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Sometime Less Is More: Utility, Preemption, and Hermeneutical Criticisms of Proposed Federal Regulation of Mortgage Brokers

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SOMETIMES LESS IS MORE: UTILITY, PREEMPTION, AND HERMENEUTICAL CRITICISMS OF PROPOSED FEDERAL REGULATION OF MORTGAGE BROKERS

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I. INTRODUCTION

Regulatory responses to predatory lending have from the outset raised two interrelated questions: What kinds of regulations will best combat predatory lending and who should enact those regulations? The former question asks what types of loan terms and lending practices should be proscribed or prescribed; the latter question asks which level of government, federal or state, is in the better position to make the policy judgments that inform the regulation of mortgage lending activities. As a growing number of state legislatures[1] have concluded that state level statutes are necessary because the substantive regulations enacted by the federal government through the Real Estate Settlement Procedures Act of 1974 (RESPA),[2] Truth in Lending Act (TILA),[3] and Home Ownership and Equity Protection Act of 1994 (HOEPA)[4] are inadequate to protect consumers, the locus of regulation—the *who* question—has became increasingly contentious. The introduction of bills in Congress that seek to regulate a particular actor in the "lending pipeline"—the mortgage broker—has inserted the jurisdictional question into a new context. It is this particular manifestation of the locus question that this Article will examine:

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1. As of early 2007, thirty-six states and the District of Columbia have enacted antipredatory lending statutes. *Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Financial Institutions: Hearing before the H. Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services.* 110th Cong. add. at 38–43 (2007) (Exhibit B to statement of Steven L. Antonakes, Massachusetts Comm'r of Banks, Conf. of State Bank Supervisors) (containing a chart that lists each of these statutes and provides a brief comparison of provisions in each). For a detailed analysis of the antipredatory lending statutes in effect in twenty-eight states at the end of 2004, see WEI LI & KEITH S. ERNST, CTR. FOR RESPONSIBLE LENDING, THE BEST VALUE IN THE SUBPRIME MARKET: STATE PREDATORY LENDING REFORMS 2 (2006), http://www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf.

2. 12 U.S.C. §§ 2601–2617 (2000).

3. 15 U.S.C. §§ 1601–1693 (2000).

4. Pub. L. No. 103-325, 108 Stat. 2190 (codified in scattered sections of 15 U.S.C.).

Are the proposals for federal regulation of mortgage brokers desirable or should the task of mortgage broker regulation be left to the states?

The desirability of some degree of regulation of mortgage brokers is widely recognized. Three facts support this consensus of opinion. First, as the National Association of Mortgage Brokers (NAMB) proudly proclaims, mortgage brokers originate approximately 70% of all residential mortgage loans[5] in the subprime lending market where the problem of predatory lending is most acute.[6] Thus, regulation of mortgage brokers is warranted by their extensive involvement in a troubled market. Second, NAMB acknowledges that mortgage brokers have unique access to borrowers and spend significant amounts of time working with borrowers.[7] Such access, which is unique among the participants in the lending pipeline, provides predatory brokers with ample opportunity to manipulate and exploit consumers. Thus, opportunity coupled with the incentive to extract high fees supports regulation. Third, mortgage brokers have been identified as participating in predatory lending.[8] In short, there are quantitative, qualitative, and experiential bases for regulating mortgage brokers at one or more levels of government.

To date, the direct regulation of mortgage brokers has taken place at the state level, as forty-nine (soon to be fifty) states regulate mortgage brokers through licensing or registration statutes and accompanying administrative regulations.[9] On the other hand, although RESPA, TILA, and HOEPA certainly impose some requirements on mortgage brokers, the federal government has not yet enacted any

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5. MODEL STATE STATUTE INITIATIVE: LICENSING, PRE-LICENSURE EDUCATION AND CONTINUING EDUCATION FOR ALL ORIGINATORS (Nat'l Ass'n of Mortgage Brokers, 2005) [hereinafter MSSI], *reprinted in Licensing and Registration in the Mortgage Industry: Hearing Before the H. Subcomm. on Housing and Community Opportunity of the H. Comm. on Financial Services*, 109th Cong. 70 (2005) [hereinafter *Licensing & Registration Hearing*]. The percentage of loans originated by mortgage brokers rises to 71% in the subprime market. *Residential Mortgage Origination Channels*, MBA RESEARCH DATA NOTES (Mortgage Bankers Ass'n, Wash., D.C.), Sept. 2006, at 1, 3, http://mortgagebankers.org /files/Bulletin /InternalResource/44664_September2006-ResidentialMortgageOriginationChannels.pdf.

6. *See* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 10–12 (2005) (discussing prime versus subprime markets and the legitimate and predatory aspects of the latter); Kathleen C. Engle & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1259–61 (2002) (identifying different loan markets and the presence of predatory lending).

7. *Licensing & Registration Hearing*, *supra* note 5, at 51 (statement of Joseph L. Falk, Chair, Government Affairs Comm., National Association of Mortgage Brokers).

8. *See, e.g.*, MINN. STAT. ANN. § 58.10 (West 2002) (stating that the purpose of Minnesota's mortgage broker licensing statute is "to help consumers avoid being victimized by unscrupulous . . . mortgage brokers"); ARK. CODE ANN. § 23-53-102(8) (West 2002) (recognizing that many homeowners have become "victims of overreaching lenders").

9. *Licensing & Registration Hearing*, *supra* note 5, at 98 (statement of Joseph A. Smith, Jr., North Carolina Comm'r of Banks, Conf. of State Bank Supervisors). At the time of Mr. Smith's testimony, Alaska and Colorado were the only states that did not have licensing or registration laws for mortgage brokers. *Id.* Subsequently, both states passed mortgage broker licensing statutes. For a chart that briefly describes the requirements of licensing statutes in all states except Alaska and provides links to regulator web sites, see Mortgage Academy, State-by-State Licensing Rules for Mortgage Brokers (Dec. 12, 2006), http://www.mortgageacademy.org/state_by_state.htm. The Alaska statute, which takes effect in 2008, is Enrolled Bill 162, which amends ALASKA STAT. § 06.01.050 (2007) and adds a new chapter 60, the Mortgage Lending Regulation Act.

statutes to regulate mortgage brokers through licensing or certification laws that would condition entry into the mortgage brokering business, monitor the conduct of brokers once in business, and sanction brokers who engage in undesirable conduct. That situation could change, however, as two bills were introduced in the 109th Congress to subject mortgage brokers to federal regulation.[10] With their introduction of these bills, the tension between the states and the federal government concerning the appropriate locus of regulation has found a new outlet.

After deconstructing the federal proposals for mortgage broker regulation and comparing them to existing state-level broker licensing statutes, this Article concludes that the federal proposals are undesirable for three reasons: they lack utility, they unwisely preempt provisions of state broker licensing statutes, and they embody a hermeneutical model that is based on faulty assumptions about consumer behavior in a residential mortgage loan transaction.

Following the Introduction, this Article consists of two main parts. In Part II of this Article, I analyze the two proposals for direct federal regulation of mortgage brokers on the basis of utility. Any utility-based analysis requires a defining statement, as utility can be understood only in connection with some goal. Utility could be understood, for example, in terms of facilitating transactional efficiency by allowing brokers to peddle loans subject only to the "corrective force" of the marketplace. In this Article, however, utility is to be understood in the sense expressed in the purposive language found in the bills themselves, which is the effectiveness at protecting consumers from predatory behavior by mortgage brokers. Drawing on a taxonomic hierarchy previously developed for a comparative analysis of state mortgage broker licensing statutes,[11] I conclude that the proposed federal laws lack utility because they only partially duplicate some of the regulatory mechanisms found in state licensing statutes and wholly omit others. Thus, the proposed federal laws are at once superfluous and incomplete.

Included in the taxonomic analysis in Part II of this Article is an evaluation of a proposal for a national registry of mortgage brokers and a database containing information about them.[12] A national registry and database could be useful tools in the battle against predatory lending, as they would enable consumers to identify and avoid brokers who have engaged in undesirable behaviors. The registry and database are not optimal regulatory measures because they promote a "borrower beware" approach rather than addressing the incentive structures that encourage brokers to engage in predatory behavior.[13] Nevertheless, increasing the visibility of predatory brokers by increasing the amount of publicly available information about

10. Predatory Mortgage Lending Practices Reduction Act, H.R. 1994, 109th Cong. (2005); Responsible Lending Act, H.R. 1295, 109th Cong. (2005). A third bill directed at mortgage broker regulation has been introduced in the 110th Congress. Senate Bill 1299, the Borrower's Protection Act of 2007, seeks to "establish on behalf of consumers a fiduciary duty and other standards of care for mortgage brokers and originators." An examination of S. 1299 is beyond the scope of this Article.

11. Lloyd T. Wilson, Jr., *A Taxonomic Analysis of Mortgage Broker Licensing Statutes: Developing a Programmatic Response to Predatory Lending*, 36 N.M. L. REV. 297, 297–98 (2006) [hereinafter Wilson, *Taxonomic Analysis*].

12. H.R. 1295 §§ 511–512.

13. *See* discussion *infra* Part III.B.

them would be a positive development. The information in the database could also be useful to lenders who want to avoid working with independent brokers who have committed predatory acts or who want to avoid hiring such brokers as in-house employees. Lastly, maintaining a national registry and database could be a suitable role for the federal government given its ability to effect nationwide participation.

Despite these possible advantages, the federal registry and database proposal that has been introduced in Congress is undesirable for two reasons. First, the proposal is currently inseparable from high-cost lending regulations that are decidedly not in consumers' best interests.[14] The benefits of the registry and database are simply not worth the cost of the many detrimental provisions found in other titles of the bill. Second, a similar registry and database is being jointly pursued by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR).[15] These state-level regulators would be the source of information collected for the proposed federal registry and database; therefore, the scope of included information would be no less comprehensive if the CSBS–AARMR proposal were favored over a federal plan. Further, if the goal truly is to protect consumers against predatory practices by mortgage brokers, the progressiveness of state efforts to combat predatory lending, in contrast to the comparatively tepid federal efforts, favors placing the registry and database in the hands of state regulators.

In the first section of Part III, I analyze the proposed federal laws for their preemptive effect on state mortgage broker licensing statutes. I demonstrate that even the bill that purports to establish only a regulatory floor for broker licensing and education requirements and leaves the states free to enact stricter rules has a significant and adverse impact on state broker licensing laws. Any contention to the contrary simply fails to recognize or acknowledge the effect of matters as fundamental as the exclusive definitions given to terms. For example, a narrow definition of *mortgage broker* that is made binding on the states inescapably limits the categories of persons—and consequently the number of persons—a state can regulate via a licensing statute.

Furthermore, it is improper to separate even the truly non-preemptive broker licensing and education requirements from the expressly preemptive provisions that govern loan terms and practices and to treat them as if they were unconnected. Two of the most effective tools available for states to regulate mortgage broker behavior are the power to suspend or revoke a broker's license and the power to impose sanctions or provide remedies for broker misconduct. Any federal law that establishes exclusive rules pertaining to broker activities necessarily limits a state's

14. *See* discussion *infra* Part II.C.3.b.

15. The Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) have formed a joint legislative task force "to identify and implement specific tools and approaches to reduce the regulatory complexity and compliance burden associated with making mortgage loans in more than one state, and to improve the state regulators' enforcement tools against abusive lending practices and improve the professionalism of the industry." *Licensing & Registration Hearing*, *supra* note 5, at 100; *see also id.* at 103–05 (discussing specifically the CSBS–AARMR registry and database of mortgage brokers).

power to define conduct that can trigger license suspension or revocation. Similarly, any federal law that imposes exclusive substantive limitations on or creates procedural barriers to claims against brokers necessarily limits a state's power to take action against a broker who has engaged in behavior that the state has determined to be harmful to its citizens. The claim of "baseline only" regulation of mortgage brokers[16] can never be true so long as the federal government claims exclusive power to define proscribed and permitted broker practices or determine sanctions and remedies. By failing to acknowledge these repercussions, federal regulation can effect a "stealth preemption"[17] of many of the important regulatory mechanisms found in state mortgage broker licensing statutes.

In the second section of Part III, I examine the hermeneutic filter upon which the proposals for federal regulation of mortgage brokers depend. The hermeneutics that underlies each of the federal proposals is grounded in the liberal economic view that government regulation is generally unnecessary and undesirable because it interferes with a self-regulating marketplace and with the exercise of individual will, which is presumed to be rational and utility maximizing.[18] The anthropology that results from this view is captured in the phrase *homo economicus*.[19] The liberal hermeneutics, with its *homo economicus* anthropology, is not, however, the only interpretative tool that can be applied to predatory lending in general and to mortgage brokers in particular.[20] In fact, several of the underlying premises of that view are contradicted by insights from psychology and behavioral economics.[21] Once this hermeneutical framework is deprived of its claim to exclusivity, interests other than the unfettered distribution of credit are legitimized and can become part of the debate. When efficient distribution of credit ceases to be *the* determinative factor and becomes instead *a* factor against which other values must be admitted, the oft-invoked "patchwork" criticism[22] leveled at state-level regulation loses much of its force.

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16. *Licensing & Registration Hearing*, *supra* note 5, at 2 (statement of the Honorable Robert Ney, Chair, H. Subcomm. on Housing and Community Opportunity); *see* discussion *infra* Part III.A (discussing the falsity of the "floor, not ceiling" claim).

