

A ROUND PEG FOR A SQUARE HOLE: THE MISMATCH BETWEEN SUBPRIME BORROWERS AND FEDERAL MORTGAGE REMEDIES

Arielle L. Katzman*

INTRODUCTION

Beginning in late 2006 and early 2007, the \$1.3 trillion U.S. subprime mortgage market¹ began to implode as subprime borrowers defaulted on their mortgages.² The ramifications of subprime default became magnified through more complex financial products tied to the income stream represented by the subprime mortgages.³ Media coverage emphasizes this macroscopic perspective of the fallout,⁴ but often neglects the plight of defaulting homeowners who personify the origin of the 2008 financial crisis.⁵ Nevertheless, a thorough resolution of the current crisis must effectively address the underlying predicament of subprime borrowers, not just the predicament of investors of the more creative financial instruments. Although the crisis has largely decimated the subprime industry,⁶ the importance of subprime

* Articles Editor, *Cardozo Law Review*. J.D. Candidate (May 2010), Benjamin N. Cardozo School of Law; B.A., Brandeis University, 2007. I express appreciation to Professor Stewart E. Sterk and the *Cardozo Law Review* Notes Editors for offering their patience and feedback as I tackled this complex topic. I also thank my family for tolerating my episodes of seclusion while I was quite engrossed in the production process.

¹ See *infra* Part I.A.1 for a description of the unique characteristics of the subprime market.

² David B. Bayless, *The Sub Prime Mess*, in *ADVANCED SECURITIES LAW WORKSHOP 2008*, at 545, 549 (PLI Corp. L. & Practice, Course Handbook Series No. 1687, 2008).

³ Subprime loans were securitized and then sold on secondary markets. See *infra* Part I.A.2.

⁴ Recent news demonstrates that the credit crisis has become a global concern, moving beyond subprime borrowers. See, e.g., Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Titans*, N.Y. TIMES, Sept. 8, 2008, at A1 (describing the government takeover of Fannie Mae and Freddie Mac, the nation's largest mortgage finance companies, which were heavily involved in securitization); Andrew Ross Sorkin, *Lehman Files for Bankruptcy; Merrill Is Sold*, N.Y. TIMES, Sept. 15, 2008, at A1 (reporting the implosion of seemingly invincible investment banks). The crisis has also spread to the prime market, which is generally considered less risky based upon stronger credit records of borrowers. Vikas Bajaj & Louise Story, *Mortgage Crisis Spreads Past Subprime Loans*, N.Y. TIMES, Feb. 12, 2008, at A1.

⁵ See Bajaj & Story, *supra* note 4.

⁶ *Nearly 150 Mortgage Operations Collapse in 2007*, REUTERS, Jan. 22, 2008,

transactions will continue for many years as the consequences of previous subprime transactions unfold, and new remedial measures alter the legal landscape. Additionally, the protracted process of litigation will further extend the significance of the subprime industry.

This Note focuses on the underlying situation and assesses remedies available to subprime borrowers. Many current remedies were designed for prime borrowers,⁷ and certain statutory provisions and regulations fail to meet the particular needs of subprime borrowers. Although this Note will not present an exhaustive catalogue of legal claims, options for legal relief include individual or class action lawsuits pursuant to the Real Estate Settlement Procedures Act (RESPA),⁸ the Truth in Lending Act (TILA)⁹ with its Home Ownership and Equity Protection Act amendments (HOEPA),¹⁰ state legislation,¹¹ and state common law.¹² Despite this assortment of causes of action, these options each pose serious obstacles to full relief for victimized subprime borrowers.¹³

In addition to statutory deficiencies, the judiciary has also failed to adequately protect the subprime borrower within legislative constraints in areas where a more liberal interpretation could expand relief.¹⁴ Statutory silence with accompanying discussions of statutory structure, purpose, and history, accounts for many judicial splits on the interpretation of numerous provisions and the availability of remedies. Although a narrow judicial interpretation of the law has the virtue of containing liability, such construction is troublesome when two equally plausible interpretations exist.¹⁵

<http://www.reuters.com/article/pressRelease/idUS127375+22-Jan-2008+PRN20080122>.

⁷ See Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2250 (2007) (assessing how “Consumer Protection Laws Presume an Antiquated Model of Finance,” which “hints at a fundamental structural problem in the law.”). Peterson’s article focuses on securitization with an emphasis on the subprime market.

⁸ Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. §§ 2601-2617 (2006).

⁹ Truth in Lending Act (TILA) of 1968, Pub. L. No. 90-321, 82 Stat. 146 (codified in scattered sections of 15 U.S.C.).

¹⁰ Home Ownership and Equity Protection Act (HOEPA) of 1994, Pub. L. No. 103-325, tit. I, subtit. B, 108 Stat. 2190 (codified as amended in scattered sections of 15 U.S.C.).

¹¹ See discussion on state remedies *infra* Part III.B.

¹² *Id.*

¹³ Peterson, *supra* note 7, at 2231-32 (“Altogether, even an abbreviated description of the federal, state, and local laws addressing predatory lending suggests a not insignificant arsenal of potential claims and defenses. Yet, this by no means suggests that this legal net is sufficient to catch every predatory loan. Previous research has chronicled significant drawbacks to each of these potential predatory lending claims and defenses.”).

¹⁴ Since most cases preceded the current subprime implosion, the hopeful may anticipate that courts will become increasingly receptive to borrower claims given the gravity of the situation, especially where the ambiguity is based upon statutory silence.

¹⁵ In striving to discern congressional intent, courts have explicitly acknowledged the gaping ambiguity of statutory silence. See, e.g., *Cohen v. JP Morgan Chase & Co.*, 498 F.3d 111, 117 (2d Cir. 2007) (“Because the text [of RESPA § 8(b)] is, in fact, subject to ‘divergent, but plausible, constructions,’ . . . we conclude that it is ambiguous in revealing Congress’s intent on

This Note will examine the mismatch between current mortgage remedies and the subprime market, characterized by three subprime themes of complex loan terms, borrower demographics, and multiparty transactions. Part I.A presents the three important characteristics of subprime transactions, and describes the development and collapse of the subprime market. The three characteristics are relevant to determining which remedies are desirable in the subprime context, and problems subprime borrowers will encounter in obtaining these remedies. Part I.B introduces RESPA and TILA, the two main options of federal relief. Because subprime foreclosure is a national concern,¹⁶ this Note focuses on federal remedies.¹⁷ Part II analyzes the incongruity between the federal remedial legislation (and corresponding regulations)¹⁸ and subprime borrowers in light of the three subprime themes. In the context of statutory and interpretive hurdles, this Note posits potential areas of reform. Part III urges borrowers not to rely exclusively on the current federal provisions and explores alternative sources of relief, such as new legislation and regulations, state remedies, and private solutions. While this Note does not attempt to propose a simple solution to repairing the subprime housing wreckage, it does strive to identify legislative and judicial barriers with which the subprime borrower must contend and points to other sources of relief.

this subject.”) (quoting *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49, 58 (2d Cir. 2004)). Administrative regulations can aid in interpretation as occurred in *Cohen*; however, this Note will examine areas where extant regulations do not resolve the uncertainties or mismatch.

¹⁶ Notwithstanding regional patterns, subprime foreclosures span from coast to coast. See Hannah Fairfield, *In the Shadow of Foreclosure*, N.Y. TIMES, Apr. 6, 2008, at B4; Heather M. Tashman, *The Subprime Lending Industry: An Industry in Crisis*, 124 BANKING L.J. 407, 412-13 (2007).

¹⁷ Although different lines of cases will develop in different jurisdictions, the shortcomings of the legislation could potentially apply to borrowers across the nation. Developments within individual states, briefly addressed *infra*, do not offer a universal remedy and may complicate compliance by imposing disparate rules on lenders with national operations.

¹⁸ When this Note refers to the inadequacies of the federal legislation, it generally includes the corresponding regulations as well.

I. THE SUBPRIME CONTEXT

A. *Development of the Subprime Crisis*

1. Subprime Market, Subprime Treatment¹⁹

The subprime market differs from the prime market both in its demographics and the nature of its transactions. Subprime borrowers generally present a higher credit risk due to lower than average credit scores and lower incomes.²⁰ A subprime loan is best defined in relation to this separate market of people who cannot obtain conventional mortgages. Three defining characteristics of the subprime market are complex loan terms, borrower demographics, and multiparty transactions. These themes form the lens through which remedies should be assessed.

a. Complex Loan Terms

Subprime loan terms are more complicated than traditional fixed-interest loans.²¹ Because of increased credit risk, subprime borrowers receive elevated, and even extortionate, rates and terms.²² Principal among these features are variable rates, additional fees, and restrictive terms. The two main nontraditional products are the interest-only loan²³ and the payment-option adjustable rate mortgage (ARM) loan.²⁴ These

¹⁹ For an excellent summary of subprime market conditions and guidance on considerations lenders should take in issuing loans, see Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37,569 (July 10, 2007).

²⁰ Tashman, *supra* note 16, at 408.

²¹ See Truth in Lending, 73 Fed. Reg. 44,522, 44,524 (July 30, 2008) (“[P]roducts in the subprime market tend to be complex, both relative to the prime market and in absolute terms, as well as less standardized than in the prime market.”).

²² See Jessica Fogel, Comment, *State Consumer Protection Statutes: An Alternative Approach to Solving the Problem of Predatory Mortgage Lending*, 28 SEATTLE U. L. REV. 435, 438 (2005).

²³ Christine Daleiden, *Understanding Subprime Mortgages*, HAW. B.J., Mar. 2008, at 6, 6-7. Under the interest-only mortgage loan, the borrower pays only the interest on the loan for a specified period of time (up to five to ten years), which does not reduce the loan balance (principal). After the expiration of the interest-only period, monthly payments increase substantially because the borrower must pay both principal and interest.

²⁴ *Id.* at 7-8. Under the payment-option ARM, the borrower may make either: (1) a minimum payment based on a very low, introductory (“teaser”) interest rate; (2) an interest-only payment; or (3) a fully amortizing payment as if it were a traditional loan. Under the minimum payment option, when the teaser rate expires, the interest rate increases without a rate cap other than that set by law; but there is a cap on the monthly payment increase. Paying only the minimum

complex characteristics obscure the true cost of the loan, and entice subprime borrowers into entering transactions beyond their financial capacities.

Complex loan terms also create an opportunity for predatory practices. These include a lack of a timely and accurate disclosure of material terms, excessive fees crammed into the loan, large prepayment penalties that lock the borrower into high rates, or monthly payments in excess of what the borrower can afford.²⁵ Although not all subprime loans are predatory, nearly all predatory loans are subprime.²⁶

Concern about loan complexity is heightened by the lack of escrow accounts in the subprime market,²⁷ which has contributed to subprime foreclosure.²⁸ An escrow account holds a borrower's payments for additional home expenses such as property taxes and mortgage insurance premiums, while ensuring that they are paid in a timely fashion.²⁹ Lenders did not offer escrow to subprime borrowers because escrowing reflects a higher monthly payment, and borrowers will often pay more attention to monthly payments than rates.³⁰ Shrouding actual housing costs poses a grave threat to the subprime borrower who already does not recognize the full extent of payments based upon complex loan terms.³¹

b. Borrower Demographics

Subprime borrowers are generally considered more vulnerable. The market represents a higher proportion of minorities and individuals with weaker economic conditions.³² Predatory lenders frequently target

monthly payment results in negative amortization (unpaid interest is added to the principal balance owed), resulting in the borrower owing more on the loan when the payment option period ends than originally borrowed. Additionally, the interest rate significantly increases to the current market rate after the option period.

²⁵ Fogel, *supra* note 22.

²⁶ Emily Jeffcott, Comment, *The Mortgage Reform and Anti Predatory Act of 2007: Paving a Secure Path for Minorities in the Midst of the Sub Prime Debacle*, 10 SCHOLAR 449, 453 (2008).

²⁷ *But see infra* Part III.A.2 on the new federal regulation recognizing the escrow problem.

²⁸ *See* Tashman, *supra* note 16, at 411-12.

²⁹ Escrow aids the homeowner in avoiding the risk of lapsed insurance coverage or delinquent taxes by guaranteeing that there is enough money to pay these bills when they are due. American Loan Search, Mortgage Escrow Accounts Explained, <http://www.americanloansearch.com/info-escrowaccounts.htm> (last visited Dec. 22, 2008).

³⁰ *Id.*

³¹ A lack of escrow increases the risk that a subprime consumer will underestimate the cost of his/her obligation. Truth in Lending, 73 Fed. Reg. 44,522, 44,558 (July 30, 2008). Moreover, based upon demographics (discussed *infra*), subprime consumers may be less familiar with escrow procedures, rendering them less likely to seek an escrow account; this presents a double risk since subprime status may indicate that the borrower has difficulty making timely payments on obligations (and will be better served by having an escrow account). *Id.* at 44,558.

³² Tashman, *supra* note 16, at 413.

specific groups such as the elderly, ethnic minorities, and individuals with lower incomes and less education. Members of these particular groups may lack the experience and knowledge of complex financial transactions to fully understand the ramifications of their loans (and are therefore easily deceived), or may not receive the same options as other borrowers.³³ In some instances, unscrupulous lenders also obscured the subprime borrower's true economic condition by offering no or low documentation loans³⁴ or falsifying income.³⁵ Additionally, subprime loans were frequently issued at high loan-to-value and debt-to-income ratios.³⁶ Subprime social and economic characteristics in conjunction with complex loan structures renders the subprime market more susceptible to abusive terms.³⁷ For example, subprime borrowers might proceed with loans even when terms were changed at closing, where the borrower has already been pressured into applying for a limited deal, currently feels committed to the loan, believes she is legally bound to proceed, does not recognize a change in terms, or fears there will not be other opportunities.³⁸

Even where a subprime borrower has a clear legal claim, subprime demographics also present other obstacles to litigation. The subprime borrower may be unfamiliar with the legal system and unable to pay lawyers and other litigation fees.³⁹ This increases the importance of the class action mechanism,⁴⁰ which can overcome these concerns and facilitate claims by enticing the plaintiff's bar. Given the significance of this vehicle to relief, this Note will point out judicial limitations on the class action mechanism in borrower suits.⁴¹

³³ Fogel, *supra* note 22, at 438-39.

³⁴ Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37,569, 37,569 (July 10, 2007).

³⁵ See, e.g., *Petit-Homme v. Litton Loan Servicing LP*, No. 08-22293-CIV, 2009 WL 825760 (S.D. Fla. Mar. 26, 2009) (granting defendant's motion to dismiss).

³⁶ Denise M. Finney, Re-defining the Subprime Mortgage Mess (Dec. 12, 2007) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1114342.

³⁷ See Truth in Lending, 73 Fed. Reg. 44,522, 44,532 (July 30, 2008) ("[T]he prime market is more transparent and competitive, characteristics that make it less likely a creditor can sustain an unfair, abusive, or deceptive practice. In addition, borrowers in the prime market are less likely to be under the degree of financial stress that tends to weaken the ability of many borrowers in the subprime market to protect themselves against unfair, abusive, or deceptive practices.").

³⁸ Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 *FORDHAM L. REV.* 2039, 2080 (2007).

³⁹ Peterson, *supra* note 7, at 2267 ("[E]ven marginal increases in the cost of dispute resolution can have a dramatic impact on subprime mortgage borrowers.").

⁴⁰ *Id.* at 2268-69 (discussing limitations on class actions in the subprime context). Class actions may also be appropriate for the subprime market in light of the unifying characteristics of subprime borrowers and standard tactics wielded against them. For class action requirements, see *FED. R. CIV. P.* 23.

⁴¹ See *infra* Parts II.B.1.b, II.C.2.b, II.C.3.d.

c. Multiparty Transactions and the Consequences of Elusive Originating Parties

The involvement of multiple parties is especially common in the subprime market.⁴² Brokerage agents, securitization,⁴³ assignment, and third-party servicing⁴⁴ of subprime loans significantly altered the traditional mortgage landscape. Rather than presenting additional sources of relief, this additional layering of parties makes it exceedingly difficult and costly for a borrower to pursue a claim.⁴⁵

Multiparty involvement is a greater concern in the subprime market because suits against originating parties are often futile. Although prime loans may also involve multiple parties, the initial contracting parties in prime transactions can generally be held liable as the major originators of prime loans operate large, relatively stable businesses. Conversely, holding originating parties liable in the subprime market is difficult because predatory brokers and lenders often operate as “fly-by-night operations,” are generally undercapitalized, on the brink of bankruptcy, or otherwise judgment proof.⁴⁶

Limited regulatory oversight over subprime players compounds this accountability concern. Where the federal agencies have oversight authority, monitoring has been lax. Additionally, subprime companies (vis-à-vis prime entities) are frequently beyond the reach of federal regulators, and do not face a serious threat of enforcement.⁴⁷ In fact, approximately ninety percent of lenders involved primarily in subprime loans are not federally regulated depository institutions such as banks or

⁴² See Peterson, *supra* note 7, at 2256 (“[C]ontemporary asset-backed securities conduits often have eleven or more integral parties: a borrower, a broker, an originator, a seller, an underwriter, a trust, a trustee, multiple servicers, a document custodian (which may be closely involved in foreclosure proceedings), an external credit enhancer, a securities placement agent, and investors. Yet, the consumer protection laws evolved with the older two and three party mortgage systems in mind.”).

