT PENALTY. ALTHOUGH THESE TERMS WERE NOT PROHIBITED BY MASSACHUSETTS LAW WHEN THE LOANS WERE MADE, THE COURTS IN MASSACHUSETTS FOUND THEM CUMULATIVELY "UNFAIR" AND A VIOLATION OF THE STATE'S UNFAIR PRACTICES LAWS.[6]

IN A NEW JERSEY CASE DECIDED IN MAY 2008, THE FORMER OWNERS OF A HOME MOVED TO VACATE THE DEFAULT JUDGMENT ENTERED IN AN EJECTMENT ACTION AFTER THE FORECLOSURE WAS COMPLETED. THE JUDGE FOUND THAT THE FORECLOSURE OF A HOME WORTH OVER $400k FOR A DEBT OF ABOUT $145k WAS A "GRAVE INJUSTICE." THE LOAN WAS SIMPLY A MISMATCH BETWEEN THE NEEDS AND CAPACITY OF THE BORROWER, AN ELDERLY WOMAN WHO HAD LIVED IN THE HOUSE FOR MORE THAN 40 YEARS. THE TERMS OF HER LOAN WERE FOUND TO BE SO DISADVANTAGEOUS THAT THERE WAS LITTLE LIKELIHOOD OF REPAYMENT. THE COURT VACATED THE JUDGMENT, NOTING THE BORROWER "MAY HAVE BEEN THE VICTIM" OF PREDATORY LENDING PRACTICES.[7]

WHAT IS EVIDENT NOW, IN THE MIDDLE OF THE SUBPRIME CRISIS, IS THAT THE STATES' ATTENTION HAS MOVED FROM WHAT TERMS ARE PERMITTED IN HIGH-COST LOANS, TO WHAT TERMS ARE *FAIR AND JUST*. A FEW SHORT YEARS AGO, STATE APL LAWS WERE FOCUSED ON WHAT TERMS COULD AND COULD NOT BE

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[6] *Commonwealth v. Fremont Investment & Loan*, 897 NE 2d 548 (Mass. 12/9/08).
[7] *Nowosleska v. Steele*, 946 A.2d 1097 (N.J. Super. 5/19/08).

INCLUDED IN HOME LOANS, AND WHAT LANGUAGE SHOULD BE USED FOR CONSUMER DISCLOSURES. ALL THAT SEEMS ANCIENT HISTORY NOW – WHAT STATES ARE DOING NOW IS ATTEMPTING TO STEM THE TIDE OF FORECLOSURES OF THESE HIGH-COST LOANS, FORECLOSURES THAT COULD EASILY HAVE BEEN PREDICTED BASED ON THE GOVERNMENT'S OWN STUDIES OF SUBPRIME LOANS GOING BACK 10 YEARS.

THE RISK AND UNCERTAINTY FOR MORTGAGE LENDERS AT THIS POINT IS HOW FAR THE STATES WILL GO WITH LEGISLATION TO BLOCK FORECLOSURES. IF THE SECURITY PROPERTY PLEDGED FOR THE LOAN CANNOT BE RECOVERED, THE TRADITIONAL STRUCTURE OF SECURED LENDING IS CALLED INTO QUESTION. ONE LAST CASE EXAMPLE ILLUSTRATES.

TWO MONTHS AGO, A NEW YORK COURT DENIED LASALLE BANK THE RIGHT TO FORECLOSE A HOME LOAN BASED ON THE BORROWER'S CLAIM OF PL.[8] BECAUSE THE BORROWER HAD NO MONEY FOR A DOWN PAYMENT, THE LENDER OFFERED AN 80/20 FIRST/SECOND MORTGAGE. THE BORROWERS FINANCED ALL THEIR CLOSING COSTS BY INCREASING THE CONTRACT SALES PRICE BY THE AMOUNT OF THE CLOSING COSTS. EVEN THOUGH SOME CLOSING COSTS WERE OF THE TYPE THAT WOULD BE EXCLUDED FROM THE FINANCE CHARGE, THE COURT CONCOCTED A TORTURED EXPLANATION FOR INCLUDING THEM IN THE FINANCE CHARGE.

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[8] *LaSalle Bank v. Searon*, --- NYS2d ---, 2009 WL 323294 (N.Y. Sup. 2009), 2009 NY Slip Op. 29055 (2/9/09).

THE GIST OF ITS JUSTIFICATION FOR INCLUDING REAL ESTATE TAX ESCROWS IN THE FINANCE CHARGE WAS THAT SINCE THE ESCROWS WERE FINANCED AT CLOSING, THE LOAN AMOUNT WAS HIGHER THAN IT WOULD HAVE BEEN IF THE ESCROWS WEREN'T FINANCED. THE LENDER THEREFORE EARNED MORE INTEREST BECAUSE OF THE HIGHER LOAN AMOUNT. THE COURT HELD THE LENDER BENEFITTED FROM THE FINANCING OF THE CLOSING COSTS, AND THEM MOVED SOME OF THEM, INTO THE ITEMS INCLUDIBLE IN THE FINANCE CHARGE. WHEN CALCULATED THIS WAY, THE TOTAL FINANCE CHARGE ON A $285K FIRST MORTGAGE EXCEEDED THE POINTS-AND-FEE THRESHOLD UNDER NEW YORK'S HIGH COST LOAN LAW BY $4.83. THIS VIOLATION OF THE FEE LIMIT OF THE HIGH COST LOAN LAW CAUSED THE COURT TO DENY THE LENDER ANY RIGHT TO FORECLOSE.

HERE IS THE REAL THREAT TO LENDERS: COURTS MAY BEGIN TO REGULARLY REFORM LOANS BASED ON CURRENT PERCEPTIONS OF WHAT IS *FAIR AND JUST*, AND NOT BASED UPON WHAT TERMS WERE LAWFUL WHEN THE LOANS WERE MADE. COURTS MAY ALSO BE TEMPTED TO HOLD UP FORECLOSURES UNTIL THE ECONOMIC AND SUBPRIME CRISIS APPEARS TO BE UNDER CONTROL. IF THAT HAPPENS, THEN LENDERS WILL HAVE GOOD CAUSE TO DOUBT THAT THEY HAVE PREDICTABLE SECURITY FOR THEIR LOANS AT ALL, AND ALL THE TARP FUNDS IN THE WORLD MAY THEN NOT BE ENOUGH TO MAKE LENDERS REOPEN THE FLOW OF MORTGAGE CREDIT NECESSARY FOR A HEALTHY AND VIBRANT HOME MORTGAGE INDUSTRY.