17. I coin this phrase as a retort to the claim by a lending industry apologist that a state's imposition of "a host of consumer protection and compliance requirements on mortgage lenders, enforced by severe remedial provisions" constituted a "'stealth override' of federal preemption" of state regulation of rates, fees, and other economic loan terms. Donald C. Lampe, *Wrong from the Start? North Carolina's "Predatory Lending" Law and the Practice vs. Product Debate*, 7 CHAP. L. REV. 135, 143 (2004).

18. *See* Mark A. Sargent, *Utility, the Good and Civic Happiness: A Catholic Critique of Law and Economics*, 44 J. CATH. LEG. STUD. 35, 39–40 (2005).

19. *See id.* at 39. *Homo economicus* is "economic man."

20. *See* CAROL JOHNSTON, THE WEALTH OR HEALTH OF NATIONS: TRANSFORMING CAPITALISM FROM WITHIN 122–25 (Pilgrim Press 1998) (proposing an anthropology captured in the phrase *homo salutaris*—healthy human). This anthropology is discussed in more detail at Part III.B.

21. *See* Patricia A. McCoy, *A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725, 726 (2005).

22. *See* Donald J. Lampe, *Predatory Lending Initiatives, Legislation and Litigation: Federal Regulation, State Law and Preemption*, 56 CONSUMER FIN. L.Q. REP. 78, 86 (2002) ("[T]he actions of some states and municipalities [have created] a non-uniform patchwork of unrealistic laws . . . .").

Also in the second section of Part III, I examine a few of the ethical repercussions of the liberal hermeneutics that are embedded in the proposals for federal regulation of mortgage brokers. I begin by emphasizing the connection between one's way of interpreting the world—one's hermeneutical filter—and the way one acts in the world—one's ethics. Stated succinctly, the way one sees the world determines the way one acts in it.[23] The uncritical acceptance of the liberal hermeneutics by the federal proposals for mortgage broker regulation manifests itself in two unfortunate ways. First, under the banner of autonomy and willful decisionmaking, the hermeneutics dictates that only those broker behaviors that sink to the level of duress, unconscionability, or outright fraud are unethical. All other practices, no matter how sharp or exploitative, are deemed acceptable expressions of "free bargaining." Second, the liberal hermeneutics limits the range of ideas that can be considered to combat predatory lending. Disclosures, general education about mortgage lending, and individual loan counseling are acceptable because they prepare consumers to exercise their "freedom" to bargain with a predatory broker. Conversely, proposals that would regulate broker behavior toward consumers on the ground that predatory brokers exploit asymmetries in information and power or that would redefine the mortgage broker-borrower relationship either to impose a general suitability requirement or to impose a borrower's agency regime—analogous to the buyer's agency regime found in real estate sales brokerage—are rejected as anathema. These ethical dimensions of the prevailing hermeneutics need to be named and brought into the public debate about predatory mortgage lending and brokering.

II. A UTILITY-BASED CRITICISM OF PROPOSALS FOR FEDERAL REGULATION OF MORTGAGE BROKERS

Federal regulation of mortgage brokers has been the specific subject of a congressional hearing before the House Subcommittee on Housing and Community Opportunity, which is a subcommittee of the House Committee on Financial Services.[24] At a Hearing on Licensing and Registration in the Mortgage Industry (Licensing Hearing), then-chair Representative Robert Ney acknowledged that federal-level regulation of mortgage brokers "has not garnered a great deal of public attention and comment" and that "[m]ost of the debate [about predatory lending]

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23. *See* PARKER J. PALMER, TO KNOW AS WE ARE KNOWN: A SPIRITUALITY OF EDUCATION 21 (1983) ("The way we interact with the world in knowing it becomes the way we interact with the world as we live in it.").

24. All five bills introduced in the 109th Congress that sought to address predatory lending were assigned to the House Committee on Financial Services. In addition to House Bill 1994 and House Bill 1295, bills assigned to this committee that sought to address predatory lending by means other than direct regulation of mortgage brokers were House Bill 200, the Prevention of Predatory Lending Through Education Act; House Bill 1182, the Prohibit Predatory Lending Act; and House Bill 4471, the Fair and Responsible Lending Act. H.R. 1994, 109th Cong. (2005); H.R. 1295, 109th Cong. (2005); H.R. 200, 109th Cong. (2005); H.R. 1182, 109th Cong. (2005); H.R. 4471, 109th Cong. (2005). House Bill 4471 is very similar to Titles I and II of House Bill 1295. *Compare* H.R. 4471 *with* H.R. 1295 §§ 101–219 (both imposing minimum standards on the home mortgage industry).

has centered on which potentially abusive lending practices should be curtailed or prohibited in an effort to protect borrowers from unscrupulous lenders."[25] The broker-directed focus of House Bill 1994 and House Bill 1295 and the statements made at the Licensing Hearing confirm that the idea of federal regulation of mortgage brokers has moved into the foreground. Along with that movement has come the debate over the proper locus of regulation.

This question was squarely presented at the Licensing Hearing in the opening remarks of Representative Ney:

> In an industry in which some say that opportunities exist for bad actors to exploit and take advantage of both sophisticated and unsophisticated consumers alike, how should access to that industry be regulated to help insulate consumers from such practices?
>
> . . . [T]here are currently a number of state laws and legislative movements on the state level that address this very topic.
>
> Are these sufficient? Or, would some degree of minimum uniformity be helpful?[26]

These framing questions reveal two distinct issues: the sufficiency of state regulations and the degree of uniformity (or diversity) among them. The sufficiency of regulation, especially as the federal proposals compare to existing state laws, will be taken up in this Part. The uniformity interest raises important preemption issues and will be taken up in Part III.

Because the states already regulate mortgage brokers through licensing or registration,[27] federal regulation of mortgage brokers has utility[28] only if it contributes a regulatory approach, insight, or mechanism not found in state laws. Absent such an original contribution, a federal law would be, at best, superfluous. At worst, a federal law that is not comprehensive in scope and seeks only modest goals could engender ill-advised imitation by some states and thus retard regulatory innovation or even roll back existing protections. With regard to the sufficiency of existing state regulation, the initial task, then, is to test the utility of proposed federal mortgage broker regulations against existing state-level mortgage broker licensing statutes.

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25. *Licensing & Registration Hearing*, *supra* note 5, at 38 (statement of the Honorable Robert Ney, Chair, H. Subcomm. on Housing and Community Opportunity).

26. *Id.*

27. *Id.* at 98 (statement of Joseph A. Smith, Jr., North Carolina Comm'r of Banks, CSBS); *see also supra* note 9 (discussing legislation passed by Colorado and Alaska that bring the total to fifty states).

28. *See* discussion *supra* p. 64 (stating that utility is to be understood in terms of effectiveness at protecting consumers from predatory behavior by mortgage brokers).

A. A Framework for Comparison

The two bills that propose federal licensing or registration of mortgage brokers differ significantly; likewise, the state laws that regulate mortgage brokers are not uniform. Thus, an initial hurdle is to establish a framework that promotes a comparison of related items despite diversity in their forms of organization and phrasing. A taxonomic organization is well suited to that task.[29] In a taxonomy, items are grouped into categories based on common traits or characteristics. Further, items within each category are organized into subcategories that express relevant differentiations within one trait or characteristic. The principal categories, and the subcategories within them, are ordered in a hierarchy that reflects an increasingly complex or sophisticated expression of a predetermined principle.[30] A taxonomic analysis provides a common typological vocabulary, which facilitates a comparative analysis of related but nonuniform items.[31] A taxonomic analysis also provides a reasoned basis for judging one comparator to be better than another, precisely because one is a more complex or sophisticated expression of the chosen organizing principle.[32] Because of these benefits, a taxonomic framework will be applied in this Part to the bills that propose federal regulation of mortgage brokers.

Defining the organizing principle for the hierarchical arrangement is at once perhaps both the most important decision in a taxonomic analysis and the most open to challenge. This is true because that principle contains a normative standard against which characteristics are judged. Fortunately, the preambles of the bills themselves provide the organizing principle. One bill identifies its purpose as seeking "[t]o protect home buyers from predatory lending practices."[33] The other professes that its purposes include seeking "[t]o protect consumers against unfair and deceptive practices in connection with higher cost mortgage transactions [and] to strengthen the civil remedies available to consumers."[34] These purposive statements thus validate effective consumer protection as the organizing principle of a taxonomic hierarchy. Taking the bills' authors at their word, this Article will judge the utility of the proposals for federal regulation of mortgage brokers, in comparison with state licensing statutes, according to each bill's ability to protect consumers from predatory acts by mortgage brokers.

In a previous article, I examined state-level mortgage broker licensing statutes and proposed that the provisions of those statutes can be organized into three distinct functional categories.[35] I identified these categories as (1) the gatekeeping function, (2) the regulatory oversight function, and (3) the mortgage broker-

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29. *See* Wilson, *Taxonomic Analysis*, *supra* note 11, at 298. For a classic example of a taxonomic hierarchy and an explanation of the process for constructing one, see TAXONOMY OF EDUCATIONAL OBJECTIVES: THE CLASSIFICATION OF EDUCATIONAL GOALS, HANDBOOK 1: COGNITIVE DOMAIN 10–11, 13–17 (Benjamin S. Bloom ed., David McKay Co. 1969) (1956).

30. *See* Wilson, *Taxonomic Analysis*, *supra* note 11, at 298.

31. *Id.*

32. *Id.*

33. H.R. 1994, 109th Cong. (2005).

34. H.R. 1295, 109th Cong. (2005).

35. Wilson, *Taxonomic Analysis*, *supra* note 11, at 299.

consumer relationship-defining function.[36] Within the first two categories, I identified multiple regulatory tools that are used to carry out the relevant function.[37] Within the third category, instead of identifying complementary *means* to achieve a stated function, I identified alternative *formulations* of a function—defining the nature of the relationship between a mortgage broker and a consumer.[38] These models, which share the common characteristic of attempting to describe (in terms that go beyond *caveat emptor*) the legal duties a broker owes to a consumer, are (1) the prescribed contract model,[39] (2) the optional agency model,[40] and (3) the mandatory, but limited, agency model.[41]

When the categories and constituent subcategories are arranged according to the principle of effective consumer protection—a principle also validated by the purposive language found in states' broker licensing statutes[42]—the following hierarchy emerges:[43]

III. The mortgage broker-consumer relationship-defining function

4. mandatory borrower's agency model[44]
3. mandatory, but limited, agency model
2. optional agency model
1. prescribed contract model

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36. *Id.*
37. *Id.* at 300–25.
38. *Id.* at 325–39.
39. *Id.* at 326–30.
40. *Id.* at 330–36.
41. *Id.* at 336–39.
42. *See, e.g.*, N.C. GEN. STAT. § 53-243.04 (2005) ("The Banking Commission may adopt any rules when it deems necessary to . . . provide for the protection of the borrowing public. . . .").
43. The hierarchy should be read from the bottom up.
44. This model does not yet exist in a systematic form. The North Carolina Mortgage Lending Act, N.C. GEN. STAT. §§ 53-243.01–.18 (2005 & Supp. 2006), includes some provisions that bear a striking resemblance to provisions in the RESTATEMENT (SECOND) OF AGENCY, but that act does not create a complete and systematic agency regime. *See* Wilson, *Taxonomic Analysis*, *supra* note 11, at 337–39 (citing RESTATEMENT (SECOND) OF AGENCY §§ 379, 382, 385 (1958)). The creation of a mandatory borrower's agency regime is supported by two developments: (1) the trajectory of regulation in the past decade, which has seen a *caveat emptor* approach give way to a reasonable, tangible net benefit standard for loan refinancing and to a suitability standard for any loan; and (2) the creation of a mandatory buyer's agency regime in the related area of real estate sales brokerage following the abolition of mandatory subagency by the National Association of Realtors. For a full expression of the argument for a borrower's agency regime, see Lloyd T. Wilson, Jr., *Effecting Responsibility in the Mortgage Broker-Borrower Relationship: A Role for Agency Principles in Predatory Lending Regulation*, 73 U. CIN. L. REV. 1471 (2005) [hereinafter Wilson, *Effecting Responsibility*]. A similar idea is the proposal in S. 1299 to create fiduciary duties that a mortgage broker would owe to a consumer. S. 1299, 110th Cong. (2007).

II. The regulatory oversight function

5. identify the acts and omissions that trigger the suspension or revocation of a license
4. provide public sanctions and private remedies for broker misconduct
3. require continuing education as a condition of licensure
2. impose record keeping, record storage, and record retention duties
1. require correction and updating of license application disclosures

I. The gatekeeping function

6. utilize a portion of mortgage broker application fee for antipredatory lending programs
5. define the criteria for approval or denial of an application for licensure
4. ensure the financial responsibility of the applicant, including bonding and liquidity requirements
3. ensure the technical competency of the applicant, including pre-licensure education and testing
2. verify the personal character and business background of the applicant (and of parent companies, subsidiaries, and controlling persons)
1. establish the scope of the licensing requirement—and thereby the scope of regulation—by defining which persons are either subject to or exempt from licensure

That this taxonomic hierarchy is unlikely to be exhaustive does not preclude its usefulness. The objection made in this Article to the proposed federal laws is not that they are similarly comprehensive as state licensing laws, with differences being but a matter of emphasis and about which reasonable persons could disagree. Instead, the objection is that entire subcategories of regulatory mechanisms are wholly missing in the proposed federal laws. Under these conditions, the taxonomic hierarchy presented above is more than adequate.