⁴³ Securitization describes the process of pooling loans to create securities, which are then sold to investors. See *infra* Part I.A.2; see also Peterson, *supra* note 7, at 2190 (“Developing within these conceptual cracks in the nation’s consumer protection edifice, securitization has allowed much of the subprime mortgage market to evolve unconfined by many of the substantive standards in consumer protection law.”); *id.* at 2185-87.

⁴⁴ RESPA defines servicing as receiving any scheduled periodic payments from a borrower under the terms of a loan, including amounts for escrow accounts, and making principal, interest, and other payments under the terms of the loan. 12 U.S.C. § 2605(i)(3) (2006).

⁴⁵ See Peterson, *supra* note 7, at 2263-69. In order just to initiate a lawsuit, a borrower must first identify and locate the numerous relevant parties.

⁴⁶ Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 361 (2005). Even when a borrower can obtain a judgment against the original lender or broker, this will not halt a foreclosure by the securitized trust. Engel & McCoy, *supra* note 38, at 2078.

⁴⁷ Azmy, *supra* note 46, at 358-60 (“[F]ederal enforcement actions have been insufficient deterrents over predatory behavior . . .”).

thrifts, and federal banking regulators have no authority over independent mortgage and finance companies, which represent approximately sixty percent of the subprime market.⁴⁸ In addition to insufficient federal oversight, as discussed *infra* Part III.B, there are various limitations to state regulation as well. Thus, inadequate supervision and weak enforcement present major concerns in the subprime industry.

2. The Growth of the Subprime Market

Securitization of subprime loans fostered the growth of the subprime industry by providing lenders with additional capital to make loans that they ordinarily would not have issued. Securitization entails the pooling of loans, and the resultant marketable financial instruments are then sold as securities in the secondary market.⁴⁹ Securitization encouraged risky lending practices by enabling issuers to transfer risk to investors.⁵⁰ Lenders exercised less care in issuing credit (employed

⁴⁸ *Id.* at 359-60; see also Dep't of the Treasury, *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure—Executive Summary*, in PRE-CONFERENCE BRIEFING TO THE 40TH ANNUAL INSTITUTE ON SECURITIES REGULATION: LESSONS LEARNED FROM THE MARKET MELTDOWN—LIFE AFTER THE AGE OF INNOCENCE: HOW TO ADVISE ON DOING BUSINESS, MANAGING RISK, DOCUMENTING DEALS AND MEETING ACCOUNTING AND DISCLOSURE OBLIGATIONS, at 67, 84 (PLI Corp. L. & Practice, Course Handbook Series No. 1706, 2008) (“In recent years mortgage brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 percent of subprime mortgages in the United States. These mortgage originators are subject to uneven degrees of state level oversight (and in some cases limited or no oversight).”). Nevertheless, it is important to acknowledge that even if a subprime company is not regulated and supervised by a federal banking agency, the Federal Trade Commission (FTC) has jurisdiction to enforce TILA, and the U.S. Department of Housing and Urban Development (HUD) can enforce RESPA against any entity for eligible loans. Additionally, state attorneys general can enforce HOEPA provisions. See E-mail from Division of Consumer and Community Affairs, Federal Reserve Board, to Arielle L. Katzman (July 7, 2009) (on file with author) [hereinafter Fed. E-mail]. State attorneys general can also enforce some RESPA provisions. U.S. Dep't of Hous. & Urban Dev., More Information About RESPA, <http://www.hud.gov/offices/hsg/ramh/res/respamor.cfm#CF> (last visited Oct. 17, 2009). Thus, TILA and RESPA (however insufficient) apply to transactions meeting their criteria irrespective of the lender's regulatory status, but a lack of supervision is still problematic because enforcement is merely a reactive and limited approach. For illustrations of the importance of a private right of action (where one has been denied) in light of deficient regulation and enforcement, see *infra* Parts II.B.3, II.C.2.a.

⁴⁹ Tashman, *supra* note 16, at 410. Given the increased credit risk of subprime borrowers and limited capital of risky lenders, securitization is more prevalent in the subprime market. See Peterson, *supra* note 7, at 2214 (“Unlike prime lenders, subprime lenders usually securitize their loans.”). Securitized products include mortgage-backed securities (MBSs) and collateralized debt obligations (CDOs) (resecuritized MBSs). Bayless, *supra* note 2.

⁵⁰ See Truth in Lending, 73 Fed. Reg. 44,522, 44,524 (July 30, 2008) (“Limitations on price and product transparency in the subprime market—often compounded by misleading or inaccurate advertising—may make it harder for consumers to protect themselves from abusive or unaffordable loans, even with the best disclosures. The injuries consumers in the subprime market may suffer as a result are magnified when originators' incentives to carefully assess

loosened underwriting standards)⁵¹ because they did not intend to hold onto the mortgages.⁵² Thus, the subprime market presented a large untapped pool of debtors (previously unable to obtain loans from prime lenders), and unscrupulous subprime lenders stood to make a handsome profit.

In addition to the transfer of risk through securitization, the booming housing market also suppressed lenders' concerns about a borrower's repayment ability. Similarly, the housing boom induced borrowers to take on unaffordable loans. With home values on the ascent, borrowers could simply resell or refinance⁵³ to a fixed-rate mortgage before rates reset by capitalizing on appreciated home values should their mortgages become unaffordable.⁵⁴ Even where borrowers refinanced, the initial lenders stood to turn a profit by packing higher fees and costs into subprime instruments, and receiving repayment of the initial loan.

3. Bringing Down the House: The Collapse of the Subprime Market

Beginning in late 2006 and early 2007, as interest rates increased and real estate appreciation slowed, mortgages came to exceed home values, and the refinancing/resale solution quickly evaporated. As teaser rates⁵⁵ expired, insolvency and foreclosure quickly ensued.⁵⁶ Once the initial borrowers defaulted on mortgage payments, the third parties who purchased and securitized the mortgages attempted to exercise their right to return them for new ones or receive a cash refund.⁵⁷ Consequently, originating mortgage lenders with little capital

consumers' repayment ability grow weaker, as can happen when originators sell their loans to be securitized.").

⁵¹ Mortgage underwriting refers to the procedure of examining all the data about a borrower's property and transaction to determine a borrower's ability to repay the loan and whether the mortgage should be issued. See Mortgage Glossary, Underwriting Definition, <http://www.mtgprofessor.com/glossary.htm#Underwriting> (last visited Jan. 23, 2009).

⁵² *Subprime Mortgage Lending and Mitigating Foreclosures: Testimony Before the H. Comm. on Fin. Servs.*, 110th Cong. (Sept. 20, 2007) (statement of Ben S. Bernanke, Chairman, Fed. Reserve Sys.), available at <http://www.federalreserve.gov/newsevents/testimony/bernanke20070920a.htm>.

⁵³ Refinancing involves replacing an old loan with a new loan with better terms. Investopedia, Refinance Definition, <http://www.investopedia.com/terms/r/refinance.asp> (last visited Jan. 23, 2009).

⁵⁴ N. ERIC WEISS, CONGRESSIONAL RESEARCH SERVICE, GOVERNMENT INTERVENTIONS IN FINANCIAL MARKETS: ECONOMIC AND HISTORIC ANALYSIS OF SUBPRIME MORTGAGE OPTIONS 4 (2008), available at http://assets.opencrs.com/rpts/RL34423_20080325.pdf.

⁵⁵ See *supra* note 24. A teaser rate refers to a very low initial rate, which subsequently undergoes a significant increase.

⁵⁶ WEISS, *supra* note 54.

⁵⁷ Bayless, *supra* note 2. Some agreements contained clauses requiring lenders to repurchase the loans from financial intermediary purchasers upon early default. See Michael Hammer, *How*

and limited liquidity began to fail.⁵⁸ In response to borrower default and lender failures, the market began to devalue subprime mortgage-backed securities, and investors were sucked into the financial maelstrom.⁵⁹ Some scholars have traced the beginning of this crisis to the housing boom of 2004, in the heyday of loan creativity, and predicted that the crisis would climax in 2008, when two million adjustable-rate mortgages reset to higher interest rates.⁶⁰

As the crisis has escalated, increased litigation has ensued, even among parties distant from the initial transactions.⁶¹ However, ancillary lawsuits, such as securities class actions, should not overshadow the plight of subprime borrowers, many of whom were victims of predatory lending and now stand to lose their homes.

B. Available Federal Statutory Relief

Subprime borrowers often bring claims in tandem under both RESPA and TILA, federal consumer protection statutes, which govern different practices and provide different remedies.⁶²

Bankruptcy Lawyers Can Navigate the Current Crisis, in THE IMPACT OF THE SUBPRIME MORTGAGE CRISIS: LEADING LAWYERS ON UNDERSTANDING THE FACTORS RESPONSIBLE, MINIMIZING THE FINANCIAL IMPACT FOR CLIENTS, AND RECOGNIZING THE EFFECTS OF THE RECESSION ON BANKRUPTCY LAW 15 (Aspatore Special Report 2009).

⁵⁸ Bayless, *supra* note 2.

⁵⁹ *Id.*

⁶⁰ Daleiden, *supra* note 24, at 6. Even small increases in interest rates can amount to significantly higher monthly payments that come to exceed a borrower's payment capacity.

⁶¹ See generally Bayless, *supra* note 2 (summarizing various types of litigation related to the subprime crisis).

⁶² While this Note focuses on borrower initiation of claims, RESPA and TILA factor into other proceedings as well. RESPA and TILA claims may be asserted as defenses or counterclaims in foreclosure proceedings. Marilyn Kennedy Melia, *Foreclosure Not Always a Foregone Conclusion*, CHI. TRIB., Feb. 18, 2007, at C2; see, e.g., 15 U.S.C. §§ 1640(h), 1635(i) (2006); see also Peterson, *supra* note 7, at 2267-68 ("Most . . . predatory lending claims . . . [are brought] as counterclaims in defense of foreclosure proceedings. . . . But at this point, predatory lending victims universally lack resources These participants in the legal system, who are facing the imminent prospect of homelessness, simply lack the capability to simultaneously defend a collection action brought by a faceless investment trust and to bring their own affirmative lawsuit against a broker, originator, or servicer."). Although the borrower's statutory claims suffer the same limitations in this context, foreclosure is significant given the rising foreclosure rates in the subprime market and the gravity of the problem at the foreclosure stage. Notably, subprime rates of default are at least six times higher than default rates on prime loans. Tashman, *supra* note 16, at 411-12 (attributing subprime defaults to adjustable rate mortgages (and high rate and payment increases), prepayment penalties, minimal income documentation, and no escrowed funds available for taxes and insurance). At the very least, a counteraction can slow the foreclosure proceeding. Melia, *supra*.

A few additional issues about RESPA and TILA claims should be noted. Defaulting borrowers have also sought protection through the bankruptcy forum prior to filing suits. Tashman, *supra* note 16, at 414-15. Another significant obstacle to initiating a suit that this Note does not address is the effect of mandatory arbitration clauses, which effectively bar borrowers

1. RESPA⁶³

RESPA, which was passed in 1974, applies to “federally related mortgage loan(s),”⁶⁴ and was enacted to help consumers become better shoppers for settlement services.⁶⁵ RESPA requires certain disclosures at various points during a loan transaction:⁶⁶ At the time of the loan application (or mailed within three days of receipt of application), borrowers must receive consumer information in the form of a booklet, a good faith estimate (GFE) of the settlement costs, and a statement as to whether the lender intends to service the loan itself or transfer it to another lender. Affiliated interests must also be disclosed before settlement.⁶⁷ At settlement of the loan, there must be disclosure of settlement costs of the loan transaction (using a HUD-1 form⁶⁸), and within forty-five days of settlement, borrowers must also receive an Initial Escrow Statement (if an account has been established), listing estimated taxes, insurance, and other charges to be paid from the escrow account within the first year. Subsequent to settlement, if applicable, borrowers must receive an Annual Escrow Statement, summarizing all payments made during the year. The borrower must also be informed of sale or assignment of the loan. Pursuant to RESPA, borrowers can initiate claims for monetary damages based on kickbacks and unearned fees,⁶⁹ servicing violations,⁷⁰ and seller-required title insurance.⁷¹

from obtaining judicial relief and joining class actions. Engel & McCoy, *supra* note 38, at 2044. Additionally, both RESPA and TILA contain provisions for administrative enforcement, which has been inadequate as discussed *supra* Part I.A.1.c.

⁶³ To supplement and clarify provisions, RESPA charges the Secretary of HUD with rulemaking power. 12 U.S.C. § 2617 (2006); *see* 24 C.F.R. pt. 3500 (2008) (Regulation X).

⁶⁴ *See* 12 U.S.C § 2602(1) (2006) (establishing criteria for classification as a federally related mortgage loan). This definition includes more than loans by *federally regulated* lenders and should cover most subprime loans. *See* 2 WEST’S FED. ADMIN. PRAC. § 1563 (4th ed. 2008) (noting that the term encompasses virtually every residential real estate transaction closing in the United States, including refinancings and subordinate mortgages).

⁶⁵ 12 U.S.C § 2601(b) (2006). Settlement services include “any service provided in connection with a real estate settlement” such as title searches, provision of title certificates, title insurance, attorney-provided services, document preparation, property surveys, the rendering of credit reports or appraisals, services rendered by a real estate agent or broker, federally related mortgage loan origination (including the taking of loan applications, loan processing, and underwriting and funding of loans), and the handling of the processing, and closing or settlement. *Id.* § 2602(3).

⁶⁶ The following summary is taken from the HUD website. *See* U.S. Dep’t of Hous. & Urban Dev., *supra* note 48.

⁶⁷ “Settlement” is used interchangeably with “closing.” *Id.*

⁶⁸ The HUD-1 is a standard form that shows all charges imposed on borrowers and sellers in connection with settlement. *Id.*

⁶⁹ 12 U.S.C. § 2607 (2006).

⁷⁰ *Id.* § 2605.

⁷¹ This Note will only address two of RESPA’s main provisions under which a borrower can bring a claim: kickbacks/unearned fees and servicing violations. RESPA also allows borrowers

2. TILA⁷²

Similarly to RESPA, the Truth in Lending Act (TILA), which was passed in 1968, takes a disclosure-focused approach. TILA requires mortgage lenders to disclose to borrowers certain information to facilitate an understanding of the true cost of a loan and to help borrowers comparison shop for the best financing available.⁷³ Prior to the extension of credit, lenders must disclose to the borrower information such as the loan's annual percentage rate (APR), finance charges, the total amount financed (including points and fees), the number of payments, and the payment schedule.⁷⁴ Borrowers⁷⁵ may bring TILA claims against creditors and assignees for actual damages, statutory damages, and attorneys fees and costs, in both an individual and class action capacity for violations of TILA's loan-specific provisions.⁷⁶ Borrowers may also rescind qualified transactions.⁷⁷

The Home Ownership and Equity Protection Act (HOEPA) amended TILA in 1994 to further regulate "high-cost" loans.⁷⁸ HOEPA imposes additional disclosure requirements, prohibits originating lenders from employing specific loan terms and practices, and requires a lender to consider a borrower's ability to pay prior to issuing credit.⁷⁹

to bring claims against home sellers for requiring buyers to purchase title insurance from a particular company. *Id.* § 2608. This Note will not discuss title insurance claims because they are less relevant to the dynamics of subprime transactions. Additionally, as discussed *infra* Part II.B.3, courts have found that no private right of action exists for violations of RESPA's other provisions.

⁷² A TILA claim can be divided into four main elements: "(1) credit being offered or extended to consumers, (2) on a regular basis, (3) finance charges attendant to the credit being offered or written agreements where credit is payable in more than four installments, and (4) the credit being primarily for personal, family, or household purposes." 76 AM. JUR. PROOF OF FACTS 3D 193, pt. VI (Aug. 2009).

⁷³ 15 U.S.C. § 1601(a) (2006); see Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-based Pricing*, 44 HARV. J. ON LEGIS. 123, 131-38 (2007) (detailing intricacies of timing for disclosures).

⁷⁴ 15 U.S.C. § 1638 (2006). This provision explains requirements for early and final disclosures.

⁷⁵ TILA exempts some transactions, such as those involving credit primarily for business, which are not relevant to this Note. See *id.* § 1603.

⁷⁶ *Id.* § 1640(a).

⁷⁷ *Id.* § 1635. Rescission voids the transaction. See discussion *infra* Part II.C.3.

⁷⁸ This category consists of non-purchase, closed-end loans which meet one of two high-cost loan triggers: (1) the annual percentage rate (APR) at consummation exceeds the yield on Treasury securities of comparable maturity by more than eight percent on first lien loans or ten percent on subordinate lien loans; or (2) the total of all the loan's points and fees payable by the consumer at or before closing exceeds the greater of eight percent of the loan total or \$400 (adjusted for inflation). *Id.* § 1602(aa); 12 C.F.R. § 226.32(a) (2008).

⁷⁹ 15 U.S.C. § 1639 (2006) (enumerating additional disclosures and warnings for qualifying loans along with other limitations such as no balloon payments, prepayment penalties, or negative amortization).

These additional requirements are of particular importance to subprime consumers that may qualify for protection.