Another question that may be raised is whether there is much value in analyzing bills that were not passed out of committee during the 109th Congress. Even though the 110th Congress has convened, these bills merit examination for at least three reasons. First, over the past several years there is a clear record of consolidation of regulatory control at the federal level at the expense of state regulation.[45] Federal regulation of mortgage brokers can be seen as a component of that consolidation, and it is reasonable to anticipate that in the future the federal government will devote more, rather than less, attention to mortgage brokers. Second, the state of the economy and growing use of exotic loan products could propel proposals for federal antipredatory lending legislation to a high place on

45. *See* OCC Preemption Determination and Order, 68 Fed. Reg. 46,264 (Aug. 5, 2003); 12 C.F.R. § 545.2 (2007); 12 C.F.R. § 701.21(b) (2007). The OCC's extension of its preemption authority to state-chartered operating subsidiaries, 12 C.F.R. § 7.4006 (2007), was upheld in *Watters v. Wachovia Bank, N.A.*, 127 S. Ct. 1559, 1572–73 & n.13 (2007).

Congress's agenda.[46] If rising interest rates, a falling economy, a depreciation of real estate values (or some combination of the three), in conjunction with interest rate escalators or balloon loan maturity dates, push the number of personal bankruptcies and home foreclosures beyond their already record high levels, Congress could feel pressure to "do something." That "something" could be to pass whatever antipredatory lending related legislation can be resurrected easily and quickly.[47] Third, it is important for the protection of America's consumers that bills proposed in the future be subjected to critical analysis, and one of the goals of this Article is to provide a transferable analytical framework.

The two bills introduced in the 109th Congress that include provisions specifically applicable to mortgage brokers are the Predatory Mortgage Lending Practices Reduction Act (HR 1994)[48] and the Responsible Lending Act (HR 1295).[49] When these proposals for federal regulation of mortgage brokers are analyzed taxonomically, they come up wanting. HR 1994 contains only one mechanism for carrying out the initial-level gatekeeping function and does nothing to advance the administrative oversight function or to redefine the mortgage broker-consumer relationship in a way that includes prescriptive duties. HR 1295 includes only two mechanisms in the gatekeeping category and only one mechanism in the regulatory oversight category. Like HR 1994, HR 1295 makes no attempt to redefine the broker-consumer relationship. Of greater consequence is the fact that a number of provisions in HR 1295 actually impede, not promote, consumer protection.

HR 1994 and HR 1295 are sufficiently different in scope, approach, and nature of their deficiencies, that they will be examined separately. Any analytical overlap that results is small and is offset by gains in the clarity of discussion. HR 1994 is deconstructed first in Part II.B; HR 1295, which is substantively more problematic, is deconstructed in Part II.C.

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46. *Licensing & Registration Hearing*, *supra* note 5, at 3 (statement of the Honorable Robert Ney, Chair, H. Subcomm. on Housing and Community Opportunity) ("Congress should also heed the warning from Fed Chairman Greenspan that creative financing of mortgages could backfire if the economy dips and interest rates increase.").

47. A witness at a congressional hearing held on May 8, 2007, said that House Bill 1295 from the 109th Congress is "an interesting starting point for reform that is worthy of consideration." *The Role of the Secondary Market in Subprime Mortgage Lending: Hearing before the H. Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services*, 110th Cong. 5 (2007) (statement of Howard Mulligan, Partner, McDermott Will & Emery LLP).

48. H.R. 1994, 109th Cong. (2005).

49. H.R. 1295, 109th Cong. (2005).

B. The Predatory Mortgage Lending Practices Reduction Act—HR 1994

1. The Gatekeeping Function—Protecting Consumers by Controlling Entry into the Mortgage Brokering Industry

HR 1994 seeks to "protect home buyers from predatory lending practices" by raising the level of competency and professionalism in the mortgage brokering industry through mandatory federal certification that will ensure each broker is trained and knowledgeable with regard to subprime lending.[50] Before examining any of the substantive provisions of the bill, two preliminary observations must be made. First, the bill is directed solely at predatory lending in the subprime market.[51] While it is generally accepted that predatory practices occur much more frequently in the subprime lending market than in the prime market, that fact does not mean there are no prime market eligible consumers who need protection from predatory brokers. A high credit score does not necessarily ensure financial sophistication.[52] Furthermore, the opportunity to obtain loans from a variety of sources, including regulated depository institutions, that are available to prime market eligible consumers—and generally not available to subprime market borrowers—does not ensure that a consumer understands principles of mortgage financing or the tools that facilitate comparison shopping for a loan. Inexperienced borrowers of any credit rating can be overwhelmed by the complexity of the mortgage financing process and can be susceptible to exploitation by a predatory broker. State mortgage broker licensing statutes do not differentiate between prime and subprime lending, and the restricted scope of HR 1994, by itself, renders the bill inferior to state-level licensing statutes.

In addition, HR 1994 is based on the highly questionable assumption that knowledge and expertise are reliable proxies for honesty and that professional behavior will flow automatically from technical training and knowledge. There is

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50. H.R. 1994. Training, education, and examination of brokers is the exclusive focus of section 2 of House Bill 1994. *Id.* § 2 (proposing amendments to the Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. § 2610 (2000)). Section 3 would impose "best practices" requirements on lenders who make high cost mortgages. *Id.* § 3 (proposing amendments to the Truth in Lending Act (TILA), 15 U.S.C. § 1639 (2000)). Section 4 provides for broker decertification for commission of an unfair or deceptive act or practice (UDAP). *Id.* § 4; *see* discussion *infra* Part II.B.2. Section 5 would prohibit precontroversy arbitration clauses. *Id.* § 5 (proposing amendments to the end of the Consumer Credit Protection Act (CCPA), 15 U.S.C. §§ 1601–1693r (2000)). Section 6 would make grants to community development corporations for predatory lending education. *Id.* § 6 (proposing amendments to the end of the Community Development Banking and Financial Institutions Act of 1994 (DBFIA), 12 U.S.C. §§ 4701–4718 (2000)). Each section is very short, and the bill is not as comprehensive as this list of sections would make it appear.

51. *See supra* note 33 and accompanying text.

52. Anecdotal evidence for this proposition comes from the author's personal experience of consulting with prime eligible borrowers, including highly educated persons holding terminal degrees, to whom the jargon and procedures of mortgage lending were completely foreign. Further evidence is provided by the growing incidence of home foreclosures in neighborhoods consisting of newly constructed homes that were financed with loans containing predatory terms or involving predatory practices, even though the borrower or buyer could have qualified for better terms than those provided by the developer or a mortgage broker.

no assurance that the correlation is direct; in some circumstances the relationship could be inverse. The assumption in the bill echoes the claim made by NAMB that most predatory practices can be attributed to inadvertent mistakes by brokers who do not know better. Increased knowledge and training, NAMB argues, will eliminate the mistakes and produce good loan brokering practices.[53] If, as is more likely, a broker's predatory behavior is intentional precisely because it is so profitable, then additional training and knowledge simply widen the informational and power asymmetries between the broker and the consumer and produce a more effective predator. With these two foundational limitations in mind, the substantive limitations of the bill can be considered.

The central provision of HR 1994 states:

> No person may, in connection with a subprime federally mortgage related loan, provide . . . mortgage brokerage services unless such person is, at the time of the provision of such services, certified by the Secretary [of Housing and Urban Development (HUD)] pursuant to this section as having been adequately trained with regard to subprime lending.[54]

While most of the prerequisites for certification are unspecified and are left to be formulated by the Secretary of HUD (Secretary), HR 1994 does direct that the final regulations require each broker to demonstrate, by written examination, a sizeable body of knowledge, including (1) "[t]he requirements and limitations under Federal laws regarding mortgage lending";[55] (2) "[l]egal and appropriate practices, methods, conventions, and terms of subprime lending in all lending functions";[56] (3) "[i]llegal and inappropriate practices, methods, . . . and terms of predatory lending";[57] and (4) "[b]asic contract law regarding competency and incapacity to contract."[58]

The certification requirement is intended to discharge a gatekeeping function by preventing uninformed and unskilled persons from entering the mortgage brokering industry and having the opportunity to harm consumers. Although prelicensing education and testing requirements are legitimate gatekeeping mechanisms, requiring them at the federal-level would result in a negligible advance for consumers, as prelicensing and education requirements are common in state licensing statutes. Further, unlike HR 1295, discussed below, the federal certification requirement of HR 1994 applies without regard to prelicensing education and testing requirements that may be imposed under state law. The existence of licensing requirements imposed by multiple jurisdictions, here the

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53. *See Licensing & Registration Hearing*, *supra* note 5, at 53 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB).

54. H.R. 1994 § 2(a) (2005) (proposing a new section 13(a) to be added as an amendment to RESPA).

55. *Id.* (proposing a new section 13(b)(2)(A) to be added as an amendment to RESPA).

56. *Id.* (proposing a new section 13(b)(2)(B) to be added as an amendment to RESPA).

57. *Id.* (proposing a new section 13(b)(2)(C) to be added as an amendment to RESPA).

58. *Id.* (proposing a new section 13(b)(2)(D) to be added as an amendment to RESPA).

federal government and states, is not by itself a reason to reject HR 1994. The increased compliance costs associated with multiple jurisdiction regulation is simply a function of a federalist form of government. These issues exist whether the multiple levels involved are the federal government and the states, or among the several states themselves. At the same time, however, if dual-level regulation is to exist, it should serve some valuable purpose.

Besides seeking to ensure the technical competency of mortgage brokers, the only other gatekeeping mechanism found in HR 1994 is the threshold task of defining the persons who are subject to certification because they qualify as a "mortgage broker." Establishing the scope of the term *mortgage broker* is crucial to the gatekeeping function for the obvious reason that excluded persons are not required to demonstrate the knowledge or training—taken in the bill as indicia of professionalism—required of persons subject to regulation. For that reason, consumers are best protected by a broad definition of *mortgage broker* with the minimum number of exemptions.

HR 1994 contains a broad, if not particularly elaborate, definition of *mortgage brokerage services*. The bill defines these services as "the bringing together of a borrower and lender to obtain a federally related mortgage loan and the rendering of settlement services, by a person who is not an employee or exclusive agent of a lender."[59] The breadth of the *bringing together* criterion is admirable, but similarly broad definitions can be found in state mortgage broker licensing statutes. For example, North Carolina's licensing statute applies to all persons who act as a mortgage broker, which it defines as a person who

> act[s], for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly, by accepting or offering to accept an application for a mortgage loan, soliciting or offering to solicit a mortgage loan, negotiating the terms or conditions of a mortgage loan, issuing mortgage loan commitments or interest rate guarantee agreements to borrowers, or engaging in tablefunding of mortgage loans, whether such acts are done through contact by telephone, by electronic means, by mail, or in person with the borrowers or potential borrowers.[60]

HR 1994 thus contributes nothing noteworthy to the concept of gatekeeping or to its implementation.

Duplication of state-level education and testing requirements and of scope of coverage provisions is not the only consumer protection deficiency of HR 1994. More serious is the bill's omission of several other important gatekeeping mechanisms found in state licensing statutes. The task of screening mortgage broker license applicants to exclude persons who pose a risk to consumers is more complex than HR 1994 allows. Omitted gatekeeping mechanisms include: (1)

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59. *Id.* (proposing a new section 13(f)(1) to be added as an amendment to RESPA).
60. N.C. GEN. STAT. § 53-243.01(1) (2005).

application form disclosures concerning the personal character and business background of the license applicant; (2) investigation procedures that enable regulators to verify information supplied by the applicant; (3) surety bond or liquid assets requirement; (4) license approval criteria other than technical competence; and (5) dedication of a portion of application fees to fund antipredatory lending programs.[61] To the extent that the bill relies on the verification of technical competency alone to discharge the gatekeeping function, it is inferior to the more comprehensive state licensing statutes.

2. *The Regulatory Oversight Function—Protecting Consumers by Affecting Broker Behavior Through Sanctions and Remedies*

HR 1994 is similarly deficient with regard to its regulatory oversight provisions. Of the five mechanisms that comprise that function under the taxonomic hierarchy, the bill addresses only one explicitly: requiring correction and updating of license application disclosures. Its terms might be capable of stretching far enough to include a second mechanism, but nothing compels that result.

Just as control over initial licensure is a powerful regulatory tool, so too is control over the conditions of license continuation and renewal. By requiring periodic and conditional renewal of a license, regulators can ensure that brokers who were deemed fit for licensure have in fact acted responsibly toward consumers. One condition for license renewal found in state mortgage broker licensing statutes is mandatory continuing education.[62] HR 1994 does not expressly include this regulatory oversight mechanism, but it could be inferred from the broadly phrased delegation of authority that directs the Secretary to "establish standards and procedures for recertification of individuals whose certifications are expiring."[63] The Secretary could determine that these standards and procedures for recertification include mandatory continuing education; then again, the Secretary might not.

Many state mortgage broker licensing statutes wisely condition license renewal on completion of a stated number of hours of continuing education.[64] Acknowledging that the mortgage financing industry changes rapidly, NAMB likewise supports continuing education for brokers.[65] Given the emphasis in HR

61. For an example of a mortgage broker licensing statute that uses license application fees as a gatekeeping mechanism, see MINN. STAT. ANN. § 58.10 (West 2002). For a discussion of the use of license application fees as a gatekeeping mechanism and the rationale for including application fees within the gatekeeping function, see Wilson, *Taxonomic Analysis*, *supra* note 11, at 310–11.

62. *See, e.g.*, KY. REV. STAT. ANN. § 294.260 (LexisNexis 2004) (requiring all mortgage loan brokers to participate in continuing professional education); 4 N.C. ADMIN. CODE 3M.0301 (2007) (providing that mortgage lending licensees can receive credit for participation in programs conducted by providers approved to present continuing education programs).

63. H.R. 1994 § 2(a) (proposing a new section 13(d) to be added as an amendment to RESPA).

64. *See, e.g.*, KY. REV. STAT. ANN. § 286.8-255(2)(c) (LexisNexis 2004) (requiring applicants to complete twelve hours of professional education).

65. *Licensing & Registration Hearing*, *supra* note 5, at 52 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB).

1994 on the adequacy of training received by mortgage broker license applicants, the absence of an explicit continuing education requirement is inexplicable and indefensible. In a complex and rapidly changing industry, training that fails to remain current cannot be considered adequate.

Additionally, by failing to impose a continuing education requirement, HR 1994 misses out on an opportunity to dictate the content that the education brokers would receive. Some state licensing statutes specify that a portion of continuing education hours must be devoted specifically to predatory lending issues.[66] Similarly, NAMB's *Model State Statute Initiative* (MSI) recommends ethics education for brokers.[67] These state statutes, and the MSI, recognize that continuing education can perform a channeling function. Perhaps at least some brokers will be persuaded not to engage in predatory behavior if they are compelled to confront the economic, personal, and social damage caused by predatory lending and if they are made aware of the sanctions that can be imposed for causing that damage.

Administrative sanctions and private remedies are additional regulatory oversight mechanisms. HR 1994 utilizes two forms of administrative sanctions for the commission of unfair or deceptive acts or practices: administrative decertification and administrative fines. Administrative decertification, which can take the form of either suspension or revocation of a broker's federal certification, is a powerful regulatory tool, as HR 1994 declares that one cannot legally engage in any mortgage brokering activity without federal certification.[68] With one laudable exception, discussed below, HR 1994 simply delegates to the Secretary the authority to "establish standards and procedures for suspension and revocation of the certification under this section."[69] Other than providing for procedural fairness by requiring an opportunity for an affected broker to be heard,[70] the bill provides no guidance for what those standards should be. The bill need not be so vague. State licensing statutes, while also delegating rulemaking authority to state regulators, enumerate a number of specific acts that can result in license suspension or revocation.[71]

One provision in HR 1994 that does deserve praise is its requirement that the final implementing regulations provide for decertification of any broker who engages in unfair or deceptive acts or practices (UDAP). The bill mandates that the standard for decertification "shall include an agency determination or a judgment

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66. *See, e.g.*, 808 KY. ADMIN. ERGS. 12:095(1)(1) – (2) (2007) (requiring that of the twelve hours of biannual continuing education for mortgage brokers at least six hours must provide instruction about K'S 360.100, Kentucky's High Cost Home Loan Act). Furthermore, "[o]nly the provisions of K'S 360.100 pertaining to predatory lending and penalties for noncompliance may be included in the education requirements." *Id.* 12:095(1)(2).

67. MSSI, *supra* note 5, at 66 (outlining the required topics of "Ethics, Diversity, and Sensitivity").

68. H.R. 1994 § 2(a) (proposing a new section 13(a) to be added as an amendment to RESPA).

69. *Id.* (proposing a new section 13(c) to be added as an amendment to RESPA).

70. *Id.* (proposing a new section 13(c)(1) to be added as an amendment to RESPA).

71. *See, e.g.*, CAL. FIN. CODE § 4975 (providing for revocation for violations of certain provisions of the Finance Code); N.C. GEN. STAT. ANN. § 53-243.11 (West 2005) (providing for revocation for misrepresentation, failing to abide by contracts, and several other practices).

by a court of competent jurisdiction that a certified individual has engaged in an act or practice that is unfair or deceptive under section [4] of the [bill]."[72] The UDAP prohibition in that section is stated directly: "It shall be unlawful, in providing any mortgage lending services for a subprime federally related mortgage loan or any mortgage brokerage services for such loan, to engage in any unfair or deceptive act or practice."[73] The sanctions for committing an unfair or deceptive act or practice are decertification, civil penalties, and enforcement options under TILA.[74]

Unfortunately, the UDAP prohibition also vests considerable discretion in the Secretary of HUD. HR 1994 makes the Secretary responsible for developing "interpretive rules and general statements of policy with respect to unfair or deceptive acts or practices" and for promulgating "regulations defining with specificity acts or practices which are unfair or deceptive,"[75] but the bill provides no guidance to shape the final content of those rules and regulations. Broad delegation of rulemaking authority is commonplace, but the lack of guidance in HR 1994 is made even more problematic than one might expect, as the rulemaking authority for the UDAP provisions is vested jointly in the Secretary, the Board of Governors of the Federal Reserve, and the Federal Trade Commission.[76] Further, the rulemaking authority vested in this triumvirate is permissive, not mandatory.[77] Given that federal-level efforts to combat predatory lending have lagged significantly behind those of the states, consumers can be justifiably skeptical about the content of UDAP rules that may or may not emerge from the collective action of these three agencies. Also to be acknowledged is the animosity of the mortgage financing industry to the use of UDAP statutes to establish violations of high-cost loan statutes. The strength of this animosity is captured in one industry apologist's attempt to disparage UDAP laws by calling their use by consumer advocates a stealth evasion of federal law.[78] If the UDAP provisions of HR 1994 are to have any real consumer protection impact, they cannot depend on the unguided discretion of the Secretary, the Board of Governors of the Federal Reserve, and the Federal Trade Commission.

Apart from designating a UDAP violation as a basis for regulatory sanction, HR 1994 omits many of the other oversight and enforcement mechanisms found in state mortgage broker licensing statutes. Perhaps the most important of the omitted mechanisms is the failure to require a broker to post a surety bond or to maintain other liquid assets which could satisfy public and private claims.[79] The existence

72. H.R. 1994 § 2(a). Although the bill refers to "section 5," it certainly means to refer to section 4.

73. *Id.* § 4(a).

74. *Id.* § 4(e).

75. *Id.* § 4(b)(1)–(2).

76. *Id.* § 4(b).

77. The bill states that the parties "*may* jointly issue" rules and regulations. *Id.* § 4(b) (emphasis added).

78. Lampe, *supra* note 17, at 143.

79. *See, e.g.*, MINN. STAT. ANN. § 58.08 (West 2002); N.C. GEN. STAT. § 53-243.05(f) (2005); VT. STAT. ANN. tit. 8, § 2203(a) (2001). For a discussion of the importance of a surety bond as a regulatory tool, see Wilson, *Taxonomic Analysis*, *supra* note 11, at 319–21.

of a surety bond and liquid assets as a condition of licensure protects consumers by ensuring that at least some amount of money will be available to compensate them for losses caused by mortgage brokers' predatory acts. In the absence of a bond or other assets, consumers can be left facing a judgment-proof broker or a "fly-by-night" broker who has closed up shop. Regulatory oversight mechanisms omitted from HR 1994 include: (1) disclosure update requirements by which brokers inform regulators of changes in the brokering business, including changes in principals and employees; (2) record keeping requirements—such as the scope of documents that must be retained, the format in which they must be retained, and the length of time they must be retained—which preserve evidence for regulators and harmed consumers; and (3) license suspension or revocation triggers (for reasons other than UDAP violations) based on a variety of financial misdeeds or acts that evidence moral turpitude.[80] When judged by the bill's self-proclaimed goal of consumer protection and when compared to state mortgage broker licensing statutes, the regulatory oversight provisions of HR 1994 exhibit little utility.

3. *The Relationship-Defining Function—Protecting Consumers by Redefining the Mortgage Broker-Consumer Relationship*

Of all the means available to combat predatory lending, redefining the legal nature of the relationship between a mortgage broker and a consumer is the least used. The more widely used approaches have been to enact positive laws that (1) proscribe the most egregious loan products and lending and brokering practices; (2) prescribe certain acts by lenders and brokers, especially providing information disclosures to consumers; (3) seek to improve general financial literacy among consumers by increasing the availability of information about the mortgage lending process; and (4) seek to improve an individual consumer's decisionmaking through individual loan counseling. As discussed in Part III below, the reliance on these mechanisms and the comparative lack of attention paid to rethinking the broker-consumer relationship is not coincidental but follows from assumptions that are accepted uncritically.[81]

The value of proscriptive rules is indisputable, as they deny predatory brokers the use of a number of tools that have been used to prey on consumers. Predatory tools that have been proscribed include fully prepaid credit insurance products, asset-based lending, loan flipping with no benefit to the borrower, recommending default on an existing loan, at-will acceleration clauses, and mandatory arbitration

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80. *See, e.g.*, KY. REV. STAT. ANN. § 294.090(7) (LexisNexis 2004) (prohibiting mortgage brokers from engaging, directly or indirectly, in any act, practice, or course of business which operates or would operate as a "fraud or deceit upon any person"); MINN. STAT. ANN. § 58.13 (West 2002) (prohibiting mortgage brokers from making any statement that "has the capacity or tendency to deceive or mislead a borrower"); N.C. GEN. STAT. § 53-243.11(8) (2005) (prohibiting a mortgage broker from engaging in any practice that "is not in good faith or fair dealing"); VT. STAT. ANN. tit. 8, § 2210(a)(3) (2001) (prohibiting a mortgage broker from engaging in "unconscionable conduct which takes advantage of a borrower's lack of bargaining power or lack of understanding of the terms or consequences of the transaction").

81. *See* discussion *infra* Part III.

clauses. The proscriptive approach alone is not able to stop predatory lending, however, because some loan terms that are predatory in some circumstances are appropriate in other circumstances. Adjustable interest rates, introductory interest rates, and balloon payments, for example, are legitimate financing tools—in the right context. In an inappropriate context, as when a consumer does not understand their effect or when they are not suited to the consumer's needs and financial situation, they can inflict great harm. Similarly, refinancing an existing loan can be a sound decision—in the right context. In an inappropriate context, as when the consumer is unlikely to recapture the refinance costs and the new loan results in economic benefit to no one other than the lender and broker, urging a refinance is predatory. For this reason, proscription is a necessary but not sufficient methodology. The vice lies not in the loan terms per se; instead, the vice lies in the broker's exploitation of an asymmetry of information and the resulting asymmetry of power.

Asymmetry of information is the origin of the general education and individual counseling methodologies. The incidence of predatory lending can be reduced, it is proposed, if consumers receive education and counseling that will enable them to protect themselves.[82] HR 1994 embraces these paths to consumer empowerment by providing funding to "make grants to nonprofit community development corporations to provide education and training to borrowers, potential borrowers, and community groups regarding illegal and inappropriate practices, methods . . . and terms of predatory lending."[83] Education and counseling likely benefit some consumers, but the effectiveness of these methodologies is limited. The effectiveness of general education is limited because it assumes that information will reach potential victims of predatory lending and that they will process the information to the degree necessary to perceive and avoid predatory terms and practices. The emphasis on individual counseling is limited because it assumes the intervention of a trained counselor for every potentially predatory loan and that a counselor's advice will outweigh a broker's enticements or the constraints of the borrower's financial situation.

Furthermore, education and counseling are no panacea because they are fundamentally misdirected. By forcing consumers to defend themselves in the lending process, education and counseling initiatives look past the root problem itself, which is the combination of incentives and relationship structures that encourage and enable lenders and brokers to prey on consumers. With few exceptions, such as the reasonable tangible net benefit requirement found in

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82. *See* Baher Azmy, *Squaring the Predatory Lending Circle*, 57 FLA. L. REV. 295, 356–57 (2005) (noting mixed conclusions concerning the effectiveness of consumer education at helping consumers avoid predatory loans).

83. H.R. 1994, 109th Cong. § 6(a) (2005) (proposing a new section 122(a) to be added as an amendment to the Community Development Banking and Financial Institutions Act of 1994 (CDBFIA)).

Regulation Z[84] and some state antiflipping statutes,[85] mortgage brokers and consumers are generally treated as fully autonomous actors whose only obligation to the other is to refrain from acts that would constitute fraud, duress, or unconscionability. *Caveat emptor* is the order of the day.

The problem with this view, as I have argued elsewhere,[86] is that it is inconsistent with reality. Consumers who have been victimized by predatory lending repeatedly state that they placed their trust in, and relied on, their mortgage broker.[87] Their reliance is understandable and reasonable, as mortgage brokers inculcate these feelings of trust and confidence by pretending to befriend the consumer, by promising to "help" the consumer, by "taking care of" the consumer's financial problems, and by exploiting relationship-based marketing techniques.[88] Predatory brokers then breach the trust they have engendered by exploiting the gaps in the proscriptive, educational, and counseling methodologies. Consumers believe that the broker who *works with* them also *works for* them. Unfortunately, the law generally does not support that understanding.

The aim of the education and counseling methodologies, as noted above, is not to change anything about the nature of the broker-consumer relationship; instead, the aim is to make consumers better negotiators within an arm's length contracting context that remains unexamined. It is here that the limitations of education and counseling are highlighted. In addition to the pragmatic issue concerning the feasibility of turning lay consumers—who are often targeted by predatory brokers precisely because of their lack of education, experience with financial products, and access to depository lenders—into a negotiating equal of a professional mortgage broker, the education and counseling initiatives burden, and implicitly blame, the wrong party. Rather than seeking to change the context that fosters exploitative broker behavior, consumers are told to protect themselves from being exploited. If, despite education and counseling, consumers fall victim to predatory practices, then it is the consumer who has "failed" in the loan negotiation process. Even if a consumer's decision to enter into a predatory loan can be attributed to subconscious decisionmaking heuristics,[89] which the broker intentionally exploited, it is still the

84. Truth in Lending (Regulation Z), 12 C.F.R. § 226.34 (2007).

85. *See, e.g.*, IND. CODE ANN. § 24-9-4-2 (LexisNexis 2006) (placing restrictions on refinancing existing loans); KY. REV. STAT. ANN. § 367.390 (LexisNexis 2004) (restricting the right to refinance loans on the same property).