II. THE FUNDAMENTAL MISMATCH BETWEEN SUBPRIME BORROWERS AND REMEDIAL LEGISLATION

There is currently a fundamental mismatch between RESPA and TILA and the subprime market as defined by the three themes of complex loan structures, borrower demographics, and multiparty transactions. Federal legislation has not sufficiently paralleled the proliferation of subprime loans, which has shifted the market dynamic,⁸⁰ and the present circumstances necessitate uniquely tailored solutions. This mismatch exists for both the requirements (which serve as the basis of available claims) and the types of remedies pursuant to RESPA and TILA.⁸¹

A. *The Futile Federal Approach*

1. Requirements: The Insufficiency of a Disclosure-Based System

RESPA and TILA were designed for the prime market. Although RESPA and TILA aid the subprime borrower in some situations, the emphasis on disclosure (and a few prohibited practices) cannot fully remedy subprime concerns.⁸² This narrow statutory approach limits available claims and erects obstacles for establishing claims where available, in a way that clashes with the reality of subprime transactions.

Firstly, borrower demographics and complex loan terms undermine the disclosure-based system's assumption that borrowers understand their transactions. Disclosure cannot be effective in the common

⁸⁰ Between 2000 and 2007, the subprime mortgage market more than quadrupled, and by 2007, subprime loans comprised nearly a quarter of the mortgage market. Tashman, *supra* note 16, at 407. In addition to increased capital availability as a result of securitization and increased risk-based pricing due to technology, the deregulation of the banking industry also promoted the development of the subprime market. Deregulation incentivized more lenders to enter the market and also enabled lenders to offer more varied loan products. *Id.* at 411.

⁸¹ See Peterson, *supra* note 7, at 2231 (“[M]ost federal statutes have narrow technical causes of action and/or relatively insignificant remedies.”). This Note will examine how statutory ambiguities and shortcomings adversely impact the subprime borrower in light of the three subprime characteristics. The importance of particular remedies in the subprime context will also be discussed.

⁸² For example, these statutes still permit the imposition of some harsh loan terms and offer no protection for situations where oral statements induced a subprime borrower into taking an unaffordable loan. See 76 AM. JUR. PROOF OF FACTS 3D 193, *supra* note 72, § 32 (stating that all TILA disclosures must be in writing).

subprime scenario where a borrower lacks a basic understanding of the loan's features, focuses on few features, is overwhelmed by the volume of information, or simply relies on information conveyed by the originator;⁸³ these circumstances are especially likely where complex terms are involved. Additionally, most borrowers probably do not carefully scrutinize their documents to ascertain disclosed terms, and subprime borrowers with complex terms seem even less likely to read their contracts than prime borrowers. Realization of loan details may not occur until they take effect. Moreover, lenders utilizing predatory tactics in the subprime industry may escape liability as long as harsh terms are adequately disclosed.⁸⁴ Disclosure does not ensure substantively fair terms, and desperate borrowers might accept any available credit even if outrageous terms are incompatible with their capacity to pay. Thus, although increased transparency is particularly relevant for subprime borrowers, and the inexperienced and uneducated in particular, disclosures only partially alleviate the problems afflicting the subprime market.

Secondly, the predominant focus fails to deal adequately with the complications of multiparty transactions and securitization,⁸⁵ prevalent features in the subprime market.⁸⁶ The current legal framework makes it difficult to extend liability beyond originating parties to hold additional parties liable, and it does not sufficiently consider the role of brokers, servicers,⁸⁷ and investors.⁸⁸ Except in limited circumstances,

⁸³ Truth in Lending, 73 Fed. Reg. 44,522, 44,524 (July 30, 2008) (“[I]t is unlikely that better disclosures, alone, will address adequately the risk of abusive or unaffordable loans in the subprime market.”).

⁸⁴ See discussion *supra* Parts I.A.1.a, I.A.1.b.

⁸⁵ Cf. Engel & McCoy, *supra* note 38, at 2041 (“[S]ecuritization inflicts negative externalities on subprime borrowers in at least four ways. First, securitization funds small, thinly capitalized lenders and brokers, thus enabling them to enter the subprime market. These originators are more prone to commit loan abuses because they are less heavily regulated, have reduced reputational risk, and operate with low capital, helping to make them judgment-proof. Second, securitization dilutes incentives by lenders and brokers to avoid making loans with excessive default risk by allowing them to shift that risk to the secondary market, which has other ways to protect itself. Third, securitization denies injured borrowers legal recourse against assignees by triggering the holder-in-due-course rule and impeding work-outs. Lastly, securitization drives up the price of subprime loans . . .”). The holder in due course rule “immunizes [loan purchasers] from defenses to underlying fraud or unconscionability claims and entitles them to proceed with foreclosure no matter how abusive the loan terms” so long as the note holder purchased it for value without knowledge of the debtors’ defenses. Azmy, *supra* note 46, at 360.

⁸⁶ Hereafter, this Note will refer to the situation described here as the “Multiparty Liability Problem.”

⁸⁷ See discussion *infra* Part II.C.1, which highlights shortcomings in holding brokers and servicers liable under TILA; see also Part II.B.1 for a discussion of broker liability under RESPA.

⁸⁸ Some scholars have advocated for an abrogation of the holder in due course doctrine beyond individual assignees, to impose liability on securitized trusts in recognition of the considerable role these entities play in enabling and supporting the subprime industry, perhaps to the disadvantage of borrowers. Under such a proposal, securitized trusts that do not adopt adequate controls to sift predatory loans out from loan pools would be liable as assignees for

under the federal legislation, a borrower cannot hold assignees liable based upon the Uniform Commercial Code (UCC) principles of the holder in due course doctrine,⁸⁹ and the use of waiver-of-defense clauses.⁹⁰ This is problematic for the subprime market where the original issuers of loans are frequently not the ultimate holders or servicers, or are bankrupt, unregulated, or otherwise unavailable. Thus, statutory assumptions of recourse against originating parties (and limitations on extending liability) narrow the vast theoretical range of potential defendants suggested by multiparty involvement. Additionally, disclosure provisions and other limitations on liability do not impose cautionary standards upon subprime agents to make viable loans. Thus, disclosure does not address the misalignment of interests that characterizes the subprime market.⁹¹

2. Remedies: Too Little and Too Limited⁹²

The remedies of the existing legislative framework fail to provide subprime borrowers with meaningful relief. The federal legislation does not aid the subprime borrower in remaining in the home and avoiding foreclosure (presumably the ultimate goal). This ideal can best be achieved through refinancing or modification of loan terms to a feasible level, but the provisions of the current legislative framework do not offer these superior options.⁹³

particular violations. Engel & McCoy, *supra* note 38, at 2041. Peterson, *supra* note 7, at 2246, proposes an approach of imputed liability to hold structured financiers, such as investment banks, liable for their own predatory behavior (conversely, assignee liability holds assignees liable for violations in origination of the loan). *See id.* at 2281 (“[S]econdary market financiers that design the capital engine generating predatory loans are usually beyond the scope of assignee liability . . .”).

⁸⁹ For a definition of holder in due course, see Engel & McCoy, *supra* note 38, at 2053 (“To satisfy the requirements of a holder in due course, the purchaser must be the holder of a negotiable note, who took the note for value, in good faith, and without notice that the note contains certain defects.”). *See also* Azmy, *supra* note 46, at 360 (“Ultimately, all state law fraud and contract claims (and some federal disclosure claims) are of limited use, either as an affirmative claim for relief or as a defense to foreclosure—because the majority of subprime loans are securitized and sold onto the secondary market.”).

⁹⁰ Waiver-of-defense clauses are contractual provisions where borrowers waive the right to assert claims or defenses against an assignee of the lender. U.C.C. § 9-403(b) (2008) (formerly at § 9-206).

⁹¹ For example, lenders express less concern about borrower risk given the refinancing and securitization options. Additionally, brokers focus on fee collection based on the quantity, not quality, of mortgages originated.

⁹² In determining appropriate remedies, one must carefully balance borrower rights against the importance of robust credit markets; a recurring theme to consider is whether the law should promote deterrence, compensation, or some combination of the two.

⁹³ See *infra* Part III.A.1 for a discussion of limited statutory refinancing and modification opportunities pursuant to new legislation.

The forms of relief accessible under the current legislation, rescission and damages, are minimal, restricted to particular violations and requirements, and narrowly construed by courts. While rescission of the bad loan to return the borrower to the status quo ante has potential value, as discussed *infra*, it presents numerous problems and does not necessarily keep a borrower in the home. Similar problems arise in obtaining actual and statutory damages. Actual damages can offer substantial relief, but proof is based on a high standard. Statutory damages may be more readily available, but only provide nominal compensation. Moreover, both types of damages may simply be inadequate for a subprime borrower facing imminent foreclosure.

To obtain any of this relief, however insufficient, a borrower still must establish a cause of action, and as indicated *supra*, the claims supplied by the current legislative scheme fail to address the root causes of failed subprime transactions. RESPA and TILA each present numerous roadblocks to the subprime borrower, which demonstrates this fundamental mismatch.

B. RESPA

RESPA was not designed to regulate the substantive terms of loans, and therefore provides little assistance to subprime borrowers unless they can prove specific violations of RESPA's prohibited practices. RESPA explicitly permits claims for kickbacks and unearned fees,⁹⁴ and servicing irregularities.⁹⁵ Essentially,⁹⁶ these are the only claims that borrowers may bring in light of the prevailing judicial determination of no implied private right of action for other RESPA provisions, which are silent on private enforcement. Nevertheless, even where borrowers may obtain damages for specified violations, they will experience difficulty in establishing a cause of action and obtaining meaningful relief, as monetary damages are limited and RESPA does not offer a right of rescission. Narrow judicial interpretation has further exacerbated RESPA's internal statutory limitations. The subprime characteristics of complex loan structures, unique demographics, and multiparty transactions provide a useful framework for examining the inadequacy of RESPA for subprime borrowers.

⁹⁴ 12 U.S.C. § 2607 (2006).

⁹⁵ *Id.* § 2605.

⁹⁶ *See supra* note 71; RESPA also explicitly allows claims for title insurance, which this Note does not address.

1. Obstacles to Claims for Kickbacks and Unearned Fees

RESPA permits a private right of action for kickbacks and unearned fees.⁹⁷ Under this provision (§ 2607), a plaintiff may obtain relief from a “person” for giving or accepting a “fee, kickback or thing of value” in exchange for a business referral, or for giving or accepting “any portion, split, or percentage” of a real estate settlement service charge other than for services actually performed (unearned fees).⁹⁸ The broad language of “person” encompasses numerous possible defendants including lenders, mortgage brokers, real estate agents, and attorneys.⁹⁹ Where a borrower can establish an illegal referral or an illegal splitting of charges, the borrower can hold parties jointly and severally liable for three times the amount of any charge paid for a settlement service, along with court costs and attorneys fees.¹⁰⁰

Nevertheless, § 2607 is of limited value, as success will yield only minimal damages and it imposes a difficult standard. Compared to litigation costs and expenses (despite a potential award of attorneys fees and costs), a small recovery provides little incentive to subprime borrowers to initiate suits. Minor damage awards also do not address imminent foreclosure. In light of the three identifying characteristics of subprime borrowers, § 2607 is of special relevance, but to even obtain relief under this provision, however inadequate, borrowers will need to contend with three major issues of construction: bona fide secondary market/table-funding differentiation, the acceptability of yield spread premiums, and the overcharge/markup distinction.

a. Secondary Market Transaction/Table-Funding Differentiation

Claims under § 2607 often involve the distinction between secondary market transactions and table-funding. RESPA does not

⁹⁷ Cases have distinguished between kickbacks and unearned fees, but both claims impose a rigid test for establishing a violation, and the statute qualifies this prohibition with numerous exceptions. See 12 U.S.C. § 2607(c) (including a bona fide salary safe harbor exception); see also *infra* note 113 (differentiating between kickbacks and unearned fees).

⁹⁸ 12 U.S.C. § 2607(a) (“Business referrals”), (b) (“Splitting charges”).

⁹⁹ See 24 C.F.R. pt. 3500 app. B (2008) (providing examples of claims that can be brought under § 2607).

¹⁰⁰ 12 U.S.C. § 2607(d)(2), (5). Nevertheless, this provision has produced conflict among the courts over whether the treble damage amount applies to the total amount paid or just three times the overpayment. See *Alexander v. Washington Mut., Inc.*, Civil Action No. 07-4426, 2008 WL 2600323, at *4-6 (E.D. Pa. June 30, 2008) (acknowledging two lines of cases, and agreeing with the first option). A standard of three times the amount paid will produce a larger value and be easier for a plaintiff to prove vis-à-vis three times the amount the plaintiff allegedly paid as a kickback or unearned fee.

apply to bona fide secondary market transactions.¹⁰¹ Conversely, a borrower can state a claim for table-funded mortgage broker transactions, which are characterized by a contemporaneous advance of loan funds in exchange for assignment of the loan to the advancer of the funds.¹⁰² Thus, a lender who purchases a mortgage on the secondary market cannot be held liable for paying a broker an alleged kickback, but the lender and broker can both be held liable for a kickback if the transaction was table-funded.

The secondary market limitation presents an obstacle for the subprime borrower whose multiparty transaction was conceivably tainted by collusion and kickbacks. Even if one concedes that the secondary market distinction is coherent (table-funding lenders bear a more direct relationship to the actual subprime loan), differentiating between the two presents a major question for litigation.¹⁰³ Allowing suits for table-funded transactions does take into account the subprime situation to some extent in extending applicability to some loan transactions that involve more than the traditional bilateral mortgagor-mortgagee agreement. However, the secondary-market exemption blocks some subprime claims and ignores the prevalence of subprime loans on the secondary market.¹⁰⁴

Once a borrower can name a potentially liable defendant, the borrower must still establish the existence of a kickback or unearned fee.

b. Yielding to Yield Spread Premiums

Courts have further narrowed the utility of § 2607 to the subprime borrower by disallowing suits for yield spread premiums (YSPs), which may be disguised kickbacks. The YSP enables the borrower to pay less at the time of settlement in exchange for a higher interest rate and

¹⁰¹ 24 C.F.R. § 3500.5 (2008) (“In determining what constitutes a bona fide transfer, HUD will consider the real source of funding and the real interest of the funding lender. Mortgage broker transactions that are table-funded are not secondary market transactions. Neither the creation of a dealer loan or dealer consumer credit contract, nor the first assignment of such loan or contract to a lender, is a secondary market transaction.”).

¹⁰² 24 C.F.R. § 3500.2 (2008).

¹⁰³ In assessing whether the lender was the original source of the funds, courts will consider “whether the lender closed in its own name and whether the lender used its own line of credit, for which it was solely responsible, to close the loan.” *Pierce v. Novastar Mortgage Inc.*, 489 F. Supp. 2d 1206, 1213 (W.D. Wash. 2007); *see also* 24 C.F.R. pt. 3500 app. B, illus. 5. It is not entirely clear if subprime loans are more likely to be table-funded as opposed to bona fide secondary market transactions, but the distinction nonetheless limits the theoretical range of subprime claims.

¹⁰⁴ See *supra* Part II.A.1 on the importance of holding additional parties liable in subprime transactions.

higher payments over the life of the loan¹⁰⁵—another feature that adds complexity to subprime loans. Subprime lenders frequently employ this device to induce borrowers to accept initially appealing obligations, which will soon exceed their financial capacities¹⁰⁶. Subprime borrowers, particularly those with little education or familiarity with novel lending practices, might find YSPs attractive, as the device can reduce or eliminate the origination fee.¹⁰⁷ Lenders may also pay fees to brokers in the form of YSPs to incentivize them into promoting high-interest loans.¹⁰⁸

Notably, YSPs are not categorically prohibited,¹⁰⁹ but a plaintiff can obtain treble damages by establishing the YSP was actually a kickback to a broker for arranging a loan at a higher rate than the plaintiff was otherwise eligible to receive.¹¹⁰ Courts apply a two-part test to determine if a YSP is reasonably related to the value of services performed, and not a kickback, inquiring: (1) whether the broker has provided the kind of goods or services typically associated with a mortgage transaction; and (2) whether there is a reasonable relationship between the total compensation paid to the broker and the total value of the goods or services actually provided.¹¹¹

¹⁰⁵ *Brazier v. Sec. Pacific Mortgage, Inc.*, 245 F. Supp. 2d 1136, 1139 n.1 (W.D. Wash. 2003) (“The broker pays the up front closing costs and recoups these costs by selling the mortgage to an investor at a higher price, reflecting the higher interest rate. The price that the investor pays the broker for this higher rate loan is the yield spread premium.” (citing 64 Fed. Reg. 10,080, 10,081 (Mar. 1, 1999))).

¹⁰⁶ Siddhartha Venkatesan, Note, *Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending*, 7 N.Y.U. J. LEGIS. & PUB. POL’Y 177, 184 (2003) (“[P]redatory lenders deceive good-faith borrowers by taking advantage of the segmentation inherent in the subprime market,” often issuing “a kickback, known as a yield spread premium, to mortgage brokers who direct, or steer, unsuspecting borrowers to that lender for loan origination. . . . The practice takes advantage of the borrower’s assumption that a mortgage broker acts as an agent working to secure the best mortgage deal possible.”).

¹⁰⁷ *See, e.g., Busby v. JRHBW Realty, Inc.*, 513 F.3d 1314, 1320-21 (11th Cir. 2008).

¹⁰⁸ *Pierce*, 489 F. Supp. 2d at 1208.

¹⁰⁹ Recently, an outright prohibition on YSPs was considered but ultimately dismissed. Press Release, Fed. Reserve Bd. Issues Final Rule Amending Home Mortgage Provisions of Regulation Z (Truth in Lending) (July 14, 2008), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm>.