86. Wilson, *Effecting Responsibility*, *supra* note 44, at 1507.

87. *See* Ronald Benton Brown et al., *Real Estate Brokerage: Recent Changes in Relationships and a Proposed Cure*, 29 CREIGHTON L. REV. 25, 34 (1995).

88. As one tool of predation, a broker will seek to influence a potential borrower's decisionmaking by emphasizing some connection between broker and borrower. The connection is intended to disarm the consumer's sense of caution and distrust. A public service announcement aired by the Indiana Secretary of State, whose duties include combating investment fraud, acts out a scenario where a predatory investment broker uses church membership as a relational and disarming tool. For a discussion of push marketing in predatory lending, see Azmy, *supra* note 82, 333–35.

89. *See* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 384–85 (1994) (discussing availability heuristics, anchoring heuristics, and optimism heuristics); McCoy, *supra* note 21, at 727–37 (discussing loss aversion, reference dependence, and choice heuristics).

consumer who is to blame. The legal obligation of a broker not to establish and exploit trust, and not to exploit information and power asymmetries, is inconceivable because such obligations are inconsistent with the arm's length relationship context. By its reliance on education and counseling, HR 1994 accepts this model as orthodoxy.

Fortunately, there is some reason to hope that this methodological myopia can be changed. At least a few states have taken steps in their licensing statutes to redefine the mortgage broker-consumer relationship to create—or at least permit—legal duties owed by a broker to a consumer. One option, found in Vermont's broker licensing statute,[90] is to prescribe a contract form that specifies the duties owed by a mortgage broker to a borrower.[91] A second option, found in the licensing statutes of Kentucky[92] and Minnesota,[93] is to create an opt-out agency regime. A third option, found in North Carolina's licensing law, is to create mandatory—but limited—agency duties.[94] Although each of these models has shortcomings,[95] each effects a contextual change by creating duties that a mortgage broker owes to a consumer simply by virtue of their relationship. One effect of the redefinition is to bring the legal view of the mortgage broker-consumer relationship more in line with the real world view. Another effect is to remove the appearance of validating exploitative practices under the banner of "arm's length negotiation." Because HR 1994 makes no attempt to critically examine the currently prevalent view of broker-consumer relations, it fails to make any advance into the highest taxonomic category.

HR 1994 is not openly antagonistic to consumers, especially because it recognizes the importance of UDAP laws in the battle against predatory lending and expressly disclaims preemption of state mortgage broker licensing laws.[96] Nevertheless, HR 1994 does little to achieve its stated goal of protecting consumers. It is not a satisfactory defense of the bill to say that it should be evaluated only with regard to the limited goals it seeks to achieve and should not

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90. VT. STAT. ANN. tit. 8, §§ 2200–2239 (2001 & Supp. 2006).

91. *Id.* § 2219.

92. KY. STAT. ANN. §§ 294.010–.990 (LexisNexis 2004 & Supp. 2006).

93. Minnesota Residential Mortgage Originator and Servicer Licensing Act, MINN. STAT. ANN. §§ 58.01–.17 (West 2002 & Supp. 2007).

94. Mortgage Lending Act, N.C. GEN. STAT. §§ 53-243.01–.18 (2005 & Supp. 2006).

95. *See* Wilson, *Taxonomic Analysis*, *supra* note 11, at 326–39 (discussing deficiencies specific to each statute).

96. Sections 1 through 4 of HR 1994 are silent about the bill's relationship to state laws that also regulate the testing and certification of mortgage brokers. H.R. 1994, 109th Cong. §§ 1–4 (2005). One could assume, therefore, that the bill does not seek to preempt state laws, as there is neither an expression of intent to occupy the field nor any reason to infer preemption. One section of the bill, section 5, dealing with arbitration agreements, does address "coordination with other law." *Id.* § 5(a) (proposing a new section 1003(c) to be added as an amendment to the Consumer Credit Protection Act (CCPA)). It provides that "[n]o provision of this section shall be construed as annulling, altering, affecting, or superseding any Federal law, or the laws of any State, relating to arbitration . . . , except to the extent that those laws are inconsistent with the provisions of this section, and then only to the extent of the inconsistency." *Id.* This provision creates a base level of regulation and does not prohibit states from imposing additional requirements. *Id.*

be criticized on the ground that other goals are not attained. That apologetic simply begs the questions of why the bill seeks to do so little and whether a federal law should be created for such modest ends. Nor can HR 1994 be defended on the ground that the Secretary will fill in the gaps. The rulemaking authority granted to the Secretary is limited to regulations "as may be necessary to carry out the amendment made by subsection (a) of this section."[97] That amendment is limited to confirming that mortgage brokers are adequately trained.[98] It cannot properly be expanded to encompass the many other omitted gatekeeping, administrative oversight, or relationship-defining goals. The achievements of HR 1994 are simply too modest to justify interjecting the federal government into the regulation of mortgage brokers, especially because the states are already engaged in regulation that is far more systematic, comprehensive, and creative.

C. The Responsible Lending Act—HR 1295

The second bill that would provide for federal regulation of mortgage brokers is HR 1295, the Responsible Lending Act.[99] This bill will be addressed in two sections. First, in this section, the bill will be analyzed for its utility. This analysis is similar in format to the utility analysis performed on HR 1994 above[100] but differs significantly in content due to the presence of terms unique to HR 1295. In this section, the Article will focus on two parts of Title V: Subtitle A, which imposes a federal licensing requirement and minimum standards for obtaining that license, and Subtitle B, which creates a federal database that would contain the names of all mortgage brokers and certain information about them. This section will demonstrate that HR 1295 lacks utility because it only partially duplicates consumer protections already found in state mortgage broker licensing statutes and omits a number of other regulatory mechanisms. Furthermore, although the sponsors of HR 1295 claim that the bill contains numerous provisions that protect consumers from predatory lending, many of the provisions in the bill relate more to advancing the interests of the lending and brokering industries than to advancing the interests of consumers. In fact, with regard to both substantive rules applicable to high-cost loans and the regulation of mortgage brokers, HR 1295 would roll back existing consumer protections.

HR 1295 is also addressed in Part III of this Article, where the bill will be analyzed specifically with regard to its preemptive effect on state mortgage broker licensing statutes. This analysis will demonstrate that another title of the bill not denominated as broker specific, Title I, is indeed relevant to the regulation of

97. *Id.* § 2(b).

98. *Id.* § 2(a) (proposing a new section 13(a) to be added as an amendment to RESPA).

99. H.R. 1295, 109th Cong. (2005). This Article analyzes HR 1295 only with regard to its impact on mortgage broker regulation. For a detailed analysis of other aspects of HR 1295, see *Legislative Solutions to Abusive Mortgage Lending: Hearing before the H. Subcomms. on Housing and Community Opportunity & Financial Institutions and Consumer Credit of the H. Comm. on Financial Services*, 109th Cong. 16 add. (2007) (Exhibit A to statement of Steve Nadon, Chief Operating Officer, Option One Mortgage, H&R Block, Coal. for Fair and Affordable Housing).

100. *See* discussion *supra* Part II.B.

mortgage brokers and to the framing question of the proper locus of broker regulation. Contrary to assurances made at the Licensing Hearing that HR 1295 would not impact states' ability to regulate mortgage brokers more aggressively than required by the bill—that HR 1295 creates a regulatory floor but not a ceiling[101]—a significant number of provisions in Title I of the bill are indeed preemptive and would in fact limit a state's ability to regulate mortgage brokers by way of licensing statutes. Thus, a goal of Part III is to expose the stealth preemption[102] of state mortgage broker licensing statutes that would occur by virtue of the connection between Titles I and V.

1. *The Gatekeeping Function—Protecting Consumers by Controlling Entry into the Mortgage Brokering Industry*

Subtitle A of title V of HR 1295 contains some provisions that could be characterized as gatekeeping mechanisms. At the same time, Subtitle A suffers from two defects. First, it omits many other gatekeeping mechanisms found in state licensing statutes. Second, it undermines the effectiveness of all gatekeeping mechanisms through an overly constrictive definition of the term *mortgage broker*.

Subtitle A establishes minimum standards that state laws must meet to enable mortgage brokers to avoid federal regulation.[103] With regard to conditions on entry into the mortgage brokering business, Subtitle A obligates states to (1) "require licensing for mortgage brokers;"[104] (2) "require, as a condition of the issuance of license, that an applicant submit a written application for a license;"[105] (3) "require, as a condition of the issuance of a license, that an applicant complete at least 24 hours of education on primary and subordinate mortgage financing and pass a written examination upon the completion of such training;"[106] (4) "require a criminal background check to be performed on the applicant;"[107] and (5) "establish minimum testing standards for mortgage brokers."[108] Through these items, Subtitle

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101. *See Licensing & Registration Hearing*, *supra* note 5, at 2 (statement of the Honorable Robert Ney, Chair, H. Subcomm. on Housing and Community Opportunity).

102. *See* Lampre, *supra* note 17, at 143.

103. H.R. 1295 § 501(a) ("The Federal mortgage broker requirements established pursuant to this title shall apply only with respect to States that, upon the expiration of the 3-year period beginning on the date of the enactment of this Act, have not enacted and do not have in effect uniform State laws and regulations described in subsection (b)."). Despite the use of the word "uniform" in reference to state laws, section 501(a) generally contains only broad directives, not specific requirements, and does not place—until the exemptions from coverage listed in section 501(b)(2)—any restrictions on a state's power to enact laws that exceed the federal minimum standards. *Id.*

104. *Id.* § 501(b)(1)(A).

105. *Id.* § 501(b)(1)(B).

106. *Id.* § 501(b)(1)(C).

107. *Id.* § 501(b)(1)(D).

108. *Id.* § 501(b)(1)(E).

A addresses two of the six mechanisms of the gatekeeping function in taxonomic hierarchy.[109]

It would be possible to conclude that the worst failing of these two mechanisms is that they are redundant expressions of gatekeeping mechanisms already found in state mortgage broker licensing statutes. State license application forms already tend to be lengthy and seek detailed information about the applicant's personal background and business history.[110] States already recognize that information disclosure and regulatory verification play important roles in keeping potentially predatory actors from having access to consumers.[111] It is unlikely that whatever federal application requirements might be developed would bring about a meaningful improvement of existing state practices, especially as those federal standards seek only to establish minimum requirements. States also already recognize the importance of prelicensing education, and, as noted earlier, some state licensing statutes contain innovative provisions that require education dealing specifically with predatory lending.[112]

A more serious concern involves skepticism that the provisions of Title V would remain as minimum standards; the concern is that the provisions represent the first step toward mandatory uniform—not minimum— standards. A close reading of the testimony at the Licensing Hearing reveals that the phrase "uniform standards" appears to be used almost interchangeably with the phrase "minimum standards."[113] It is no secret that lending industry participants who operate on a

109. The requirements that brokers obtain a license and that the process for obtaining a license begins with a written application are so fundamental to regulation of mortgage brokers that those items are assumed and do not even appear in a hierarchy of regulatory mechanisms that enable licensure to combat predatory practices. Prelicensing education and testing, which are treated as two items in HR 1295, are a single mechanism in the hierarchy. The second gatekeeping mechanism present in HR 1295 is the criminal background check, although the background check required by many state licensing statutes is far more comprehensive. *See infra* note 110 and accompanying text.

110. For examples of the extensive background disclosure, both personal and occupational, required by state mortgage broker licensing statutes, see Commonwealth of Kentucky: Office of Financial Institutions, Downloadable Forms, http://www.kfi.ky.gov/industryinfo/formsapps.htm (follow hyperlinks under "Mortgage Application/Forms") (last visited Sept. 16, 2007); NC Mortgage Lending & Licensing Compliance Forms, http://www.nccob.org/nccob/mortgage/formsfees/ (follow "MU1" hyperlink) (last visited Sept. 16, 2007); State of Vermont, Application for Lender, Mortgage Broker and/or Sales Finance Company Licenses, http://www.bishca.state.vt.us/BankingDiv/lenderapplic/license_applic_mortg-lenders_mortg-brokers.htm (follow hyperlinks under "MU Forms") (last visited Sept. 16, 2007). The background disclosure sections of the multistate broker application forms proposed by the CSBS/AARMR Regulatory Task Force are similarly comprehensive. *See Licensing & Registration Hearing*, *supra* note 5, at 110–52 (appendix to statement of Joseph A. Smith, Jr., North Carolina Comm'r of Banks, CSBS).

111. *See* Wilson, *Taxonomic Analysis*, *supra* note 11, at 302–07.

112. *See supra* note 66 and accompanying text.

113. The blending of these terms begins in title V of HR 1295, which refers to "[m]inimum [s]tandards" in the title to Subtitle A but speaks of "[u]niform [s]tate [l]aws" in HR 1295 section 501(b). H.R. 1295 § 501(b). Picking up on the uniformity path, the emphasis changes to promoting "standardiz[ation of] mortgage brokerage licensing requirements" and on states' "adher[ence] to uniform standards." *Licensing & Registration Hearing*, *supra* note 5, at 8, 48 (statements of Teresa A. Bryce, Senior Vice President and Director of Legal and Corporate Affairs, Nexstar Financial Corporation).

nationwide basis covet uniform national standards to reduce what they see as unnecessary compliance burdens imposed by individual state laws.[114]

The gatekeeping provisions of Subtitle A are also deficient because at least three mechanisms are omitted. HR 1295 does not provide for the use of application fees for antipredatory lending programs, does not define the criteria for approving or denying a license application, and does not seek to ensure the financial responsibility of mortgage brokers by imposing a surety bond or financial liquidity requirement.[115] As previously discussed concerning HR 1994, partial redundancy and limited objectives are inadequate reasons for involving the federal government in the regulation of mortgage brokers.[116]

The most serious objection to Subtitle A, however, relates to the most fundamental gatekeeping mechanism—establishing the scope of persons who are subject to, or excluded from, the licensing requirement. If persons are excluded from the licensing requirement, the number and vigor of other gatekeeping mechanisms are immaterial. In short, the effectiveness of mortgage broker regulation is directly related to the inclusiveness of coverage and inversely related to its exclusions. In this regard, HR 1295 is a significant step backwards for consumer protection because its exemptions from coverage are unacceptably expansive.

HR 1295 begins innocuously enough. According to section 501, the bill imposes minimum federal standards for the regulation of "mortgage brokers,"[117] a term which is defined in section 503 to mean "a person who engages for compensation, either directly or indirectly, in the acceptance of applications for mortgage loans for others, solicitation of mortgage loans on behalf of borrowers, or negotiation of terms or conditions of loans on behalf of borrowers or lenders."[118] From the standpoint of consumer protection, the bill turns in the wrong direction in section 501(b)(2), which identifies eight classifications of persons and organizations that are excluded from the bill's definition of *mortgage broker*.[119] Some of these exemptions should be uncontroversial because the exempted person or organization is otherwise regulated, such as nonprofit budget or debt counseling services,[120] or poses little threat of predatory conduct, such as a political subdivision or a college or university.[121]

One exemption, however, is so broad that it threatens to swallow the rule. Section 501(b)(2)(F)(iii)(V) exempts from the definition of *mortgage broker* any person who "is a creditor (as defined in section 103(f) of the Truth in Lending Act) who makes or invests in residential real estate loans aggregating more than

114. *See infra* note 232 and accompanying text.

115. *See* Wilson, *Taxonomic Analysis*, *supra* note 11, at 319–21 (discussing the importance of the bond or financial liquidity requirement to consumer compensation).

116. *See* discussion *supra* Part II.B.

117. Title V is entitled "Requirements for Mortgage Brokers," and the title of section 501 is "State Regulation of Mortgage Brokers." H.R. 1295 tit. V, § 501.

118. *Id.* § 503(3).

119. *Id.* § 501(b)(2)(A)–(H).

120. *Id.* § 501(b)(2)(B).

121. *Id.* § 501(b)(2)(D).

$1,000,000 per year, and irrespective of whether such creditor is licensed . . . by an agency of a State."[122] The breadth of this exemption was uniformly criticized at the Licensing Hearing by consumer advocates and lending industry advocates alike. A consumer advocate testified that the exemption granted by section 502(b)(2)(F)

> covers almost any mortgage broker in my State who might otherwise not be exempted. This essentially permits brokers to avoid State and Federal regulation, seemingly by table-funding a few loans a year . . . and immediately assigning them . . . . It is hard to imagine any mortgage broker who would not be covered by this exemption.[123]

Even the representative of the Mortgage Bankers Association (MBA) expressed concern that "the exceptions to licensing contained within Title V . . . provide too many loopholes where an individual could easily avoid licensure."[124] The MBA warned that "[t]he subcommittee may wish to examine the exemption . . . to ensure that it does not establish such a low threshold as to allow a mortgage broker an easy way to avoid licensure."[125] A statute that permits a large number of brokers to escape regulation fails in its gatekeeping function.

2. *The Regulatory Oversight Function—Protecting Consumers by Affecting Broker Behavior Through Sanctions and Remedies*

Other than the mortgage broker database that would be established by Subtitle B,[126] subtitle A of HR 1295 contains only one of the five regulatory oversight mechanisms listed in the taxonomic hierarchy: the imposition of mandatory continuing education for licensees. Section 501(b)(1)(F) "require[s] continuing education of mortgage brokers, including at least 12 hours of education on a biennial basis, a minimum of 2 hours of which shall address ethics education."[127] Similar to the gatekeeping mechanisms, the mildest criticism of the continuing education requirement of HR 1295 is that it duplicates continuing education requirements found in state mortgage broker licensing statutes.[128]

A more serious criticism of the regulatory oversight provisions of HR 1295 is that the bill omits all of the other oversight mechanisms that promote consumer protection. Omitted from HR 1295 are (1) duties to correct and update information contained on initial application and subsequent license renewal forms; (2) duties pertaining to the type of records a broker must keep, the format in which they must

122. *Id.* § 501(b)(2)(F)(iii)(V).

123. *Licensing & Registration Hearing*, *supra* note 5, at 12 (statement of Daniel F. Hedges, Director, Mountain State Justice, Inc.).

124. *Id.* at 48 (statement of Teresa A. Bryce, Senior Vice President and Director of Legal and Corporate Affairs, Nexstar Financial Corporation).

125. *Id.*

126. *See* discussion *infra* Part II.C.3.b.

127. H.R. 1295 § 501(b)(1)(F).

128. *See supra* note 62 and accompanying text.

be preserved, the location at which they must be kept, and the length of time they must be preserved; and (3) public sanctions and private remedies for broker misconduct, including action against a surety bond.[129]

The omission of sanctions and remedies from Title V is exacerbated by the presence in Title I of limitations on consumer remedies, safe harbors for lenders and brokers, and procedural impediments to consumer claims. These limitations and safe harbors, which will be discussed in more detail in Part III below,[130] are relevant to the oversight function of broker licensing statutes because they would severely hinder a state's ability to use sanctions and remedies to regulate broker behavior. It is only by ignoring the intimate connection between the substantive provisions relating to high-cost loan terms and lending practices in Title I and the minimum standards applied to mortgage brokers in Title V[131] that the bill's cosponsor can claim that Title V does not preclude states from imposing stricter regulations. The connection cannot, of course, be legitimately ignored, and the claim of "a floor and not a ceiling" is both disingenuous and untrue. On this ground, Subtitle A does not merely duplicate existing consumer protection mechanisms; it actually erodes them.

3. *The Relationship-Defining Function—Protecting Consumers by Redefining the Mortgage Broker-Consumer Relationship*

HR 1295 makes no attempt to combat predatory lending by redefining the mortgage broker-consumer relationship. Instead, HR 1295 uses consumer counseling and mandatory disclosures to fill in the gaps that exist in the proscriptive approach. These "consumer empowerment" methodologies, which are found in Titles I and II,[132] merely seek to fine tune the existing framework of mortgage broker-consumer relations rather than to critically examine that framework. HR 1295 does, however, include an additional and new form of consumer empowerment: the creation of a national registry and database of mortgage brokers, authorized by Subtitle B of Title V. The counseling and disclosure provisions of HR 1295 will be addressed first, followed by a detailed deconstruction of the proposed registry and database.

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129. *See supra* note 115 and accompanying text.

130. *See* discussion *infra* Part III.A.

131. *See supra* note 113.

132. The ability of disclosures, education, and counseling to protect consumers from predatory behavior has been seriously questioned. *See* McCoy, *supra* note 21, at 738–39 (noting that the effectiveness of education and counseling is doubtful due to insufficient funding and staffing, lack of immediate feedback or opportunities for corrective action, inadequate impact on cognitive anomalies, and clever and relentless manipulation by predators). The effectiveness of disclosures has been questioned even by a mortgage brokerage industry representative. Responding to an observation that borrowers are already signing without reading ten or fifteen pieces of paper at a closing, the representative for NAMB stated, "I disagree with waivers, whether they be under Truth in Lending waivers on rescissions, or anything else. I think waivers are very dangerous for consumers and I would not want to see . . . waiver provisions enhanced." *Licensing & Registration Hearing*, *supra* note 5, at 19 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB).

a. Consumer Counseling and Mandatory Disclosures

The counseling requirements of HR 1295 are set forth in Title II, which consists of two subtitles. Subtitle A, Consumer Counseling, addresses exclusively high-cost lending, while Subtitle B, Expanded Housing Counseling Opportunities, focuses on an array of housing issues including "mortgage-related counseling (including home equity conversion mortgages and credit protection options to avoid foreclosure)."[133]

Subtitle A consists of a single section that would be added to TILA.[134] Section 201 of the bill provides as follows:

> (y)(1) . . . A creditor may not extend any credit in the form of a higher-cost mortgage to any consumer unless the creditor has provided to the consumer, at such time before the consummation of the mortgage and in such manner as the Board shall provide by regulation—
>
> (A) a separate written statement recommending that the consumer take advantage of available home ownership or credit counseling services before agreeing to the terms of any higher-cost mortgage; and
>
> (B) a written statement containing the names, addresses and telephone numbers of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by [HUD], a State housing finance authority . . . , [or other authorized agency] as qualified to provide counseling on—
>
> (I) the advisability of a higher-cost mortgage transaction; and
>
> (ii) the appropriateness of a higher-cost mortgage for the consumer.[135]

This provision is really a disclosure requirement and not a counseling requirement at all, as the only obligation imposed is to give the consumer one piece of paper that recommends counseling and a second piece of paper that contains counselor contact information. Subtitle A does not require that the consumer ever actually contact a credit counselor or ever actually receive any counseling. Thus, like any other disclosure, a predatory lender or broker can draw on a number of tricks to render the disclosure ineffective, including marginalizing the form itself, marginalizing the value of any advice the consumer might receive, claiming that the time required for counseling would risk an increase in interest rates or even jeopardize the entire

133. H.R. 1295, 109th Cong. § 212 (2005) (proposing a new subsection (g)(3)(A)(ii) to be added as an amendment to section 4 of the Department of Housing and Urban Development Act).

134. *Id.* § 201 (proposing to amend section 129 of the Truth in Lending Act (TILA)).

135. *Id.* § 201 (proposing a new subsection (y)(1) to be added as an amendment to section 129 of TILA).

deal, and preying on the consumer's need for funds.[136] Further, like all disclosure mechanisms, Subtitle A does nothing to address the ability of a broker to simultaneously encourage a consumer's trust and exploit information and power asymmetries.

Subtitle B contains a number of education and counseling initiatives, purportedly created to expand housing opportunities. They include making home ownership information available via a toll-free telephone number and the Internet,[137] funding not-for-profit organizations that provide housing counseling,[138] and producing a mortgage information booklet written in "understandable and accessible" language.[139] Subtitle B also includes outreach initiatives directed at "vulnerable populations,"[140] the very existence of which seems a rejection of the mortgage lending industry's constant denial of targeting and reverse re-lining. Evidence of such targeting, especially on the basis of race, has been established by any number of studies.[141] Finally, Subtitle B delegates to the Secretary the task of establishing minimum standards for counseling materials and for persons who will act as counselors.[142]

These education and counseling provisions are subject to the same two criticisms identified above with regard to HR 1994.[143] First, the effectiveness of education and counseling at preventing consumers from becoming victims of a predatory loan is debatable. Second, these provisions are wrongly focused. It should not be the obligation of the consumer to take steps to avoid being cheated; it should be the obligation of the mortgage broker not to cheat. Thus, instead of striving to educate and counsel consumers so that they can better protect themselves, the goal should be to address the structural systems that enable predation to occur and the

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136. *See* Wilson, *Effecting Responsibility*, *supra* note 44, at 1500–01.

137. H.R. 1295 § 213(a) (proposing a new subsection (h)(2) to be added as an amendment to section 106 of the Department of Housing and Urban Development Act of 1968 (DHUDA)).

138. *Id.* § 213(a) (proposing a new subsection (h)(6) to be added as an amendment to section 106 of DHUDA).

139. *Id.* § 218(2) (proposing a new subsection (a) to be added as an amendment to section 5 of RESPA).

140. *Id.* § 213(a) (proposing a new subsection (h)(5) to be added as an amendment to section 106 of DHUDA).

141. For studies finding race-based disparity in subprime lending, see ACORN FAIR HOUSING, THE HIGH COST OF CREDIT: DISPARITIES IN HIGH-PRICED REFINANCE LOANS TO MINORITY HOMEOWNERS IN 125 AMERICAN CITIES 11–13 (2005), http://acorn.org/fileadmin/Affordable_Housing/hmda/High_Cost_of_Credit_Report.doc; *see also* KEVIN STEIN, CAL. REINVESTMENT COAL., WHO REALLY GETS HIGHER-COST HOME LOANS?: HOME LOAN DISPARITIES BY INCOME, RACE AND ETHNICITY OF BORROWERS AND NEIGHBORHOODS IN 12 CALIFORNIA COMMUNITIES IN 2004 12–16 (2005), http://www.calreinvest.org/system/assets/14.pdf; DEBBIE GRUENSTEIN BOCIAN, KEITH S. ERNST, & WEI LI, CTR. FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 2–3 (2006), http:// www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf; CAL. REINVESTMENT COAL. ET AL., PAYING MORE FOR THE AMERICAN DREAM (2007), http://www.nedap.org/pressroom/documents/2007_Report-2005_HMDA.pdf. The data analyzed for these and other studies come from disclosures required by the Home Mortgage Disclosure Act of 1975, 12 U.S.C. §§ 2801–2810 (2000).