¹¹⁰ *See, e.g., Maganallez v. Hilltop Lending Corp.*, 505 F. Supp. 2d 594, 603-04 (N.D. Cal. 2007).

¹¹¹ *Busby*, 513 F.3d at 1321. Once a court concludes that a broker has provided goods or services, as per a 2001 HUD Statement of Policy, in applying the second prong, the court will not determine whether there is a direct linkage between the YSP and goods or services, but will examine all of the goods or services and evaluate them in light of all compensation that a broker received from any sources. *See Culpepper v. Irwin Mortgage Corp.*, 491 F.3d 1260, 1273 (11th Cir. 2007). The assessment of reasonableness of total compensation involves both an objective inquiry (comparing market rates in the area for similar goods or services) and a subjective inquiry (analyzing particular goods or services offered). *Id.* at 1267-68 (discussing 2001 HUD Statement of Policy); *see also* Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53,052, 53,055-56

Nevertheless, some courts, at least in cases preceding the subprime fallout, have made it difficult for a plaintiff to recover on the YSP-kickback theory.¹¹² Some courts have also curtailed YSP cases by barring class actions for these claims.¹¹³ This narrow construction acutely affects subprime borrowers given the particular importance of claims based on high fees attendant to multiparty relationships, and the virtues of class actions.

c. The Overcharge v. Markup Distinction

Under the prevailing judicial interpretation of the prohibition against unearned fees,¹¹⁴ a subprime borrower cannot obtain relief for an “overcharge,” but might recover in some circuits, by proving a “markup.”¹¹⁵ An overcharge refers to provision of goods or services for

(Oct. 18, 2001) [hereinafter 2001 HUD Statement of Policy].

¹¹² Azmy, *supra* note 46, at 350 n.267 (citing cases and concluding “[a]fter some initial uncertainty, courts have made it more difficult to demonstrate that a yield spread premium constitutes an illegal kickback under RESPA”).

¹¹³ *Busby*, 513 F.3d 1314. Nevertheless, in an atmosphere of increasing judicial willingness to offer aggrieved borrowers a forum, class action certification has been recognized in cases alleging a fee for which no services have been performed, which falls under the rubric of an unearned fee, as opposed to a YSP, which is tested as a kickback. *Id.* at 1321, 1324-26 (noting that the reasoning for disallowing YSP class actions is largely based on the 2001 HUD Statement of Policy urging case-by-case review).

¹¹⁴ Based upon the 2001 HUD Statement of Policy, courts have recognized four categories of impermissible unearned fees: (1) unearned split fees; (2) markups; (3) overcharges; and (4) unearned, undivided fees. *Freeman v. Quicken Loans, Inc.*, Civ. Action Nos. 08-1626, 08-1627, 08-4744, 2009 WL 2448033, at *12-13 (E.D. La. Aug. 10, 2009) (providing an excellent summary of case law involving various unearned fees); *see also* 2001 HUD Statement of Policy, *supra* note 111, at 53,059. (“The Secretary, therefore, interprets Section 8(b) of RESPA to prohibit all unearned fees, including, but not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.”). This Note focuses on the overcharge/markup distinction, which pertains most to the subprime borrower.

¹¹⁵ *See Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3d Cir. 2005); *Maganalvez v. Hilltop Lending Corp.*, 505 F. Supp. 2d 594, 604 (N.D. Cal. 2007) (summarizing consensus among several circuits that RESPA does not prohibit overcharges). Despite judicial agreement that RESPA does not prohibit overcharges, there is currently a circuit split over whether RESPA prohibits markups. *Morrison v. Brookstone Mortgage Co.*, No. 2:03-CV-729, 2006 WL 2850522, at *4-7 (S.D. Ohio Sept. 29, 2006) (discussing the circuit split and holding that a RESPA markup violation requires a third party to split a charge). *Contra Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49, 57-58 (2d Cir. 2004) (finding the statute ambiguous and deferring to the 2001 HUD Statement of Policy to conclude that a markup constitutes a violation even if the transaction lacks a culpable giver (and only has a culpable receiver) provided that the excess is not for services actually performed by the settlement service provider). This markup conflict confuses the categorization discussed *supra* note 114, which distinguishes between markups and undivided, unearned fees. The requirement of a culpable third party limits RESPA claims.

substantially more than the provider's cost.¹¹⁶ A markup entails charging a borrower a greater price than that which the settlement service provider paid to a third party, without providing additional goods or services.¹¹⁷ Both overcharges and markups result in an oppressively high fee for the subprime borrower, and an exclusion of overcharges, and limitations on markups by some courts strips subprime borrowers of protection. This is problematic since extortionate terms packed into complex loans can easily escape detection by inexperienced subprime borrowers, and the realization may not occur until after the transaction. Notably, based upon a finding of no clear statutory prohibition, courts have sanctioned overcharges and declined to defer to the U.S. Department of Housing and Urban Development's (HUD) position that overcharges should also be prohibited.¹¹⁸ The judicial determination in this context that RESPA was not intended to impose price controls¹¹⁹ demonstrates that RESPA was not designed to ensure substantively fair terms,¹²⁰ much to the detriment of the subprime borrower.

2. Claims for Servicing-Related Violations

RESPA's provision on servicing improprieties (§ 2605) permits individual and class action suits for actual damages, additional statutory damages, costs of the action, and attorneys fees,¹²¹ where the borrower has not received notification regarding transfer of servicing,¹²² or has not received a response to a qualified written request for servicing information (or questioning of a purported account error).¹²³ In relation

¹¹⁶ *Morrison*, 2006 WL 2850522, at *4 n.5; 2001 HUD Statement of Policy, *supra* note 111, at 53,059.

¹¹⁷ *Morrison*, 2006 WL 2850522, at *4 n.5.

¹¹⁸ *See, e.g., Santiago*, 417 F.3d at 386-88; *Kruse*, 383 F.3d at 56-57.

¹¹⁹ *Santiago*, 417 F.3d at 388 n.3; *Kruse*, 383 F.3d at 57.

¹²⁰ Conversely, HOEPA, which only applies to qualifying loans, prohibits certain onerous lending terms and practices such as prepayment penalties. 15 U.S.C. § 1639 (2006). This distinction may evince consistency in congressional approach because HOEPA amended TILA, so perhaps it reflects a realization of changing market conditions, including increased use of predatory practices in the subprime market. *See Tashman, supra* note 16, at 413.

¹²¹ 12 U.S.C. § 2605(f) (2006).

¹²² 12 U.S.C. § 2605(a) (requiring a lender to disclose at the time of application the possibility that loan servicing could be assigned, sold, or transferred to another at any time while the loan is outstanding). Moreover, a transferring lender must provide appropriate notice to the borrower of loan servicing at the time of transfer to the servicer. Section 2605(b) details notice in terms of timing, contents of notice, etc. The notification must assure the borrower that there has been no change in the loan terms, other than those directly related to the servicing of such loan. *Id.* § 2605(b)(3)(G). Transferees must also provide borrowers with notification of transfer. *Id.* § 2605(c).

¹²³ *Id.* § 2605(e).

to servicing, a borrower may also be able to bring a claim for some problems in escrow account administration.

In light of the modern practice of loan servicing by parties other than original lenders, and the ability of servicers to initiate foreclosures,¹²⁴ § 2605 has potential utility to aggrieved subprime borrowers. Section 2605 actually acknowledges the economic reality that the lender and servicer are probably not the same party.¹²⁵ As the borrower's priority is to avoid foreclosure, the servicing relationship assumes paramount importance.¹²⁶ Thus, servicing disclosures are significant, and particularly important given the subprime theme of multiparty transactions.

a. Failure to Respond to a "Qualified Written Request"

Section 2605 requires servicers to respond to a borrower's request for information and to take appropriate action, which includes making corrections or providing a borrower with clarification.¹²⁷ Additionally, during the sixty-day period in which a servicer can take appropriate action, it must protect the borrower's credit and not provide information on any overdue payment, related to the qualified written request, to consumer credit agencies.

The qualified written request provision does have some benefits. This nonlitigious (or prelitigation) alternative can resolve a discrepancy without the costs of litigation. The provision also enhances transparency, which is vital to subprime transactions with complex terms and uninformed borrowers. Additionally, not transmitting information to consumer credit agencies protects the subprime borrower from collateral adverse economic consequences that might result due to the release of information on a disputed matter.¹²⁸

Nevertheless, the qualified written request will seldom aid the subprime borrower. Resorting to this remedy may still entail consultation with an attorney (not a viable option for the struggling

¹²⁴ Peterson, *supra* note 7, at 2210 ("[O]ften servicing is done by a company specializing in this activity.").

¹²⁵ See 24 C.F.R. § 3500.5(b)(7) (2008) (listing § 2605 as an exception to the secondary market exemption).

¹²⁶ See Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121, 124-26 (2008) (concluding that the "flawed system of mortgage servicing is a key contributor to the current crisis in the American home-mortgage market. . . . Although policy makers have focused on loan origination, consumers can suffer dire harms from poor mortgage servicing.").

¹²⁷ 12 U.S.C. § 2605(e).

¹²⁸ See *Katz v. Dime Sav. Bank, FSB*, 992 F. Supp. 250, 255-57 (W.D.N.Y. 1997). Involvement of a consumer credit agency is highly probable in subprime cases where mortgagors are conceivably struggling to make payments to various creditors.

debtor) as an inexperienced borrower is probably unaware of the right to a qualified written request. Additionally, the qualified written request does not assist the insolvent subprime borrower whose main problem is an unaffordable mortgage.¹²⁹

b. The Damage Ditch

Although potential recovery of actual and statutory damages balances the goals of compensation and deterrence, obtaining meaningful recovery under § 2605 is difficult. Actual damages offer greater potential relief, but entail a tough standard. To recover actual damages, a borrower must demonstrate actual harm, and proof of causation between the violation and the alleged harm.¹³⁰ Courts have recognized pecuniary damages for (1) out-of-pocket expenses incurred while dealing with the RESPA violation such as expenses for preparing, photocopying, and obtaining certified copies of correspondence; (2) lost time and inconvenience (time spent away from employment to handle RESPA correspondence to the extent it resulted in actual pecuniary loss); (3) late fees; and (4) denial of credit or of access to the full amount of a credit line.¹³¹ Not only have courts declined to liberally award these pecuniary damages, but they also disagree on the availability of nonpecuniary damages such as damages for emotional distress.¹³² Additional statutory damages do not improve the situation, as they are discretionary, require a pattern or practice of noncompliance with § 2605 (which remains an undefined standard), and are limited to \$1,000 for such pattern or practice in individual suits. Even if a more liberal construction can overcome some of these constraints, it is highly unlikely that it will produce a value substantial enough to offer meaningful relief from imminent foreclosure.

¹²⁹ A qualified written request provides a borrower with vital details such as an account balance, but it is improbable that a lender would gratuitously adjust a loan once a borrower discovers and objects to the outrageous terms.

¹³⁰ See, e.g., *Johnstone v. Bank of America, N.A.*, 173 F. Supp. 2d 809, 813-14 (N.D. Ill. 2001); *Spencer v. Hutchens*, 471 F. Supp. 2d 548, 554 (M.D.N.C. 2006); see also *infra* Part II.C.2.b (discussing how, under TILA, courts have required a showing of detrimental reliance to prove actual damages in cases of disclosure violations).

¹³¹ *McLean v. GMAC Mortgage Corp.*, 595 F. Supp. 2d 1360, 1366 (S.D. Fla. 2009).

¹³² Compare *id.* at 1366-74 (recognizing possibility of, but denying, damages for emotional distress, lost time, lost wages, damage to credit, and out-of-pocket expenses incurred in dealing with the RESPA violation), and *Johnstone*, 173 F. Supp. 2d at 813-17 (holding borrower could recover actual damages for emotional distress in addition to damages for late fees, foreclosure proceedings, time spent, and inconvenience), with *Katz*, 992 F. Supp. at 255-57 (excluding noneconomic damages, including emotional damage and personal injury, from the actual damage calculation under RESPA, and holding that, to sustain a claim for economic loss under the facts, plaintiff would need to produce evidence of an intent to refinance or sell the home or that he was denied such opportunities as a result of the defendant's conduct).

c. Evading Escrow Account Violations

RESPA requires servicers to make timely payments from escrow accounts,¹³³ and to provide borrowers with an itemization of payments to be made from the escrow accounts and notification of any shortage in the accounts.¹³⁴ RESPA also limits advanced deposits in escrow accounts.¹³⁵

However, escrow requirements provide little assistance to the subprime borrower. Firstly, use of escrow in the subprime market is rare, especially in comparison to the prime market.¹³⁶ In fact, the absence of escrow accounts has contributed to subprime failure.¹³⁷

Secondly, even if subprime borrowers have escrow accounts, several circuits have restricted suits pursuant to escrow account administration.¹³⁸ For example, based on statutory silence, courts have found no private right of action on the provision limiting advance deposits in escrow accounts, although the issue is far from resolved.¹³⁹

3. Irradicating an Implied Private Right of Action

Although RESPA has other substantive provisions and requirements in addition to those regulating kickbacks/unearned fees and servicing, borrower relief under RESPA is severely constrained by

¹³³ 12 U.S.C. § 2605(g) (2006). For background on escrow, see *supra* notes 27-31 and accompanying text.

¹³⁴ 12 U.S.C. § 2609(b)-(c). An escrow statement details the borrower's current monthly payment, the portion of the monthly payment being placed in the escrow account, the total amount paid into the escrow account during the period, the total amount paid out of the escrow account during the period for taxes, insurance premiums, and other separately identified charges, and the balance in the escrow account at the conclusion of the period. *Id.* § 2609(c)(2)(A).

¹³⁵ *Id.* § 2609(a).

¹³⁶ Truth in Lending, 73 Fed. Reg. 44,522, 44,557-62 (July 30, 2008).

¹³⁷ See *supra* notes 27-31 and accompanying text.

¹³⁸ If subprime borrowers had escrow accounts, these requirements could be useful in providing advance notice and clarification of future payment allocation, which can help gauge actual total cost of home ownership. However, judicial limitations on suits undermine the helpfulness of these provisions.

¹³⁹ *Hardy v. Regions Mortgage, Inc.*, 449 F.3d 1357 (11th Cir. 2006) (finding no private right of action); *McAnaney v. Astoria Fin. Corp.*, 357 F. Supp. 2d 578, 590-91 (E.D.N.Y. 2005) (noting that the Second Circuit has not yet resolved whether a private right of action exists under § 2609, but most circuits have found none exists based on silence in § 2609 compared to explicit authorization of a private right in other RESPA provisions, as well as exclusion from the statute of limitations section). *Contra Heller v. First Town Mortgage Corp.*, No. 97 Civ. 8575, 1998 WL 614197, at *2-4 (S.D.N.Y. Sept. 14, 1998) (finding a private right of action under § 2609). Notably, § 2609 explicitly provides for an administrative civil penalty for failure to submit escrow statements. 12 U.S.C. § 2609(d). Additionally, the other escrow provision on timely payments, § 2605(g), appears to allow a private right of action.

judicial interpretation that RESPA lacks an implied private right of action. Notwithstanding ambiguity and limitations in applying the preceding provisions on kickbacks/unearned fees and servicing, courts cannot dispute the explicit statutory language, which confers borrowers with a private cause of action. But a question arises on RESPA sections which are silent on a private remedy for borrowers. A more liberal construction of this silence could enhance relief to subprime borrowers.

Most courts have held that no private right of action exists for various RESPA provisions relevant to the subprime borrower, finding that RESPA as a whole does not imply a private right of action.¹⁴⁰ In determining the existence of a private right of action, courts consider several factors.¹⁴¹ The intent of Congress has played an especially prominent role in the analysis.¹⁴² Under the relevant inquiry, courts have rejected various RESPA claims including escrow claims on advanced deposits mentioned *supra*. Courts have also denied private suits for inaccurate HUD-1 disclosures relating to charges for settlement services.¹⁴³ Additionally, courts have disallowed private rights of action for a lender's failure to provide a borrower with a GFE of settlement charges within three days of a loan application.¹⁴⁴ Accurate disclosures and GFEs are especially relevant to the vulnerable subprime borrower who already contends with complex terms and settlement costs ranging from "high to plainly exorbitant."¹⁴⁵ The lack of lender liability to

¹⁴⁰ *Sturm v. Peoples Trust & Sav. Bank*, 713 N.W.2d 1, 3-4 (Iowa 2006) (discussing various provisions in the private right debate and noting the outlier Sixth Circuit decision of *Vega v. First Federal Savings & Loan Association*, 622 F.2d 918 (6th Cir. 1980), which found RESPA implies a private cause of action).

¹⁴¹ These factors amount to a four prong test:

(1) whether the plaintiff is a member of the class for whose special benefit the statute was enacted; (2) whether there is an indication of legislative intent to create or deny an implied remedy; (3) whether a private cause of action is consistent with the underlying purposes of the legislative scheme; and (4) whether the cause of action is one traditionally relegated to state law.

McAnaney, 357 F. Supp. 2d at 590 (citing *Cort v. Ash*, 422 U.S. 66, 78 (1975)).

¹⁴² *Id.*

¹⁴³ See 12 U.S.C. § 2603 (2006); *Sanborn v. Am. Lending Network*, 506 F. Supp. 2d 917, 923 (D. Utah 2007) (rejecting plaintiff's attempt to link the HUD-1 violation with § 2605, which provides a private right of action); *Morrison v. Brookstone Mortgage Co.*, 415 F. Supp. 2d 801, 804-06 (S.D. Ohio 2005).