142. H.R. 1295 § 213(a) (proposing a new subsection (h)(1)(A) to be added as an amendment to section 106 of the DHUDA).

143. *See* discussion *supra* Part II.B.1.

incentives that entice brokers to commit predatory acts. State experiments with redefining the broker-consumer relationship attempt to do this; HR 1295 does not.

In addition to education and counseling initiatives, HR 1295 also relies on disclosures to "protect" consumers. These disclosures, found in Title I of the bill, purport to fulfill three functions: (1) an informative function that emphasizes consumer awareness of the terms included in a loan; (2) an empowering function directed at increasing a consumer's negotiation skills; and (3) a cautionary function served by providing sobering descriptions of the cost and potential consequences of a "higher-cost mortgage." An example of an informative disclosure is the requirement that a creditor disclose the existence, effect, and statutory authority for a balloon feature in a loan.[144] The principal example of an "empowering" disclosure is the requirement that the consumer be informed of all "points, fees, or other charges payable to the creditor or any third party [that] are included, directly or indirectly, in the principal amount of the loan or otherwise financed by the creditor."[145] The value of this disclosure lies, in theory, from the consumer's ability to use the disclosure to engage in comparison shopping. The cautionary disclosures appear to be an intensification of the warnings currently found in HOEPA.[146] These disclosures caution the consumer that (1) the interest rate and fees charged for a subprime market loan are higher than the interest rate and fees charged for a prime market loan, which results in a higher monthly payment;[147] (2) the terms of a subprime loan and the fees charged for it can vary from broker to broker and that a consumer's credit score may entitle him or her to a lower cost loan than a broker might present;[148] (3) a bill consolidation loan may not be in the consumer's best interest because the "savings" from lower monthly payments on the consolidated debt may not be recaptured and because the extended repayment term substantially increases the total amount of payments that will be made on the consolidated debt;[149] and (4) the consumer "may get into serious financial difficulties if [the consumer] use[s] this loan to pay off old debts and then replace[s] them with other new debts."[150]

Disclosures, standing alone, are inadequate to fill the gaps that exist in the proscriptive approach to predatory lending, because the disclosure approach itself is riddled with gaps. A predatory broker can deprive disclosures of the informative

144. *Id.* § 103(b)(3) (proposing a new subsection (e)(3) to be added as an amendment to section 129 of TILA).

145. *Id.* § 103(d) (proposing a new subsection (m)(2) to be added as an amendment to section 129 of TILA).

146. Home Ownership and Equity Protection Act of 1994 (HOEPA), Pub. L. No. 103-325, 108 Stat. 2190 (codified in scattered sections of 15 U.S.C.).

147. H.R. 1295 § 103(k) (proposing a new subsection (a)(1)(C) to be added as an amendment to section 129 of TILA).

148. *Id.* (proposing a new subsection (a)(1)(D) to be added as an amendment to section 129 of TILA).

149. *Id.* (proposing a new subsection (a)(1)(E) to be added as an amendment to section 129 of TILA).

150. *Id.* (proposing a new subsection (a)(1)(F) to be added as an amendment to section 129 of TILA).

and empowering functions intended by sections 103(b), (d), and (k) in several ways. First, a broker can minimize the impact of a required disclosure simply by burying it in a stack of documents. For a consumer already overwhelmed by the number and complexity of documents involved in a real estate mortgage loan, a disclosure form can become just one more document to sign when told. A broker can also minimize the impact of a disclosure by manipulating the context in which the disclosure is made—for example, by compressing the time that a consumer is given to read and comprehend documents or by creating an intimidating atmosphere that dissuades a consumer from asking questions or pursuing answers, including the use of threats to terminate the transaction. Additionally, brokers can further minimize the effectiveness of a disclosure by using nontransparent acronyms, such as "YSP"[151] and "POC,"[152] to obfuscate the content of the disclosure.[153]

Similarly, a broker can rob the disclosures required by section 103(k) of their cautionary effect in two ways. First, a broker can marginalize the disclosures by characterizing them as just another form that "the bureaucrats" require and nothing that consumers should "trouble" themselves with. Second, a broker can render the disclosures ineffective by exploiting the psychological factors—including optimism, anchoring, and availability heuristics[154]—that impel a consumer toward finalization of the loan. Such manipulation should come as no surprise when the responsibility for conveying disclosures to a consumer is placed in the hands of the very person who profits most when disclosures are least effective. With the informative, empowering, and cautionary effects of disclosures so easily diminished or avoided, disclosures fail to reduce the information and power imbalances between mortgage brokers and consumers.

A second failing of the disclosure methodology, which it shares with education and counseling methodologies, is that it is directed at the wrong party. The purpose of all disclosures is to make the consumer a better bargainer and thus better able to defend against the tactics of a predatory broker. There is no recognition in the disclosure approach that the nature of the mortgage broker-consumer relationship should give rise to duties that place limitations on broker conduct. It is precisely this recognition that underlies the initiatives in some state broker licensing statutes, incomplete though they may be, to impose contractual or agency like duties from

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151. YSP refers to yield spread premium.

152. POC means paid out of closing.

153. YSPs have been criticized because they are a form of compensation the borrower pays to the mortgage broker without knowing that the payment is occurring. Wilson, *Taxonomic Analysis*, *supra* note 11, at 329. The compensation is disguised because the payment comes from the lender, but the borrower is the source of the payment by paying an interest rate higher than the lender's predetermined par rate. *Id.* I have argued that the YSP compensation system is a form of steering, as the broker is compensated for convincing a borrower to take a loan with an interest rate higher than that dictated by the risk of default indicated by the borrower's credit score. *Id.* If the YSP were knowingly agreed to by a borrower as a way to get additional funds from a lender to have a "no fee" closing, it would not be so odious. Unfortunately, YSPs are too often abused and the borrower is uninformed about their effect, even when "disclosed" on a HUD-1 Settlement Statement. *See id.* Similarly, the designation POC is used to disguise a variety of charges that are not explained to or fully understood by borrowers.

154. *See* Forrester, *supra* note 89.

brokers to consumers.[155] Disclosures simply say to a consumer, "It is your job to avoid being victimized." When disclosures fail to achieve that goal, the fault is assumed to lie with the consumer, who, according to this view, had all the tools needed to deal with the broker. The mortgage brokering and lending industry can thus consider itself absolved of responsibility—moral as well as legal—for the damage done to the consumer.[156]

b. National Database of Licensed Mortgage Brokers

The proposal for a national database of licensed mortgage brokers is found in HR 1295 at Subtitle B of Title V. Specifically, section 511 provides that the "Secretary . . . shall provide for the establishment and maintenance of a national database of mortgage brokers."[157] The creation of a national database of mortgage brokers is something of an advance over the consumer education, counseling, and disclosure methodologies of consumer protections, as the database includes at least some notion of broker accountability. Although the database, like education, counseling, and disclosures, is primarily a consumer self-defense device, it also gives notice to brokers that predatory behavior is improper and that there will be consequences—publicly available information about their predatory behavior—if they engage in it.[158] This benefit is subject, however, to two qualifications. The first is that the proposal for a national database must be severed from the remainder of HR 1295. The consumer protection benefits of the database proposed in Title V are far outweighed by consumer harming provisions found in the remainder of the bill.[159] The second qualification is that the scope of the database must be sufficiently broad and the information contained in it must be sufficiently complete to enable the realization of the "predator avoidance" goal. Achieving this goal is thus a function of what information is compiled and stored in the database and who has access to it. Addressing those questions is the task of the remainder of this subsection.

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155. *See, e.g.*, CAL. FIN. CODE § 4979.5 (West Supp. 2007) ("A person who provides brokerage services to a borrower in a covered loan transaction by soliciting lenders or otherwise negotiating a consumer loan secured by real property, is the fiduciary of the consumer . . . .").

156. The "blame the consumer" approach is most conspicuous in the disclosure concerning new debt incurred after taking out a bill consolidation loan. When consumers incur new credit card debt after "paying" the old debt via a debt consolidation loan, the new charges may result from uninsured medical bills or reduction in income because a good paying job has been lost and replaced by a lower paying one in the service sector, not from indiscriminate spending.

157. Responsible Lending Act, H.R. 1295, 109th Cong. § 511(a) (2005).

158. The Minnesota mortgage broker licensing statute contains a similar provision that allows for publication of a broker's wrongdoing on the state's Department of Commerce web site. *See* MINN. STAT. ANN. § 58.12 (West 2002); Minnesota Department of Commerce, Enforcement Actions, http://www.state.mn.us (follow "State Agencies" hyperlink; then follow "Commerce Department" hyperlink; then follow "Enforcement Actions" hyperlink) (last visited Sept. 16, 2007).

159. *See* discussion *supra* Part II.C.1–2.

i. Universal Inclusion in the Database—Unrealized

The operative provisions of Subtitle B of Title V are found in section 512.[160] On first reading, section 512(1) appears to require universal inclusion of all mortgage brokers, as it requires that the national database "include a listing of each person licensed under State law or regulation or under Federal mortgage broker requirements under section 502 to act as a mortgage broker."[161] A database that is truly universal could assist consumers by preventing brokers from concealing their predatory behavior through geographic migration.[162] Currently, when conditions in one locale become too "hot" for a broker, they can relocate to another state and begin anew. So long as the broker has not acquired a criminal record available through an FBI records search, which is customarily required by state mortgage broker licensing statutes,[163] and so long as the broker is willing to lie about the existence of past predatory activities on a license application, consumers in the new state will not learn about prior predatory acts. By placing information from all fifty states into a central clearinghouse, a national database would improve consumers' ability to identify predatory brokers and avoid doing business with them. Such a database would also help each state discharge its gatekeeping function by eliminating the anonymity that enables bad actors to reenter the marketplace. Further, a universal database would help lenders avoid unknowingly hiring a predatory broker.

Unfortunately, the potential benefits that could be realized from a national database are compromised in HR 1295 because the scope of the proposed database is not universal. The exemptions from the definition of *mortgage broker* found in section 501(b)(2)[164] would produce expansive exclusions from the national database and render it underinclusive. Furthermore, as this section provides that "the laws and regulations of a State shall exempt" the same categories of persons as HR 1295, the underinclusiveness of the database is not limited solely to those brokers who would be subject to the bill's federal minimum standards.[165] In fact, this definitional preemption renders meaningless the distinction made in section 512(1) between brokers licensed "under state law or regulation" and brokers licensed "under

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160. H.R. 1295 § 512.

161. *Id.* § 512(1).

162. *See Licensing & Registration Hearing*, *supra* note 5, at 55 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB).

163. For examples of lender applications requiring consent to federal criminal background checks, see Commonwealth of Kentucky Office of Financial Institutions, Forms and Applications, http://www.kfi.ky.gov/industryinfo/formsapps.htm (follow "Criminal Background Check Requirements" hyperlink) (last visited Sept. 16, 2007); North Carolina Comm'r of Banks, NC Mortgage Lending & Licensing Compliance Forms, http://www.nccob.org/NCCOB/Mortgage/FormsFees/ (follow "MLA01" hyperlink) (last visited Sept. 16, 2007); Vermont Department of Banking, Insurance, Securities & Health Care Administration, Authority to Release Information, http://www.bishca.state.vt.us/BankingDiv/lenderapplic/Authtorelease.PDF (last visited Sept. 16, 2007).

164. H.R. 1295 § 501(b)(2).

165. *Id.*

Federal mortgage broker requirements."[166] With regard to regulation of persons who are to be included in the database by virtue of licensure under state or federal law, the two groups are rendered coextensive.

The database proposed in HR 1295 is further underinclusive because it fails to address a second means by which a predatory broker can avoid detection—regulatory migration.[167] Regulatory migration takes place when a broker moves from a setting where regulation and licensing occur at the individual level to a setting where regulation occurs at the institutional level with no individual license, or vice versa. If regulation is at the institutional level, an independent broker who takes a job with a mortgage bank will not be subject to a personal history and business background check by the state that would uncover predatory acts the broker had previously committed. Similarly, a broker whose employment by a mortgage banking company was terminated because of predatory behavior could apply for an independent broker's license with little fear that prior predatory acts would become known. Because of privacy rights and concerns about potential liability, employers are notoriously reluctant to release information about former employees.

A significant amount of testimony given at the Licensing Hearing by representatives of NAMB and MBA concerned the level at which registration should occur. The mortgage banking industry representative argued in favor of institutional-level licensing and against individual level licensing of employees who broker loans.[168] According to this representative, individual-level licensing is unnecessary for two reasons: mortgage bankers are already subject to extensive regulation and they bear the risk of financial loss from loan defaults that result from predatory activities.[169] Mortgage bankers assert that the risk of loss, which they emphasize mortgage brokers do not have, is all that is needed to ensure that they will vigorously investigate the backgrounds of persons applying for employment.[170] In short, the mortgage bankers contend that industry self-interest and self-policing fulfill the same gatekeeping function as the individual-level licensing required for mortgage brokers. The mortgage brokering industry representative argued equally vehemently in favor of individual level licensing for both groups.[171] Although undoubtedly one reason for the mortgage brokers' position is preservation of competitive parity with mortgage bankers regarding compliance obligations and

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166. *Id.* § 512(1). Section 501(a) states that the federal mortgage broker requirements "shall apply only" to states that have not enacted the laws and regulations described in subsection (b). *Id.* § 501(a). The exemptions from the definition of *mortgage broker* in section 501(b)(2), on the other hand, are binding on all states, which means that the federal definition and the states' definition of a *mortgage broker* will be identical. *Id.* § 501(b)(2).