¹⁴⁴ See 12 U.S.C. § 2604 (2006); *Collins v. FMHA-USDA*, 105 F.3d 1366 (11th Cir. 1997) (finding no private right of action based upon legislative history and silence as compared to other sections of the statute). The fact that a prior version of the statute provided a private right of action suggests congressional intent to eliminate such a right. Nevertheless, perhaps the subprime chaos and rampant fraud necessitates an explicit reinstatement of the remedy. Notably, HUD publicly acknowledges that "[t]he RESPA statute does *not* provide an explicit penalty" for this provision, but "bank regulators may choose to impose penalties on lenders who fail to comply with federal law." U.S. Dep't of Hous. & Urban Dev., *supra* note 48.

¹⁴⁵ *McCoy*, *supra* note 73, at 137. Conversely, under TILA, private rights of action generally exist for disclosure transgressions. Perhaps this distinction is not entirely unreasonable since consequences of shrouded settlement costs may be quantitatively less than repercussions of faulty TILA disclosures for terms such as finance charges. Additionally, a deterrent rather than

borrowers in these cases makes lenders less inclined to ensure accuracy,¹⁴⁶ thereby impairing the borrower's ability to gauge the actual costs and affordability of a mortgage. This undermines the purpose of RESPA to enable informed consumer decisions. It is also paradoxical that a disclosure statute would limit liability for these disclosure deficiencies.

Empowering a borrower to vindicate his/her own rights without depending upon administrative enforcement would help achieve a full array of meaningful remedies.¹⁴⁷ While administrative enforcement generally focuses on deterrence, private suits focus on compensation. Further, deficient or unavailable administrative enforcement and oversight by the relevant regulatory agencies renders private suits particularly exigent for subprime loans;¹⁴⁸ in this situation, these private suits would also exert a deterrent effect. Thus, absent a private right of action, subprime lenders can easily escape liability, and borrowers can only base claims on a few provisions.

In conclusion, while RESPA can potentially aid the subprime borrower, it ultimately does not provide meaningful relief. First, RESPA's primary focus on disclosure rather than substantive terms fails to address the most egregious practices, which have produced subprime failures. Second, in addition to the inadequacy of RESPA-conferred rights, corresponding remedies are minor. Third, RESPA only explicitly permits a few private actions, and a cramped judicial interpretation has exacerbated the scarce options. Lastly, the absence of an implied right of action prevents borrowers from achieving a more complete vindication of rights within the narrow confines of the RESPA universe. These shortcomings demonstrate that RESPA's approach is inattentive to subprime characteristics. Similar deficiencies plague TILA, which will be examined in the following section.

C. TILA

Like RESPA, TILA is primarily a disclosure statute, designed to aid borrowers when lenders have been dishonest in disclosures or have failed to make disclosures to induce borrowers to enter into transactions. Subprime borrowers encounter a mismatch between TILA's requirements and available remedies and the subprime market's

compensatory approach may better suit RESPA cases where damages will be smaller.

¹⁴⁶ *See id.*

¹⁴⁷ *Cf. Fogel, supra note 22, at 459-60.* Fogel touts the superiority of state deceptive trade practices statutes, discussed *infra* Part III.B, for, among other reasons, their provision of private rights of action.

¹⁴⁸ *See supra* notes 47-48 and accompanying text.

complex terms, characteristic demographics, and multiparty transactions.

TILA's deficiencies are attributed to both the form and application of its provisions. Numerous courts have emphasized that because TILA is remedial in nature, its terms should be liberally construed in favor of the borrower.¹⁴⁹ Accordingly, while remaining consistent with the current statutory language, courts can interpret various TILA provisions to provide more meaningful relief to subprime borrowers.¹⁵⁰ Thus, judicial activism can expand liability. Moreover, TILA contemplates an active role of the Federal Reserve Board in implementing its provisions,¹⁵¹ and courts have frequently deferred to these administrative pronouncements.¹⁵²

Although TILA's HOEPA amendments seem particularly responsive to the unique needs of the subprime borrower,¹⁵³ they are no panacea. HOEPA serves as a testimonial that high-cost loans require additional protections and that recipients of these loans are particularly vulnerable to exploitative lenders unaffected by TILA disclosure rules.¹⁵⁴ HOEPA can aid the borrower's quest for legal relief by providing the borrower with additional causes of action. Nevertheless, predatory lenders can still escape liability by setting terms just below the minimum threshold,¹⁵⁵ though still egregious, to avoid compliance with the more rigorous provisions.¹⁵⁶ Thus, a higher threshold may enable abusive practices.¹⁵⁷ Additionally, HOEPA protections do not

¹⁴⁹ See, e.g., *Jefferies v. Ameriquest Mortgage Co.*, 543 F. Supp. 2d 368, 378 (E.D. Pa. 2008) ("TILA is a strict liability, remedial statute that is to be construed liberally in favor of borrowers." (citing *Smith v. Fid. Consumer Disc. Co.*, 898 F.2d 896, 898 (3d Cir. 1990)).

¹⁵⁰ TILA also specifically grants discretion to the judiciary through its provisions that allow a defendant to escape liability where there has been a correction of error; an unintentional violation/bona fide error; or good faith compliance with a Federal Reserve Board rule, regulation, or interpretation. 15 U.S.C. § 1640(b), (c), (f) (2006).

¹⁵¹ The Federal Reserve Board has rulemaking and administrative authority in implementing TILA. 15 U.S.C. § 1607(a), (d) (2006). These rules comprise Regulation Z (12 C.F.R. pt. 226). The Board may issue regulations "as in the judgment of the Board are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604 (2006).

¹⁵² See, e.g., *Cetto v. LaSalle Bank Nat'l Ass'n*, 518 F.3d 263, 274-77 (4th Cir. 2008). Thus, as was true under RESPA, additional legislation is not the only route to reforming the constrained language.

¹⁵³ Notably, HOEPA was passed in 1994, well before the subprime heyday. Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, tit. I, subtit. B, 108 Stat. 2190 (codified as amended in scattered sections of 15 U.S.C.); see also *supra* note 120.

¹⁵⁴ Azmy, *supra* note 46, at 352-56.

¹⁵⁵ See *supra* Section I.B.2 (detailing HOEPA requirements). Additionally, the triggers may not accurately reflect the amount borrowers pay because they exclude some fees. Joshua Michael Stolly, Comment, *Subprime Lending: Ohioans Fall Prey to Predatory Lending at Record Levels—What Next?*, 34 OHIO N.U. L. REV. 289, 302 (2008).

¹⁵⁶ Fogel, *supra* note 22, at 450-51.

¹⁵⁷ See *infra* Part III.A.2 for a discussion of how the new regulations have partially responded. However, even with a lower threshold, one can anticipate ancillary litigation over calculations to

apply to all types of loans. Significantly, HOEPA does not cover home purchase loans.¹⁵⁸

1. Liable Parties: Is There Anyone to Hold Accountable?

Borrowers may institute actions for TILA's limited remedies of damages and rescission against both creditors and assignees.¹⁵⁹ Where there has been multiple assignments, suits can be brought against any assignee in a chain of assignees.¹⁶⁰ Classification of actors into these two categories presents difficulties.

TILA's restrictions on liable parties may enable numerous parties to easily evade liability. In most subprime loans, mortgage brokers act in the role of "creditor" envisioned by TILA. Brokers handle actual tasks associated with origination of the loan, such as direct communication with the borrower; however, brokers generally do not meet TILA's definition of creditor.¹⁶¹ Additionally, although brokers may be liable for some advertising violations, these violations do not confer a private right of action.¹⁶² Conversely, servicers may be

determine applicability. *See* *Jefferies v. Ameriquest Mortgage Co.*, 543 F. Supp. 2d 368 (E.D. Pa. 2008) (denying summary judgment on application of HOEPA based upon incorrect calculations and the existence of genuine issues of material fact as to which fees to include in the calculations).

¹⁵⁸ 15 U.S.C. § 1602(aa)(1) (2006); *see also* McCoy *supra* note 73, at 136 (As a result of inapplicability to home purchase loans and high triggers, "HOEPA disclosures apply at most to five percent of subprime first-lien home loans."). The first lien is the primary claim by the lender for satisfaction of outstanding debt, and is created from a first mortgage. MortgageLoan.com, First Lien Definition, <http://www.mortgageloan.com/finance-glossary/First-lien> (last visited Dec. 24, 2008). As far back as 2000, a HUD report acknowledged an increase of subprime loans in the first-lien market. Suzanne F. Garwood & Melanie L. Hibbs, *The HUD and Treasury Joint Report on "Curbing Predatory Home Mortgage Lending."* 54 CONSUMER FIN. L.Q. REP. 218, 224 (2000). Presumably the number of subprime loans in the first lien market has only increased since this report in light of the housing boom and proliferation of subprime home purchases discussed *supra* Part I.A.2. However, HOEPA would only apply to first-lien refinance, not home purchase, loans. HOEPA also excludes reverse mortgage transactions and transactions under open credit plans. 15 U.S.C. § 1602(aa)(1).

¹⁵⁹ 15 U.S.C. § 1641 (2006).

¹⁶⁰ *Id.* § 1641(e); *see also* Peterson, *supra* note 7, at 2240.

¹⁶¹ Section 1602(f) defines a creditor as a person who regularly extends consumer credit, and to whom the debt is initially payable. *See also* Peterson, *supra* note 7, at 2255-56 ("[T]he federal statute which purports to promote useful and accurate disclosure of credit prices, does not govern the business or individual that actually speaks to a mortgage applicant. . . . [L]iability . . . is confined to errors in the complex paperwork, which many consumers have difficulty reading, and which are typically ignored in hurried loan closings long after borrowers arrive at decision on which broker and/or lender to use."). Typically the lender, not the broker, whose name appears on the legal obligation will bear responsibility for any disclosure mistakes. Fed. E-mail, *supra* note 48.

¹⁶² Peterson, *supra* note 7, at 2256 ("[T]hese provisions are quite limited in their substantive reach. For example, they never explicitly prohibit misleading advertising or even false descriptions of loans.").

creditors, but often they are not, and it is not always clear whether a servicer qualifies as an assignee or is merely a servicer.¹⁶³ These limitations are exacerbated in the subprime situation where many parties were involved in foisting an unaffordable loan on the borrower, and the initial creditor may no longer be actively involved in the transaction, or may have entered bankruptcy. Thus, there may not be anyone for the subprime borrower to hold liable.¹⁶⁴ Where available, HOEPA provides some relief by broadening the creditor definition.¹⁶⁵

Notably, TILA's and HOEPA's assignee provisions consider multiparty transactions to some extent, but establishing liability is still difficult. By allowing assignee liability, they partially erode the shields of waiver-of-defense clauses and the holder in due course doctrine. However, holding an assignee liable for damages under TILA requires that a violation be "apparent on the face of the disclosure statement" provided by the original creditor.¹⁶⁶ Admittedly, HOEPA has more lenient standards for imposing a more extensive liability on assignees, which seemingly recognizes the reality of subprime transactions.¹⁶⁷ But, subprime borrowers must still first qualify under HOEPA's high thresholds. Irrespective of the merits or drawbacks of broadening assignee liability, these facts demonstrate that TILA does not adequately consider the importance of assignee liability to subprime claims in light of multiparty involvement and several iterations of

¹⁶³ A servicer is not treated as an assignee unless the servicer is or was the owner of the obligation, where the ownership role cannot be for mere administrative convenience. 15 U.S.C. § 1641(f)(1), (2); *see also* *White v. Homefield Fin., Inc.*, 545 F. Supp. 2d 1159, 1167 (W.D. Wash. 2008) (finding an issue of material fact as to whether a party was the actual lender or only the current loan servicer). Indeed, courts have expressed frustration where it is not clear whether a defendant is a servicer or owner of the mortgage, or both. *See* JOHN C. MURRAY & BAXTER DUNAWAY, *SUBPRIME MORTGAGE AND MORTGAGE-BACKED SECURITIZATION LITIGATION*, LAW OF DISTRESSED REAL ESTATE § 55A:17 (2009).

¹⁶⁴ *See* discussion *supra* Part II.A.1 on the Multiparty Liability Problem.

¹⁶⁵ A HOEPA creditor originates at least two HOEPA mortgages in a twelve-month period, or originates one or more HOEPA mortgages through a broker. 15 U.S.C. § 1602(f). Conversely for non-HOEPA loans, a creditor extends more than five loans in the preceding calendar year. 12 C.F.R. § 226.2(a)(17)(i) n.3 (2008). For an interesting analysis of the issue, *see Cetto v. LaSalle Bank Nat'l Ass'n*, 518 F.3d 263, 271-72 (4th Cir. 2008).

¹⁶⁶ 15 U.S.C. § 1641(e).

¹⁶⁷ First, purchasers of HOEPA loans are liable for damages unless they can demonstrate that "a reasonable person exercising ordinary due diligence" could not have determined that the loan was covered by HOEPA. 15 U.S.C. § 1641(d)(1). *Compare id.*, with *id.* § 1641(e)(1)(A) (non-HOEPA loans require that a violation be "apparent on the face of the disclosure statement" for assignee liability). Second, HOEPA expands liability by subjecting the assignee of a high cost loan to liability for all claims and defenses, which might include such claims as fraud, unconscionability, and state deceptive trade practices, rather than merely TILA and/or HOEPA remedies. Peterson, *supra* note 7, at 2241. For authority noting that most HOEPA loans will allow assignee liability, *see Azmy, supra* note 46, at 354 n.294. *But see* Venkatesan, *supra* note 106, at 222 ("While it is true that the ordinary due diligence standard of HOEPA has already partially abrogated this doctrine [holder in due course], this standard is not yet solidified in this context, and still favors assignees.").

assignment.¹⁶⁸ Once a plaintiff clears this first hurdle of naming a liable party, TILA's damage and rescission remedies each present more obstacles to the subprime borrower.

2. The Dilemma of Damages

Borrowers can obtain statutory and actual damages under TILA by proving that creditors failed to disclose such vital information as the amount financed, the APR, the finance charge, and payment schedule.¹⁶⁹ However, monetary damage requirements frustrate meaningful recovery.

a. Statutory Damages

Borrowers have one year from the date of occurrence of the violation to recover statutory damages ranging from \$400 to \$4,000.¹⁷⁰ Borrowers with HOEPA loans can potentially obtain greater statutory damages.¹⁷¹

Recovery of statutory damages under TILA does not offer adequate relief to the subprime borrower. Judicial conflict on whether statutory damages are mandatory¹⁷² imposes a further constraint on borrowers. However, even a liberal awarding of statutory damages cannot compensate for the small authorized range. The additional recovery for HOEPA loans does not significantly improve the situation since HOEPA loans comprise just a narrow slice of the subprime market's most egregious loans. The only upside to the statutory damage provision is that there is no requirement of proving actual damages.¹⁷³

¹⁶⁸ See, e.g., Venkatesan, *supra* note 106. Even if a borrower can hold an assignee liable, recovery is limited by joint and several liability; thus, settlement in full with one defendant bars statutory claims against the other. *White*, 545 F. Supp. 2d at 1165-66. If both are judgment proof, which is not uncommon in the subprime context, the borrower is still left with little recourse. Peterson, *supra* note 7, at 2269-73.

¹⁶⁹ 15 U.S.C. § 1640(a) (2006) (by reference to cited provisions).

¹⁷⁰ 15 U.S.C.A. § 1640(a)(2)(A)(iii) (West 2009).

¹⁷¹ These additional damages are in the amount of the sum of all finance charges and fees paid by the consumer, unless a creditor's failure to comply was not material. *Id.* § 1640(a)(4).

¹⁷² *Mitchell v. Security Inv. Corp. of Palm Beaches*, 464 F. Supp. 650, 653 (S.D. Fla. 1979) ("This Court can, in its discretion, deny s 1640 damages if they are deemed inappropriate."). Nevertheless, the *Mitchell* court explained that based upon the law in the Circuit, where there is a disclosure violation, statutory damages are appropriate. *Contra Kurz v. Chase Manhattan Bank*, 273 F. Supp. 2d 474, 478 (S.D.N.Y. 2003) (court lacks discretion in imposing liability once violation is found); *Equity Plus Consumer Fin. & Mortgage Co. v. Howes*, 861 P.2d 214, 216 (N.M. 1993) (finding a "mandatory" civil penalty, as most courts have, and holding that Congress intended to create a scheme of private attorneys general).

¹⁷³ *Kurz*, 273 F. Supp. at 478; *Equity Plus Consumer Fin.*, 861 P.2d at 216.

To even attain these meager damages, borrowers must fulfill the statutory predicates for establishing a claim, which are not attuned to the subprime characteristics. For example, courts disagree on whether form and timing errors merit statutory damages.¹⁷⁴ Here, two equally plausible interpretations exist,¹⁷⁵ and courts should adopt the statutory reading most favorable to borrowers. A borrower-oriented reading would accord with the goals of the remedial statute. From both a compensatory and deterrent perspective, borrower autonomy over claims is especially critical in light of lackadaisical oversight and enforcement over the subprime market.¹⁷⁶ The exigency of borrower enforcement power is further magnified by the already limited availability of remedies based strictly upon the text.

Additionally, such technical violations may prove significant for subprime borrowers. Inexperienced subprime borrowers with complex loans may require greater clarification,¹⁷⁷ and the mode of presentation of terms may be critical to conveying information. Moreover, in upholding an approach of “hypertechnicality,” one circuit court has held that mortgagors should not need to make any “assumptions” about loan terms.¹⁷⁸ Assumptions to compensate for form and timing errors are particularly inappropriate in the subprime context.

¹⁷⁴ These errors may involve a failure to disclose finance charges and APR more conspicuously than other terms, and failure to make necessary disclosures prior to the consummation of the transaction. This reasoning is based on statutory structure and silence, and legislative history. See *In re Ferrell*, 358 B.R. 777, 785-90 (B.A.P. 9th Cir. 2006), *aff'd*, 539 F.3d 1186 (9th Cir. 2008) (citing to authority on both sides regarding damages for form and timing errors, but denying damages for such violations).

¹⁷⁵ *Baker v. Sunny Chevrolet, Inc.*, 349 F.3d 862, 868 (6th Cir. 2003) (denying statutory damages for form and timing violations, but acknowledging “two readings of the statute, both of which find support in the relevant caselaw and neither of which appears to be clearly correct on its face.”).

¹⁷⁶ See *supra* Part I.A.1.c; see also *supra* notes 140-48 and accompanying text (discussing the absence of a RESPA private right of action). In the context of RESPA, one court explained that consumer protection statutes are “designed to remedy and prevent harm arising from practices that injure many people but are not, in most instances, sufficiently damaging to outweigh the cost of litigation. . . . Statutory damages relieve litigants of the burden of having to prove an exact measure of pecuniary harm arising from a violation of their rights under the statute.” *Kahrer v. Ameriquist Mortgage Co.*, 418 F. Supp. 2d 748, 756 (W.D. Pa. 2006) (quoting *Patton v. Triad Guaranty Ins. Corp.*, No. CV100-132 (S.D. Ga. Oct. 10, 2002)).

¹⁷⁷ HOEPA’s additional disclosure requirements for qualifying loans demonstrate that increased explanation should correlate with increasing complexity of loans.

¹⁷⁸ *Hamm v. Ameriquist Mortgage Co.*, 506 F.3d 525, 529 (7th Cir. 2007) (recognizing varying approaches of other circuits, but noting that in the Seventh Circuit “when it comes to TILA, ‘hyper-technicality reigns.’” (citing *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760, 764 (7th Cir. 2006))). The *Hamm* court found a TILA violation for failing to explicitly state the payment period of loans in the disclosure statement (though present on other forms) because “the borrower should not have to make any assumptions; she should be told her payment period in explicit terms.” *Id.* at 531. Furthermore, statutory inclusion signifies that Congress perceived the importance of such technical matters.

Nevertheless, a denial of statutory damages does not preclude recovery of actual damages.¹⁷⁹

b. Actual Damages

Actual damages offer subprime plaintiffs a more substantial recovery above the paltry statutory allowance¹⁸⁰ and essentially reverse the abusive terms, but the actual damage standard is difficult to meet. To sustain a claim for actual damages, most courts require a demonstration of detrimental reliance.¹⁸¹ Thus, a plaintiff must show that: (1) he read the TILA disclosure statement; (2) he understood the charges being disclosed; (3) had the disclosure statement been accurate, he would have sought a lower price; and (4) he would have obtained a lower price.¹⁸²

This test discriminates against the subprime borrower. First, based on the demographic composition of the subprime market and the technical complexity of subprime loans, it seems unlikely that subprime borrowers would carefully read disclosure statements (especially if steered by a predatory lender).¹⁸³ Second, prong two undercuts the subprime borrower's claim that disclosed charges were not understood. Notably, fraud, which is beyond the scope of RESPA and TILA, may have induced the lack of understanding. Additionally, prongs three and four ignore the reality that subprime borrowers have fewer options in obtaining credit because of elevated risk profiles; thus, finding a lower price may not be feasible.

Not only is the actual damage standard demanding, but it also clashes with the requirements for class action suits, thereby further

¹⁷⁹ 15 U.S.C. § 1640(a) (2006); Eugene J. Kelley, Jr. & John L. Ropiequet, *Actual Damages Under the TILA: Collapsing Class Actions*, 55 CONSUMER FIN. L.Q. REP. 200, 200 (2001) (noting that although actual damages may be available for classes of claims that are ineligible for statutory damages, the actual damage standard is difficult to satisfy, especially for class actions); see also *In re Ferrell*, 358 B.R. at 782, 790-91. Thus, the unlikelihood of recovering statutory or actual damages for technical violations essentially eliminates a private right of action for such noncompliance.

¹⁸⁰ In severe cases, some courts have even considered mental anguish and distress in the actual damage calculation. See, e.g., *Kurz v. Chase Manhattan Bank*, 273 F. Supp. 2d 474, 480 (S.D.N.Y. 2003).

¹⁸¹ Most district courts require detrimental reliance, and in recent years, circuit courts have affirmed. Peter N. Cubita, *The Evolution of the TILA Actual Damages Standard*, 57 CONSUMER FIN. L.Q. REP. 197, 197-98 (2003); see, e.g., *In re Smith*, 289 F.3d 1155, 1157 (9th Cir. 2002) (noting agreement with other circuit courts).

¹⁸² *Perrone v. General Motors Acceptance Corp.*, 232 F.3d 433, 437 (5th Cir. 2000).

¹⁸³ Even prime borrowers may not always read disclosures. As for broker and lender deceit, claims based on deceptive trade practices statutes frequently accompany TILA and RESPA suits, and will be briefly addressed in Part III.B *infra*.

circumscribing collection of actual damages.¹⁸⁴ For example, actual damage claims often involve individualized proof, which militates against a finding of commonality,¹⁸⁵ a requisite element of class actions¹⁸⁶—the suits that hold great potential for subprime borrowers.

Thus, given the obstacles to receiving statutory and actual damages, the availability of dual damages is largely illusory¹⁸⁷ and poses a particular challenge to the subprime borrower. But, regardless of whether a borrower can obtain damages, TILA provides the more significant remedy of rescission.¹⁸⁸

3. The Right to Rescission

Borrowers of eligible loans can rescind their loan for any reason within three business days of the later of loan consummation or delivery of correct TILA disclosures.¹⁸⁹ The time expands to three years subsequent to consummation for those borrowers who can prove that they received inaccurate material disclosures,¹⁹⁰ were not provided with material disclosures, or were not informed of the right to rescind.¹⁹¹ Rescission aims to achieve a return to the status quo ante: The consumer (obligor) repays the loan proceeds, less any closing costs or previous payments made, in exchange for release from liability for any finance or other charge, and any security interest¹⁹² given by the obligor.¹⁹³

¹⁸⁴ See generally Kelley & Ropiequet, *supra* note 179; see also notes 39-40.

¹⁸⁵ See Kelley & Ropiequet, *supra* note 179, at 200.

¹⁸⁶ FED. R. CIV. P. 23(a)(2).

¹⁸⁷ Kelley & Ropiequet, *supra* note 179, at 206.

¹⁸⁸ See 15 U.S.C. § 1635(g) (2006) (“Additional relief”). The non-mutually exclusive nature of damages and rescission demonstrates that they can be roughly conceptualized as serving different purposes; statutory damages are a deterrent measure, actual damages are compensatory, and rescission is restorative. Cf. *Mitchell v. Sec. Inv. Corp. of Palm Beaches*, 464 F. Supp. 650, 653 (S.D. Fla. 1979) (statutory damages are a civil penalty and rescission effects a return to the status quo); see also discussion *infra* Part II.C.3.d. Notably, a rescinding party is not limited to some arbitrary value, just as one collecting actual damages is not limited, but statutory damages are capped.

¹⁸⁹ McCoy, *supra* note 73, at 130 n.40 (citing 15 U.S.C. § 1635(a)). Borrowers must receive written notice of the right to rescind at closing. *Id.*

¹⁹⁰ *Id.*

¹⁹¹ See 12 C.F.R. § 226.23(a)(3) (2008). “Material disclosures” include the required disclosures of the APR, the finance charge, the amount financed, the total of payments, and the payment schedule. *Id.* at n.48. For HOEPA loans, inclusion of prohibited terms is deemed a failure to deliver the required material disclosures, thus triggering the extended rescission period. 15 U.S.C. § 1639(j) (2006).

¹⁹² A security interest is defined as the right of a creditor to take all or part of a property offered as security. Investorwords.com, Security Interest Definition, http://www.investorwords.com/4449/security_interest.html (last visited Dec. 25, 2008).

¹⁹³ 15 U.S.C. § 1635(b) (2006); Lawrence Young, *Hot Topics for Consumer Class Actions*, in 10TH ANNUAL CONSUMER FINANCIAL SERVICES LITIGATION INSTITUTE, at 49, 58 (PLI Corp. L. & Practice, Course Handbook Series No. 1472, 2005). Thus, rescission effectively provides the

Rescission is of particular importance to subprime borrowers with loans with adjustable rates and other complex terms. The impact of these loan terms endure (and rates may escalate)¹⁹⁴ absent a restorative remedy like rescission. Nonetheless, although rescission offers borrower relief that is superior to damages by extricating the borrower from a bad loan, it still fails to achieve the ultimate objective of allowing a borrower to remain in his/her home.

Additionally, numerous statutory, prudential, and practical limitations dilute this remedy. For example, rescission is not available for home purchase loans or certain refinancings with the same creditor.¹⁹⁵ Presumably, these exclusions preclude remediation for a significant number of subprime borrowers, because one imagines the typical subprime borrower as seeking assistance in purchasing a home. Moreover, even where loans are eligible, rescission may be difficult or impossible if loans are part of securitized loan pools, which is common among subprime loans,¹⁹⁶ and underscores the Multiparty Liability Problem. Furthermore, once borrowers can establish eligibility for rescission based on threshold requirements, they must still contend with issues of time limits, actual execution of rescission, the impact of refinancing, and class action restrictions. As was true for other provisions, in working with this rigid statutory framework, courts have failed to heed the wisdom expressed by Professor Williston in his discussion of consumer credit protection and rescission: “[W]hen remedial statutes have been enacted for the benefit of a protected class such as consumers, courts liberally interpret the statute to promote the legislative objectives.”¹⁹⁷

a. Tight Time Limits

The limited timeframe of rescission poses an obstacle to subprime borrowers that would otherwise qualify for the remedy. Three business days do not provide adequate time for a borrower to develop insight about the ill-suited loan just assumed; this is especially true for the typical subprime borrower. Even with proper disclosure of terms, inexperienced subprime borrowers with complex loans may need more

borrower with interest-free use of the money for up to three years. *Id.*

¹⁹⁴ This contrasts to violations under RESPA, which generally relate to one-time fees. Thus, limiting the more extreme right of rescission to TILA claims, which are of greater value, is logical.

¹⁹⁵ 15 U.S.C. § 1635(e). Section 1635(a) explains which types of loans are eligible for rescission.

¹⁹⁶ Engel & McCoy, *supra* note 38, at 2078 (citation omitted).

¹⁹⁷ 28 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 70:235 (4th ed. West 2009).

time (than even the expanded three years) to detect a violation than prime borrowers, for whom the period may also be insufficient.¹⁹⁸ Conceivably, subprime borrowers may not discover violations until initial teaser rates expire and loans reset. With respect to timing, subprime borrowers are further constrained by the judicial consensus that TILA's rescission provision is a statute of repose, and thus not subject to equitable tolling.¹⁹⁹

b. Execution Difficulties

Execution of rescission also presents some practical difficulties that challenge the subprime borrower. Subprime borrowers who are struggling to make payments may experience severe trouble in accumulating sufficient funds to pay off and terminate the past transaction. In some instances, another loan will be necessary, the terms of which can be even more onerous²⁰⁰ despite full compliance with disclosures. Moreover, courts may deny rescission based on a borrower's inability to repay loan proceeds.²⁰¹ This determination is within the court's equitable discretion, and will be made on a case-by-case basis.²⁰² The requirement of establishing an ability to repay, while logical, particularly offends subprime borrowers, who are more likely to have a funding deficiency or experience difficulty in obtaining a new loan.

c. Refinancing Ramifications

Borrowers who succeed in refinancing subprime loans may also encounter difficulty in attaining rescission, as courts are split on the

¹⁹⁸ Cf. Fogel, *supra* note 22, at 450 ("Borrowers often do not realize that material terms have not been disclosed until they consult an attorney . . ."). Fixing an appropriate time is a difficult task for all types of claims.

¹⁹⁹ *In re Cmty. Bank of N. Va.*, 467 F. Supp. 2d 466, 480-81 (W.D. Pa. 2006) (citing *Beach v. Ocwen Fed. Bank*, 523 U.S. 410 (1998)). Conversely, some courts permit tolling for statutory damage claims. See, e.g., *Marcelos v. Dominguez*, No. C 08-00056, 2008 WL 1820683, at *4 (N.D. Cal. Apr. 21, 2008). Circuit courts are split on granting equitable tolling for RESPA claims, but many district courts permit it. *Id.* at *6.

²⁰⁰ Cf. Gretchen Morgenson, *The Silence of the Lenders*, N.Y. TIMES, July 13, 2008, at B1 (discussing how replacement loans in the modification context are often just as unaffordable as the original loans).

²⁰¹ *In re Luciano*, 200 F. App'x 628, 630 (9th Cir. 2006) (affirming denial by bankruptcy court, holding it acted within its discretion where borrower failed to show ability to tender repayment).

²⁰² *White v. Homefield Fin., Inc.*, 545 F. Supp. 2d 1159, 1167 (W.D. Wash. 2008); *Johnson v. Chase Manhattan Bank, USA N.A.*, Civil Action No. 07-526, 2007 WL 2033833, at *5 (E.D. Pa. July 11, 2007).

effect of refinancing.²⁰³ Some courts disallow rescission of a loan subsequent to refinancing since refinancing eliminates any security interest (and rescission results in the removal of a security interest). Thus, these courts have concluded that refinancing “supercedes” the deed of trust (security interest) underlying the original loan.²⁰⁴ Other jurisdictions have disagreed, noting that TILA and applicable regulations refer to a right to rescind the *transaction*, not just a right to rescind the *security interest*, and rescission would also entitle mortgagors to finance and other charges.²⁰⁵

Although a refinancing may help to avoid foreclosure, borrowers should still have the option of other remedies. Refinancing offers a prospective solution, but it does not remedy past transgression by returning excess payments incurred, as the rescission remedy provides. Where a subprime borrower received a bad loan and made payments to the profit of a lender whose practices violated TILA, rescission should be available. By allowing past lenders to escape liability, they are not deterred from engaging in predatory lending practices, nor are consumers fully compensated for abusive transactions. Judicial interpretation of rescission in cases of refinancing will prove significant in light of numerous refinancing initiatives.²⁰⁶

d. Curbing Class Actions

The prevailing circuit view rejecting a classwide right to rescission²⁰⁷ denies subprime borrowers the benefits of class actions. Although all three circuits that have considered the question to date denied class certification,²⁰⁸ the contrary approach of some district courts²⁰⁹ foreshadows more extensive appellate review.²¹⁰ The

²⁰³ See *Monaco v. Bear Stearns Residential Mortgage Corp.*, 554 F. Supp. 2d 1034, 1038-39 (C.D. Cal. 2008) (holding that it is constrained to disallow rescission subsequent to refinancing, but noting that other circuits diverge from the approach of the Ninth Circuit.). *But see* *Barrett v. JP Morgan Chase Bank, N.A.*, 445 F.3d 874, 877-83 (6th Cir. 2006) (noting that most district courts agree that refinancing does not extinguish the right to rescission).

²⁰⁴ *King v. California*, 784 F.2d 910, 913 (9th Cir. 1986).

²⁰⁵ *Barrett*, 445 F.3d at 878; *see* 15 U.S.C. § 1635(b) (2006).

²⁰⁶ For a discussion on refinancing opportunities created by new legislation and private initiatives, *see infra* Parts III.A.1, III.C.

²⁰⁷ Most recently, in a two-to-one decision, the Seventh Circuit overturned a Wisconsin district court decision, which granted class certification. *Andrews v. Chevy Chase Bank*, 545 F.3d 570 (7th Cir. 2008), *cert. denied*, 129 S. Ct. 2864 (2009). Notably, the Seventh Circuit expressed a desire to avoid creating a circuit split. *Id.* at 576-77.

²⁰⁸ *Andrews*, 545 F.3d at 576. This calculation includes the Seventh Circuit.

²⁰⁹ *See McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418, 423 (1st Cir. 2007) (finding no classwide right after acknowledging divergence among district courts). The *McKenna* court was persuaded by the lack of a pecuniary cap and the attendant threat of creditor insolvency, the availability of alternative damage remedies, and arguments for implied exclusion (amendment

extensive history of litigation and potential magnitude of the issue suggest this federal split is ripe for Supreme Court review.²¹¹ The debate focuses extensively on statutory structure, legislative intent and history, public policy, and judicial efficiency. This is another area where the judiciary wields enormous power to fill the gap created by statutory silence.²¹²

Notably, the recent litigation has involved declaratory judgments of the possibility of rescission vis-à-vis rescission simpliciter.²¹³ Although it would be exceedingly difficult to determine damages on a classwide basis, a classwide declaration of the right to rescind does not offend the argument that rescission was intended as a private restorative—rather than compensatory—remedy.²¹⁴ Thus, a classwide declaration could actually expedite the judicial process without confirming fears of infinite liability that would be detrimental to the loan market. In emphasizing the personal nature of TILA and variations in the “transactional ‘unwinding’ process,”²¹⁵ courts ruling against use of the class action vehicle have failed to heed the declaratory/simpliciter distinction.²¹⁶ Moreover, not all borrowers will rescind and the

of the damages section to specifically refer to class actions and impose a damage cap, but silence in the rescission provision). *See also* *LaLiberte v. Pacific Mercantile Bank*, 53 Cal. Rptr. 3d 745, 750 n.4 (Ct. App. 2007), *cert. denied*, 128 S. Ct. 393 (2007) (summarizing the two strands of cases); Angela C. Zambrano & Kent Barnett, *Putting the Cart before the Horse: Should a Court Certify a Class of Residential Consumers Seeking a Declaration that the Consumer—if They Later Choose—are Entitled to Rescind for a TILA Violation?*, 125 BANKING L.J. 160 (2008) (offering an extensive discussion on the issue).

²¹⁰ This issue has not been litigated in the Second and Ninth Circuits, which are generally considered liberal.

²¹¹ The Supreme Court has already denied certiorari on this issue on two known occasions: in *LaLiberte*, 53 Cal. Rptr. 3d 745, which involved an appeal from a California appellate court’s denial of class action rescission; and in *Andrews*, 545 F.3d 570, which involved a denial by the Seventh Circuit.

²¹² In denying class action relief, courts have focused on the presence of a statutory cap in the damage provision on class actions and silence in the rescission provision. *Andrews*, 545 F.3d at 575. But absence from the rescission provision is not dispositive; specification of statutory damages for class action recovery maintains consistency with the limit specified for individual statutory damages. *Cf. id.* (“It is of course possible (as our dissenting colleague suggests) that this difference in TILA’s remedial provisions could be understood to mean that TILA’s rescission remedy may be pursued on a class basis, without any liability limit.”).

²¹³ Rescission simpliciter would grant class members actual rescission. A declaration of the possibility of rescission would declare a TILA violation, and class members could individually seek rescission. *McKenna*, 475 F.3d at 426-27.

²¹⁴ *Andrews*, 545 F.3d at 575.

²¹⁵ *Id.* at 574.

²¹⁶ For example, the First Circuit dismissed the relevance of this distinction, disallowing certification for both direct and declaratory actions. *McKenna*, 475 F.3d at 426-27. The Seventh Circuit acknowledged this distinction, noting that a declaration of rescission would be followed by individual proceedings; but, rather than construing this as a preservation of the personal nature of rescission, the court concluded that TILA is “procedurally and substantively incompatible with the class-action device.” *Andrews*, 545 F. 3d at 574. The Seventh Circuit also found that the personal nature of the claims undercuts the predominance and superiority requirements of a class action. *Id.* at 577.

judiciary still retains discretion in granting equitable relief.²¹⁷ While persuasive, countervailing arguments exist, there is adequate support for both positions, and the ultimate resolution will produce a far-ranging impact.²¹⁸ Although classwide rescission will not always be appropriate, courts should not categorically proscribe it as a matter of law.

In conclusion, despite TILA's advances as compared to RESPA, TILA also clashes with the three subprime characteristics. First, while additional HOEPA protections remedy some of the subprime problems, eligibility standards are too narrow. Second, TILA's constrained definitions of potentially liable parties allow unscrupulous subprime players to escape responsibility for misconduct. Third, the statutory and actual damage provisions frustrate meaningful relief. Lastly, while rescission adds an ostensibly desirable remedy to the subprime borrower's arsenal of claims, its numerous limitations undermine its effectiveness. As was the case with RESPA, more than a self-operating, disclosure-based approach is needed to guard against predatory abuses in the subprime market.

III. ADDITIONAL SOURCES OF RELIEF²¹⁹

Thus far, this Note has identified federal provisions of particular importance to the subprime borrower, while pointing out deficiencies

²¹⁷ 545 F.3d at 578-79 (Evans, J., dissenting) (finding statutory clarity, and stating any ambiguity should be construed in favor of "victims," shifting the burden onto unscrupulous lenders rather than creating a "procedural obstacle" for borrowers).

²¹⁸ Jo Carrillo, *Dangerous Loans: Consumer Challenges to Adjustable Rate Mortgages*, 5 BERKLEY BUS. L.J. 1, 39-40 (2008) ("Andrews is a significant test of whether a class of plaintiffs who allege substantial violations of TILA's disclosure provisions can lower their individual legal costs and enhance their legal strength by seeking class-wide rescission It also raises the issue of whether courts have the power . . . 'to shield lenders from liability in ways that Congress has not.'"). Carrillo's article was published prior to the Seventh Circuit's decision.

²¹⁹ In addition to the federal, state, and private advances discussed in this Note, regulatory responses to the subprime fallout are apparent. Various state attorneys general, the Securities and Exchange Commission, and the FBI have initiated investigations against subprime mortgage businesses. See Bayless, *supra* note 2, at 549. These sources are beyond the scope of this Note, which focuses on borrower-initiated relief. Nonetheless, policing of the industry has its merits, as the deregulation of the industry has been cited as a contributing factor to the subprime fallout. See *supra* note 80. Although these approaches generally embrace a deterrent rather than a compensatory approach, these efforts may result in borrower relief or restitution. See, e.g., Gretchen Morgenson, *Countrywide to Set Aside \$8.4 Billion in Loan Aid*, N.Y. TIMES, Oct. 6, 2008, at B1 (discussing an eleven-state settlement in a predatory lending case which will result in the largest ever loan modification program). Additionally, the FTC has made headlines with recent enforcement actions, which may compensate borrowers. See Press Release, Fed. Trade Comm'n, Bear Stearns and EMC Mortgage to Pay \$28 Million to Settle FTC Charges of Unlawful Mortgage Servicing and Debt Collection Practices (Sept. 9, 2008), available at <http://www.ftc.gov/opa/2008/09/emc.shtm>.

attributed to statutory misalignment (in terms of requirements and remedies) with the unique characteristics of the subprime market. These identified areas are prime candidates for reform. Extant mortgage disclosure rules were designed for prime lending conditions and are unsuitable for the current subprime atmosphere—truly meaningful comparison shopping requires additional reform.²²⁰ But, instead of focusing exclusively on one route of reform based on a liberalization of the federal statutory, regulatory, or case law regimes, change must also arise from alternative and multiple sources. Innovation must draw upon multiple avenues of reform to produce the swiftest and most efficacious result, balancing compensation for deserving subprime borrowers with deterrence of predatory lenders. And to maximize the chances of success and meaningful relief, borrowers must pursue all potential remedies.

Relief opportunities must be evaluated with reference to the three subprime characteristics of complex terms, borrower demographics, and multiparty transactions.

A. *New Federal Policies Fight Back*

New legislation and regulations can provide the most explicit expansion of remedies and allay judicial concerns about overbroad construction. Legislative and regulatory changes can address virtually all of the problems identified in this Note, for example by expanding assignee liability, extending the availability of rescission, and prohibiting YSPs. However, it is unrealistic to propose that lawmakers enact amendments to account for all of the identified imperfections. Additionally, laws and rules must strike a balance between protecting borrowers and creating a favorable environment for the industry.

Nevertheless, new legislation and regulations enacted since the subprime implosion remedy some of the problems identified, and continued political discussions will potentially expand relief further.²²¹ However, much of the relief is prospective, as is generally the case with new legislation and regulations,²²² offering little recourse to subprime

²²⁰ See generally McCoy, *supra* note 73.

²²¹ See, e.g., Lori Montgomery & David Cho, *Pelosi Pushing Mortgage Relief*, WASH. POST, Dec. 16, 2008, at D1.

²²² This maxim can be found in many sources. See, e.g., FREDERIC JESUP STIMSON & HARVEY CORTLANDT VOORHEES, A CONCISE LAW DICTIONARY OF WORDS, PHRASES, AND MAXIMS: WITH AN EXPLANATORY LIST OF ABBREVIATIONS USED IN LAW BOOKS 262 (rev. ed. 1911). There is often a lag in the effective date to provide lenders sufficient time for compliance. Additionally, the new policies do not moot this thesis as the law-making process, particularly the legislative process, frequently proceeds at a snail's pace. Cf. David M. Herszenhorn, *Bush Signs Sweeping Housing Bill*, N.Y. TIMES, July 31, 2008, available at <http://www.nytimes.com/>

borrowers who took loans before the effective date of the new policies and who must still contend with the obstacles addressed in this Note.

1. New Responsive Legislation

The Housing and Economic Recovery Act of 2008 attacks the mortgage crisis from various angles, but it is by no means complete.²²³ As for new prospective rights and requirements, which serve as the predicate for available remedies, the new law partially responds to the subprime situation. It expands the types of home loans subject to early disclosures,²²⁴ and now requires disclosure of the maximum monthly payment for variable loans,²²⁵ which is significant to those with complex rate structures, as is typical for subprime borrowers.

Notwithstanding general prospective application, the legislation offers some immediate relief to borrowers. It doubles statutory damages for civil liability under TILA to the new range of \$400-\$4,000.²²⁶ But, this is still a relatively modest amount, especially in light of the difficult standard subprime borrowers face in supplementing this amount with actual damages. The legislation also assists eligible homeowners in refinancing into new government-insured fixed-rate loans by guaranteeing up to \$300 billion in insurance for refinancings that satisfy certain criteria.²²⁷ Significantly, this assistance achieves the borrower's primary goal of avoiding foreclosure and keeping his/her home. Nonetheless, the more than two-million Americans threatened by potential home loss far exceed the program's scope and will not all

2008/07/31/business/31housing.html (the new legislation has been "hailed as the most aggressive intervention by the government into the housing market in more than a generation, perhaps since the New Deal."). Moreover, new legislation and regulations cannot precisely anticipate the nuances of the individual cases on which judges must deliberate.

²²³ Pub. L. No. 110-289, 122 Stat. 2654 (codified as amended in scattered sections of the U.S.C.); Paul F. Hancock & Ezra Zask, *The New Law Designed to Help Struggling Homeowners Facing Foreclosure—Will It Really Work?*, in THE HOUSING AND ECONOMIC RECOVERY ACT OF 2008: AN IMMEDIATE LOOK AT THE LEGAL, GOVERNMENTAL, AND ECONOMIC RAMIFICATIONS OF THE PRESIDENT'S MORTGAGE FORECLOSURE RELIEF LEGISLATION 18 (Aspatore Special Report 2008) ("The new law really was not designed to deal with problems on a going-forward basis This law may have come at the end of the subprime crisis, since these loans with high rates of default are no longer being made."); John F. Wasik, *Many Face Foreclosure Despite Bailout Law*, ASBURY PARK PRESS, Aug. 10, 2008, at B2.

²²⁴ Housing and Economic Recovery Act § 2502(a)(1)-(5) (codified as amended at 15 U.S.C.A. § 1638(b)(2)(A) (West 2009)).

²²⁵ *Id.* § 2502(a)(6) (to be codified as amended at 15 U.S.C. § 1638(b)(2)(C)).

²²⁶ *Id.* § 2502(b) (codified as amended at 15 U.S.C.A. § 1640(a)(2)(A)(iii) (West 2009)).

²²⁷ Housing and Economic Recovery Act, div. A, tit. IV (codified at 12 U.S.C.A. § 1715z-23, 15 U.S.C.A. § 1639a, and codified as amended at 12 U.S.C.A. § 1708 (West 2009)). This refinancing assistance has been termed the HOPE for Homeowners Program. See U.S. Dep't of Hous. & Urban Dev., HOPE for Homeowners, <http://www.hud.gov/hopeforhomeowners/> (last visited Nov. 1, 2009) (providing information on the program's requirements).

benefit from the aid.²²⁸ Additionally, refinancing is also dependent upon lenders taking a voluntary loss, which essentially leaves the subprime borrower at the mercy of a lender who bears responsibility for the unscrupulous loan terms at issue. The \$700 billion government bailout in 2008 supplements this refinancing aid;²²⁹ however, the availability of this bailout to the subprime market, the market of the most financially challenged borrowers, may be quite limited.²³⁰

Most recently, in the first feverish days of his presidency, President Obama presented his Homeowner Affordability and Stability Plan.²³¹ This plan has three main components: (1) access to low-cost refinancing for eligible “responsible” homeowners; (2) strengthening confidence in Fannie Mae and Freddie Mac to provide support for low mortgage rates; and (3) creation of a \$75 billion Homeowner Stability Initiative (HSI) to assist at-risk homeowners with loan modification. Additionally, the plan advocates legislative changes to empower bankruptcy judges with the ability to issue loan modification orders. Notwithstanding initial optimism, a Congressional Oversight Panel recently expressed doubt about whether Obama’s plan could sufficiently halt the foreclosure crisis.²³² The program’s failure to adequately deal with the specific characteristics of subprime products is a principal reason for the critique.²³³

²²⁸ Wasik, *supra* note 223. Given the program’s requirements, it is also not entirely clear how useful the program will be for subprime borrowers in particular. Hancock & Zask, *supra* note 223; *see also infra* note 230.

²²⁹ See Jeanne Sahadi, *Bailout 101: What New Law Says*, CNN MONEY, Oct. 4, 2008, http://money.cnn.com/2008/10/03/news/economy/house_bill_summary/index.htm?postversion=2008100412. The bailout also empowers federal agencies to encourage loan servicers to modify mortgages through such measures as reducing the principal or interest rate.

²³⁰ For example, some of the \$700 billion package will be used to aid Fannie Mae and Freddie Mac in refinancing loans. However, these companies do not hold subprime loans. Thus, the aid “would have virtually no impact on the millions of people who took out expensive subprime loans and who are at the heart of the nation’s foreclosure crisis.” Edmund L. Andrews, *White House Scales Back a Mortgage Relief Plan*, N.Y. TIMES, Nov. 12, 2008, at B1.

²³¹ U.S. DEP’T OF TREASURY, MAKING HOME AFFORDABLE: UPDATED DETAILED PROGRAM DESCRIPTION (Mar. 4, 2009), http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf. President Obama continued this enthusiasm half-way through his first year with the launch of a national campaign for his Making Home Affordable Program. Press Release, Treasury Pub. Affairs, Obama Admin. to Launch Nat’l Outreach Campaign in Support of Making Home Affordable Program (June 26, 2009), *available at* http://www.financialstability.gov/latest/pr_06262009.html. The Making Home Affordable Program incorporates the HOPE for Homeowners Program. *See generally* U.S. Dep’t of Hous. & Urban Dev., *supra* note 227.

²³² Peter S. Goodman, *Panel Says Obama Plan Won’t Slow Foreclosures*, N.Y. TIMES, Oct. 10, 2009, at B1.

²³³ *Id.* (“The report rebuked the administration for failing to shape a program that addressed the most significant engines of the foreclosure crisis—soaring joblessness and *exotic mortgages* with low introductory interest rates that give way to sharply higher payments over the next three years.”) (emphasis added).

2. New Regulations Complement Legislation

Recent regulations issued by HUD and the Federal Reserve Board also attempt to redress the subprime crisis.

The new HUD rules²³⁴ that go into effect January 1, 2010 ameliorate some shortcomings that contributed to the subprime fallout. HUD will now require lenders and brokers to provide borrowers with a standard GFE, designed to provide clear and comprehensive information on a prospective mortgage. HUD is also limiting changes to GFEs, and requiring more meaningful disclosure of YSPs. Additionally, HUD will require the inclusion of a new page in the HUD-1 Settlement Statement that will allow a consumer to easily compare final loan terms and closing costs with those listed on the GFE. Enhancing clarity of disclosures should aid subprime borrowers in understanding the actual terms of their final loan, and foster more informed decision-making.

The new Federal Reserve Board regulations also respond to the subprime plight. The provisions most relevant to the subprime dilemma create a new category of higher-priced mortgages (below HOEPA thresholds) subject to additional protections.²³⁵ This new category should include virtually all subprime mortgage loans,²³⁶ and the modification supports this Note's proposition that HOEPA eligibility requirements did not adequately protect subprime borrowers. Significantly, the category of higher-priced mortgages will include home purchase loans, in addition to refinancings and home equity loans, a major advance from the narrower scope of loans eligible for HOEPA protection.²³⁷ The regulations also innovate in favor of subprime borrowers by requiring lenders to establish escrow accounts for all higher-priced first-lien mortgages, which should encompass most subprime transactions.²³⁸

Additionally, subprime borrowers may also benefit from new Federal Reserve Board requirements of general applicability, though the availability of some causes of action falls short and is far from

²³⁴ The following description was gleaned from a HUD factsheet. U.S. DEP'T OF HOUS. & URBAN DEV., NEW RESPA RULE FAQs (2009), <http://www.hud.gov/offices/hsg/ramh/res/resparulefaqs.pdf>.

²³⁵ The rules prohibit lenders from making loans without regard to a borrower's ability to repay from income and assets other than home value, require creditors to verify income and assets relied upon to determine repayment ability, and ban prepayment penalties except under some conditions. 12 C.F.R. § 226.35(b)(1)-(2) (2009); Press Release, Fed. Reserve, *supra* note 109.

²³⁶ *Id.*

²³⁷ Truth in Lending, 73 Fed. Reg. 44,522, 44,537-38 (July 30, 2008) (codified at 12 C.F.R. § 226.35(a) (2009)).

²³⁸ *Id.* at 44,559. The escrow account must be available for at least twelve months.

resolved.²³⁹ For example, despite increased requirements on servicers and brokers, only parties fitting into the definition of creditors and assignees face civil liability under TILA;²⁴⁰ thus, subprime borrowers still must contend with the Multiparty Liability Problem. A similar shortcoming applies to the rule banning several deceptive or misleading advertising practices, “including representing that a rate or payment is ‘fixed’ when it can change.”²⁴¹ This seems to directly respond to a subprime tactic, as inexperienced subprime borrowers with complex variable loan terms may have fallen prey to such deception. However, TILA generally does not permit a civil action, as opposed to an administrative enforcement action, for a violation of the TILA advertising rules, and it is unclear whether the new restriction alters this standard.²⁴²

Moreover, like the new HUD regulations, the new Federal Reserve Board provisions may provide too little too late, as the Federal Reserve Board rules generally did not take effect until October 2009—over a year from passage.²⁴³ This potential relief does not help the numerous borrowers already straddled with overdue payments, or facing rate elevations.

B. *State Law Makes Strides in Expanding Claims*

Frustrated with the inadequacy of federal protection, some scholars have argued for resolution at the state level.²⁴⁴ Despite the advantage of uniformity of a federal approach, state remedies can provide significant relief. In addition to state predatory lending statutes, some of which expand assignee liability,²⁴⁵ Unfair or Deceptive Trade Practices statutes (UDAP) have gained prominence, and provide another route to aiding the subprime borrower.²⁴⁶ Remedies under state consumer

²³⁹ Robert A. Cook, *Mortgage/Subprime Mortgage Lending Update*, in 13TH ANNUAL CONSUMER FINANCIAL SERVICES LITIGATION INSTITUTE, at 143, 151-53 (PLI Corp. L. & Practice, Course Handbook Series No. 1656, 2008).

²⁴⁰ See *id.* at 150, 152.

²⁴¹ See Press Release, Fed. Reserve, *supra* note 109.

²⁴² Cook, *supra* note 239, at 152-53.

²⁴³ Press Release, Fed. Reserve, *supra* note 109. The escrow rule does not go into effect until April 2010. *Id.*

²⁴⁴ Fogel, *supra* note 22, at 436 (“Although federal statutes regulating the lending industry are supported by strong policy statements that appear to provide significant protection for borrowers, ambiguous contract terms, weak enforcement provisions, and numerous statutory exceptions undermine the protective purposes of such statutes.”).

²⁴⁵ Engel & McCoy, *supra* note 38, at 2090-94.

²⁴⁶ These statutes have been termed “little FTC Acts”; UDAPs give consumers a private cause of action, and “typically treat FTC regulations and opinions as presumptive evidence of a deceptive or unfair trade practice.” Peterson, *supra* note 7, at 2229. Conversely, no private right of action is available under the Federal Trade Commission Act. *Id.* at 2225-29.

protection statutes may be more effective than weak federal and state predatory lending statutes.²⁴⁷ Increased efficacy is due to statewide similarity; and more general terms of unfair, unconscionable, or deceptive conduct, which do not require proof of a seller's fraudulent intent or misrepresentation. Additionally, these statutes authorize private rights of action; longer statutes of limitation; attorneys fees for prevailing consumers; and punitive, treble or minimum awards.²⁴⁸ State statutes also regulate the brokerage profession, honing in on the individuals most actively involved in mortgage transactions.²⁴⁹ Moreover, states can serve as laboratories of reform, enacting creative solutions, uniquely tailored to the state's concerns. For example, Massachusetts made the unprecedented move of declaring a temporary moratorium on foreclosures.²⁵⁰ In addition, to this statutory approach, some scholars have espoused state common law doctrines as holding great potential, especially for addressing the Multiparty Liability Problem confronting subprime borrowers.²⁵¹ These various state mechanisms are responsive to issues already discussed that are particularly acute for the subprime borrower, and more effectively address the causes of abusive subprime transactions than simple disclosure rules.

In some instances, the interaction of state and federal law works to the borrower's advantage. Absent an inconsistency with TILA or RESPA, a state claim may be brought for additional relief,²⁵² and borrowers often join TILA, RESPA and state claims in one action. Thus, the federal legislation suggests that Congress intended for the states to enhance protection for borrowers.²⁵³ Moreover, some courts have found a RESPA or TILA violation to constitute an unfair and deceptive practice pursuant to state statute, and that these state

²⁴⁷ Fogel, *supra* note 22, at 454-55.

²⁴⁸ *Id.*

²⁴⁹ 18 AM. JUR. PROOF OF FACTS 3D 559, §§ 4, 8 (Aug. 2009).

²⁵⁰ *MA Declares Moratorium on Foreclosures*, WCVB TV BOSTON: THE BOSTON CHANNEL, May 1, 2007, <http://www.thebostonchannel.com/news/13228876/detail.html>.

²⁵¹ In addition to breach of contract claims, common law claims include fraud for lender (and broker) misrepresentations in mortgage origination, unconscionability, and breach of fiduciary duty of mortgage brokers who purport to represent the interests of consumers. *See* Peterson, *supra* note 7, at 2229. Beyond these conventional common law approaches, some scholars advocate going beyond an expansion of assignee liability and applying doctrines of imputed liability, which include aiding and abetting liability, civil co-conspirator liability, and joint venture liability. *See supra* note 88. For example, under an aiding and abetting theory, parties related to the lender may be sued for the lender's improper practices. *See* Bayless, *supra* note 2, at 551 (In the case of *In re First Alliance Mortgage Co.*, 471 F.3d 977 (9th Cir. 2006), the court upheld a jury verdict holding Lehman Brothers liable for a subprime lender's fraudulent practices. The court found that Lehman Brothers continued to finance subprime mortgages by providing credit lines to the subprime lender despite knowledge of the lender's fraudulent practices.); Peterson, *supra* note 7, at 2247.

²⁵² 12 U.S.C. § 2616 (2006); 15 U.S.C. § 1610 (2006).

²⁵³ Fogel, *supra* note 22, at 464.

provisions incorporate RESPA and TILA disclosure requirements.²⁵⁴ This can enable a state claim to advance despite the unavailability of a federal claim, due to the nonexistence of a private right of action or the expiration of the statute of limitations;²⁵⁵ such allowance addresses major barriers that the federal statutes impose upon subprime borrowers. Additionally, states that have adopted TILA as a matter of state law are exempt from the federal act; thus, if the laws of these states allow recoupment, borrowers defending themselves against foreclosure or a collection suit are arguably not constrained by the three-year limitation on exercising the right of rescission.²⁵⁶ This increased availability of the rescission right, which is of fundamental importance to the subprime borrower, also presents another victory for subprime recovery.

On the other hand, federal law may also undercut state law. For example, federal preemption prevents many state statutes from regulating national banks as well as state entities that issue “alternative mortgage products.”²⁵⁷ This preemption thwarts a potential monitoring agent, which is especially problematic in light of lax federal regulation. Notably, UDAP statutes vis-à-vis state predatory lending statutes, may resolve this problem since UDAP statutes are rarely preempted by

²⁵⁴ *Brazier v. Sec. Pac. Mortgage, Inc.*, 245 F. Supp. 2d 1136, 1142 (W.D. Wash. 2003).

²⁵⁵ *See Monaco v. Bear Stearns Residential Mortgage Corp.*, 554 F. Supp. 2d 1034, 1039-40 (C.D. Cal. 2008); *Anderson v. Wells Fargo Home Mortgage, Inc.*, 259 F. Supp. 2d 1143, 1147-48 (W.D. Wash. 2003).

²⁵⁶ *McCoy*, *supra* note 73, at 130 n.40 (noting five states are exempt) (citations omitted). The Federal Reserve Board may exempt some transactions from TILA and federal enforcement where there is a substantially similar state law and adequate enforcement, but this exemption does not apply to the civil liability provisions. 15 U.S.C. § 1633 (2006); 12 C.F.R. § 226.29 (2008).

²⁵⁷ *See Fogel*, *supra* note 22, at 453 (discussing preemption of national banks). However, federal law does not impact compliance with state laws affecting the business of banking such as contract law, tort, public safety, and general criminal law. *Id.* Additionally, the Supreme Court has recently held that, although states lack “visitorial” (essentially supervisory) powers over national banks (as the Office of the Comptroller of the Currency (OCC) has exclusive authority), states may bring enforcement actions against these banks. *See Cuomo v. Clearing House Ass’n*, 129 S. Ct. 2710 (2009). Nevertheless, federal preemption remains a powerful force. Federal preemption also applies to state entities issuing alternative mortgage products (such as those with variable interest rates) pursuant to the Alternative Mortgage Transaction Parity Act (AMTPA) of 1982. 12 U.S.C. §§ 3801-3806 (2006). Because federally chartered institutions were authorized to issue nontraditional mortgage products, AMTPA “eliminate[s] the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide[s] them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.” *Id.* § 3801(b). This topic has generated significant litigation, and the situation created by AMTPA is highly relevant to the subprime crisis because AMTPA arguably promoted the issuance of subprime products while preventing a more strict system of regulation. *See generally* Kristine Cordier Karnezis, Annotation, *Validity, Construction, and Application of Alternative Mortgage Transaction Parity Act of 1982*, 12 U.S.C.A. §§ 3801 *et seq.*, 7 A.L.R. FED. 2D 151 (West 2009) (outlining contentious issues and cases under AMTPA). As discussed *supra* note 48, the vast majority of subprime lenders are not federally regulated.

federal law.²⁵⁸ Additionally, both RESPA and TILA contain provisions that preserve state law so long as it is not inconsistent with the federal law,²⁵⁹ but a finding of inconsistency will dispose of a state claim. Moreover, a restrictive interpretation of federal law can color the outcome under state law, which is often modeled after federal law. For example, a denial of classwide rescission pursuant to TILA, which denies subprime borrowers a tremendous tool of litigation, may also prevent a similar claim pursuant to state law.²⁶⁰ Perhaps this relates to judicial leerness of allowing a state cause of action to proceed where it is viewed as circumventing a disallowed federal claim.²⁶¹

Thus, despite some potential advantages, the limitations of state law render action at the federal level a necessity, and a liberal jurisprudence comprises a fundamental aspect of this resolution. The subprime crisis has a national scope, and a federal response has the most potential for a consistent and wide-ranging solution. Nevertheless, state law should continue to supplement a strengthened federal regime.

C. *The Potential of Private Solutions*

In addition to governmental remedies, market solutions can also aid subprime borrowers, perhaps providing more effective relief. Loan modification²⁶² and refinancing are superior to damages and rescission since they enable borrowers to achieve the ultimate goal of remaining in their homes in exchange for affordable payments. Subprime borrowers may obtain loan modifications through private negotiations with their lenders and servicers. Borrowers will have increased leverage in these negotiations where they assert defenses in foreclosure suits²⁶³ or threaten lawsuits for violations of lending laws. Nevertheless, the inflexibility of these parties²⁶⁴ has necessitated governmental

²⁵⁸ Fogel, *supra* note 22, at 464-65.

²⁵⁹ *See supra* note 252.

²⁶⁰ *See McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418, 422, 427 (1st Cir. 2007) (denying classwide right to rescission under parallel state statute).

²⁶¹ *See, e.g., Morrison v. Brookstone Mortgage Co.*, 415 F. Supp. 2d 801, 806 (S.D. Ohio 2005) (disallowing common law fraud claim, finding it “would improperly circumvent the Court’s holding with respect to Plaintiff’s claim under § 2603” [a RESPA provision on disclosure of settlement costs which does not impart a private cause of action]).

²⁶² “A loan modification is a permanent change in one or more of the terms of a loan to a mortgagor (borrower), which allows the loan to be reinstated and results in a payment the borrower can afford.” Shawn M. Yesner, *Loan Modifications Can Help Borrowers Keep Their Homes*, ANDREWS FIN. CRISIS LITIG. REP., 2009 WL 1886103 (July 2, 2009) (quoting HUD). Modifications “may include reducing the interest rate, changing the interest rate from adjustable to fixed, reducing principal balance, recapitalizing principal balance and other fees into the loan, and re-amortizing the loan.” *Id.*

²⁶³ *Id.*

²⁶⁴ Alan Zibel, *Hedge Funds See Profit in Buying Bad Mortgages*, AZSTARBIZ, Aug. 3, 2008,

involvement. Additionally, borrowers may encounter problems in pursuing modifications where their loans have been securitized into loan pools.²⁶⁵ Alternatively, borrowers can achieve immediate relief by refinancing their loans in arrangements with *new* private creditors, but borrowers with poor credit will likely experience particular difficulty qualifying for new deals in the current tight credit environment.

Another private solution has emerged via new third-party investors. Private equity groups, hedge funds, and other investors see opportunity in the wreckage, and have started purchasing distressed loans and foreclosed property from wallowing Wall Street investment banks at bargain basement prices.²⁶⁶ These new investors have embarked on private modifications that are similar to the (limited) provisions of the new federal legislation, but perhaps a free market solution will produce a more efficient result. These purchasers tout their superior ability to modify mortgages with terms favorable to consumers.²⁶⁷ Although this downstream approach does not address the root of the problem—an unregulated industry foisting draconian terms on the unsuspecting—it may be useful to borrowers. An estimated seventy percent of homeowners who are seriously delinquent in mortgage payments are not receiving assistance by lenders or servicers,²⁶⁸ and this private intervention may prod passive creditors into taking action.²⁶⁹ If the government is reluctant to intervene or tailors its programs too narrowly, perhaps a private market solution can remedy this neglect.

CONCLUSION

For many subprime borrowers, the American dream of home ownership has quickly morphed into a nightmare with scarce outlets for

<http://www.biltmorecapital.net/newsarchive/azstarnet/azstarnet.html>. Nonetheless, this Note must acknowledge one industry effort, HOPE NOW, which is an alliance between HUD-approved counseling agents, servicers, investors, and other mortgage market participants that provides free foreclosure prevention assistance. Hope Now, <http://www.hopenow.com> (last visited Dec. 22, 2008). HOPE NOW will craft “workouts” for borrowers, which may include lowering an interest rate or spreading out interest payments. See Daleiden, *supra* note 24, at 12.

²⁶⁵ See Vikas Bajaj & Eric Dash, *Banks Alter Loan Terms To Head Off Foreclosures*, N.Y. TIMES, Nov. 1, 2008, at B1. The impact of these initiatives is basically limited to loans owned by banks, because restrictive contracts limit banks’ flexibility to change the terms of loans packaged into securities, which banks service on behalf of investors in these mortgage-backed securities. Banks may own just a small fraction of total loans serviced. *Id.*

²⁶⁶ Zibel, *supra* note 264.

²⁶⁷ *Id.* (One hedge fund partner proclaimed, “We’re much easier to deal with than a bank.”).

²⁶⁸ Wasik, *supra* note 223 (citing the State Foreclosure Prevention Working Group). Wasik advocates pressuring creditors to lower payments, extend terms, and accept forbearance and deeds in lieu of foreclosure.

²⁶⁹ But perhaps some banks are beginning to realize loan modifications might be good for business. See Bajaj & Dash, *supra* note 265.

relief. The unbridled subprime industry utilized many predatory tactics to the detriment of borrowers, and now that housing prices are on the decline, borrowers must contend with the serious housing crisis that has erupted. Predation has also reemerged in the form of foreclosure rescue scams.²⁷⁰

Under the current federal legislative and regulatory schemes, which were designed for the prime market, borrowers face great difficulty in obtaining meaningful remedies. These problems are compounded when viewed through a subprime lens, focusing on the characteristics of complex loan terms, borrower demographics, and multiparty transactions. Forms of available relief are limited, and obtaining the meager remedies is difficult as the borrower must prove a violation of RESPA or TILA, both of which focus primarily on disclosure and do not adequately address egregious substantive terms or deception, major concerns of subprime loans. Additionally, the restricted availability of HOEPA weakens its limited, but potential utility. Moreover, courts have narrowly construed these provisions, erecting high standards for borrower recovery.

As for forms of relief, rescission is only available under TILA in extremely narrow circumstances, while damages under both RESPA and TILA are minimal and difficult to prove. Furthermore, available federal claims do not assist the borrower in remaining in the home—the Holy Grail of the crisis. The significant remedies of loan modification and refinancing, which preserve home ownership while reducing payments to an affordable level, are simply unavailable under RESPA and TILA. Despite some government initiatives on modification and refinancing, negotiations are largely dependent upon the private market.

As interest rates continue to reset on adjustable rate mortgages, subprime litigation and foreclosure will continue to swell. To obtain effective relief, subprime borrowers must not rely exclusively on RESPA and TILA and their corresponding regulations, but should pursue all available remedies including state claims and private negotiations; they may need to expend greater effort to obtain relief as they deal with a mismatched framework. Although new policies may expand remedies and avert a subsequent mortgage meltdown, aggrieved subprime borrowers should not expect a monolithic and retrospective resolution of the problem, or at least not any time soon.

²⁷⁰ TIMOTHY C. MOYNAHAN, REBECCA L. PAOLINO & JOY HARMON SPERLING, UNDERSTANDING THE HOMEOWNER AFFORDABILITY AND STABILITY ACT: AN IMMEDIATE LOOK AT THE LEGAL, GOVERNMENTAL, AND ECONOMIC RAMIFICATIONS OF PRESIDENT OBAMA'S MORTGAGE RESCUE PROGRAM 10 (Aspatore Special Report 2009).