167. *See Licensing & Registration Hearing*, *supra* note 5, at 55 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB).

168. *Id.* at 7, 45–46 (statement of Teresa A. Bryce, Senior Vice President and Director of Legal and Corporate Affairs, Nexstar Financial Corporation).

169. *See id.* at 44, 46.

170. *See id.*

171. *Licensing & Registration Hearing*, *supra* note 5, at 8–9, 52 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB).

costs, a more civic oriented justification offered by the brokers' representative was protecting consumers by preventing regulatory migration.[172]

If institutional level licensing is permitted, many loan brokers will not be "licensed under State law or regulation or under Federal mortgage broker requirements" and thus would not be included in the national database.[173] Once again, the underinclusiveness of the database would inhibit its value to consumers, compromise each state's gatekeeping efforts, and be of little service to subsequent employers.

ii. Intended Users and Uses of Information in the Database—Unclear

Section 512 establishes four categories of persons or groups entitled to access information in the database and determines the types of information that will be made available to those persons or groups.[174] Implicit in these differentiations are decisions that seek to balance the benefits of making information about mortgage brokers available to users of the database with mortgage brokers' concerns about privacy and unfounded or disputed claims. In principle, accommodating these interests is necessary; whether the accommodation proposed in HR 1295 achieves a reasonable balance of competing interests is debatable.

The database user identified in section 512(2) is the public at large.[175] Information that shall be made available to the public consists of "complaints made, and final disciplinary and enforcement actions taken, against each licensed mortgage broker."[176] Unsurprisingly, mortgage brokers object to the publication of "complaints made" on the ground that an untested complaint could contain unfounded allegations. NAMB argues that the database should disclose information about final disciplinary and enforcement actions only.[177] That approach is too restrictive, however, as it would exclude all complaints that were terminated in any manner short of a final action. A negotiated settlement, for example, could be structured to include a withdrawal of the consumer's complaint, which would not result in a final disciplinary or enforcement action. A state regulator could, of course, continue with an administrative action, but with a placated consumer and limited public resources, that course of action is unlikely. If the database is to fulfill its consumer informing and cautioning function, it must include "complaints made."[178] Where there is no final adjudicated decision, broker denials of wrongdoing could be included in the database, much as consumers can dispute adverse entries on a credit report. Consumers can then decide whether to work with

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172. *Id.* at 8–9.

173. H.R. 1295, 109th Cong. § 512(1) (2005).

174. *Id.* § 512(2)–(5).

175. *Id.* § 512(2).

176. *Id.*

177. *See Licensing & Registration Hearing*, *supra* note 5, at 55 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB) (arguing that the national database should include only "substantiated claim[s]" that are "fully adjudicated by the proper governmental entity").

178. H.R. 1295 § 512(2).

or avoid a broker based on several factors, including the number of complaints disclosed and the persuasiveness of the broker's denial of wrongdoing.

Although the inclusion of *complaints made* is good for consumers, the intended scope of that term is not clearly established and could be construed in a way that would unduly hinder the bill's informative and cautionary goals. The language, *complaints made, and final disciplinary and enforcement actions taken*, sounds as if the only matters included are administrative proceedings conducted by the state agency that involve a violation of the state's broker licensing statute. While administrative proceedings are clearly important to a consumer's decisionmaking process, they are not the only relevant proceedings. Judicial proceedings, which result in a judgment as opposed to a disciplinary action, are also obviously relevant. Further, complaints of wrongdoing other than violation of a licensing statute should be disclosed to consumers. Many states require applicants for a broker's license to disclose all felony charges of every nature, all misdemeanor charges involving financial matters, and all bankruptcy proceedings, precisely because those matters are deemed relevant to the state's evaluation of the applicant's trustworthiness.[179] That information is similarly relevant to a consumer's evaluation. It would be appropriate for section 512(2) to include some limits on the types of administrative and judicial proceedings that must be disclosed, and the length of time that the proceedings remain relevant, but as written section 512(2) is too restrictive.

The database users identified in section 512(3) are the Secretary and state agencies and officials who are responsible for licensing or testing mortgage brokers.[180] Under this section, the database shall make available to the Secretary, and state agencies and officials "such information regarding mortgage brokers as the Secretary, by regulation, considers appropriate for the Secretary and such agencies and officials to carry out their functions regarding regulation, licensing, or testing of mortgage brokers, including information regarding employment histories and criminal backgrounds of mortgage brokers."[181] The nature of "appropriate" information is left unspecified, except with regard to two items: "employment histories and criminal backgrounds."[182] As these two items raise different concerns, they should be treated differently with regard to the disclosure of information from the database.

The treatment of criminal background information was considered in the analysis of section 512(2).[183] Criminal history that is relevant to a broker's trustworthiness in financial matters, and not stale due to passage of time, should not be restricted to the Secretary and officials of state agencies. NAMB representatives repeatedly emphasize the importance of mortgage financing to consumers and the

179. *See supra* note 163.
180. H.R. 1295 § 512(3).
181. *Id.*
182. *Id.*
183. *See supra* notes 175–79 and accompanying text.

critical role brokers play in the financing process.[184] Such statements support including information about a broker's criminal history in the general public category of section 512(2), in addition to the regulator category of section 512(3). Inclusion in section 512(2) would promote the consumer information and cautionary functions; inclusion in section 512(3) would promote the government's gatekeeping function, especially in regard to geographic migration. In light of these interests, brokers cannot plausibly argue that information about their criminal history is unreliable or a private matter.

The restriction of a mortgage broker's employment history to the Secretary and state regulators is more problematic. Both regulators and consumers have an interest in a broker's employment history because of the adverse information that might be discovered. The fact that a broker was discharged from employment because of engagement in predatory activities or other financial malfeasance is undeniably relevant to a consumer's decision to work with or avoid a broker. That information is also undeniably relevant to a regulator's gatekeeping function. Nevertheless, there are valid concerns about privacy and reliability that justify restricting employment information to the Secretary and state regulators.

Perhaps the most persuasive reason for restricting public access to employment information is that the information may not be fully reliable. The grounds for an adverse employment action are often multifaceted and disputed. Further, employment related decisions, when memorialized in employment files, are often couched in deliberately generic and uninformative terms. This unreliability has two related outcomes. First, it lends credence to a broker's interest in limiting access to potentially ambiguous and incomplete, yet damaging, information. Second, this unreliability means that the informative and cautionary benefits to consumers are low. Unlike consumers, the Secretary and state regulators can be expected to—and are bound to—maintain the confidentiality of a broker's employment records. Thus, the restriction of employment information to the Secretary and state regulators is appropriate.

The database users identified in section 512(4) are "persons employing or using the services of mortgage brokers."[185] Little can be said about the substance of this section because it does not describe the nature of the information that would be made available to the intended users. This section merely states that the database shall make available "such information regarding mortgage brokers as the Secretary, by regulation, considers appropriate."[186] The scope of persons who are

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184. *See Licensing & Registration Hearing*, *supra* note 5, at 51 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB) ("[Mortgage brokers] guide consumers through the mortgage loan origination process [and] work closely with consumers throughout the homebuying and ownership process."). For an uncharacteristically candid statement of the responsibility mortgage brokers should owe to consumers as a result of the close relationship brokers seek, see Howard Schneider, *Walking a Tightrope*, NAT'L MORTGAGE BROKER MAG., July 2006, at 1, 1, *available at* http://www.nationalmortgagebroker.com/index.php?pid=magazine&cid=02 ("Education, borrower needs, financial capabilities [have] becom[e] important skills to cultivate in what once was seen purely as a sales business.").

185. H.R. 1295 § 512(4).

186. *Id.*

to have access to whatever information is determined to be "appropriate" does, however, merit discussion. The meaning of the words *employing or using* is not transparent. Employing could refer to the W-2 type relationship that would exist between a lender and an in-house worker or to the relationship that would exist between a lender and an independent mortgage broker through whom a lender makes its loan products available to consumers. Employing could also refer to the relationship that arises when a consumer engages a mortgage broker to locate a loan. This latter possibility is made even more credible by the fact that section 512(4) also applies to persons "using the services of" a mortgage broker.[187]

Despite the ambiguity, it is unlikely that section 512(4) intends to include, or should be taken to include, consumers within the class of intended users for two reasons. First, as members of the general public, consumers are already included in section 512(2).[188] Although the set of consumers who "use" the services of a mortgage broker is smaller than the set of all consumers, if the goal of section 512(2) is to inform and caution consumers about predatory brokers—if it is directed at members of the public who are planning to use a mortgage broker—then the *use* distinction loses much, if not all, of its meaning. Thus, it is inconsistent with the categorical arrangement of the subparts of section 512 to include consumers twice.

Second, the various subparts of section 512 appear to be designed to address the information needs of, and disclosure concerns relating to, the principal categories of persons or groups who have an interest in acquiring information about mortgage brokers. These persons and groups are consumers in the general public, government regulators, and lenders that work with brokers.[189] The first two categories line up with the scope of sections 512(2) and 512(3), and this pattern suggests that the lenders are covered by 512(4). While the scope of 512(4) should be stated with greater clarity, a reasonable reading is that the section is intended to provide information that would help a lender avoid employing a predatory broker as an in-house employee or using the services of a predatory broker as an independent agent.[190]

Section 512(5), the final subsection, is completely unspecific and open-ended. It provides only that the database shall "provide for the maintenance of such other information as the Secretary considers appropriate."[191] Apparently, the Secretary will have the discretion to decide not only what information will be maintained but also who will have access to it. With no information about the identity of intended users or the nature of included information, it is impossible to determine whether section 512(5) allows the Secretary to identify additional types of information that can be made available to the established categories of database users or whether the Secretary is empowered to create entirely new categories.

One observation that can be made about the yet-to-be-determined content of section 512(5) is that it recalls the requirement of section 511(b) that the Secretary

187. *Id.*
188. *Id.* § 512(2).
189. *Id.* § 512(2)–(4).
190. *Id.* § 512(4).
191. *Id.* § 512(5).

shall "consult with the American Association of Residential Mortgage Regulators [(AARMR)], the Conference of State Bank Supervisors [(CSBS)], and other appropriate organizations in determining the information to be maintained in the database."[192] Requiring the Secretary to consult with the CSBS and the AARMR is a generally positive development for consumers.[193] At the same time, however, it is worth noting that in determining the content of section 512(5), the Secretary need not consult with consumers or with consumer advocacy groups.[194] As the identity of "other appropriate organizations" is apparently left to the Secretary's discretion,[195] one can be justifiably skeptical that consumer participation will be significant, if permitted at all.

A far more preferable model for the makeup of a consulting group can be found in the Predatory Lending Advisory Council, proposed in House Bill 200.[196] Of the thirteen members of this Council, four members are to be representatives of community-based organizations, three are to be representatives of state agencies for consumer affairs or consumer protection, three are to be private homeowners, and three are to be representatives of the private real estate industry, "such as realtors, mortgage brokers, and bankers."[197] This composition need not be copied exactly, but section 511(b)[198] should require that the Secretary consult with advisors who represent a diversity of interests and should even be weighted in favor of including voices that do not otherwise have access, either through lobbying or personal contacts, to decisionmakers in the government.

iii. An Alternative to the National Database of Mortgage Brokers of HR 1295

A national database that achieves universal inclusion of all mortgage brokers in all states and does not unduly restrict the information consumers can access about brokers would be a useful tool for combating predatory lending. Such a database has the potential to (1) help consumers identify and avoid doing business with brokers who exhibit predatory tendencies; (2) help state regulators carry out the gatekeeping function of mortgage broker licensing statutes by preventing predators from entering the mortgage brokering business; and (3) help

192. *Id.* § 511(b).

193. *See Licensing & Registration Hearing, supra* note 5, at 97 (statement of Joseph A. Smith, Jr., North Carolina Comm'r of Banks, CSBS). Smith astutely recognized that while "changes in technology and deregulation make financing . . . loans a global industry," residential mortgage lending "is a local activity," and "[t]he damage done by predatory lending and mortgage fraud . . . is . . . local." *Id.* In response to the question about whether "a uniform standard be a minimum standard, . . . a 'floor' or a 'ceiling'," Smith replied, "Since borrowers' needs may vary widely from one state to another, uniform standards should be the floor, rather than the ceiling, for the mortgage industry." *Id.* at 102.

194. *See* H.R. 1295 § 512(5).

195. *Id.* § 511(b).

196. Prevention of Predatory Lending Through Education Act (PPLTEA), H.R. 200, 109th Cong. § 5(a) (2005).

197. *Id.* § 5(b)(1)–(4).

198. H.R. 1295 § 511(b).

conscientious lenders avoid hiring or doing business with predatory brokers. Unfortunately, HR 1295 does not achieve these goals. The broad exclusions from the definition of *mortgage broker* render the scope of the database far from universal, and the restriction of a broker's criminal history to regulators denies consumers the use of important information relevant to their choice of a broker. Finally, the modest benefits conferred by the database that would be created by HR 1295 are overshadowed by the scaling back of substantive consumer protections produced by other titles of the bill.[199]

A further reason to reject the national database proposed in HR 1295 is that a similar proposal is being developed by CSBS and AARMR.[200] One immediate advantage of the database proposed by CSBS and AARMR over the HR 1295 database is that the former will include all mortgage brokers required to be licensed under state law.[201] Because the CSBS–AARMR proposal does not impose an artificially narrow definition of *mortgage broker*, its coverage will achieve a significantly greater degree of inclusiveness.[202] Additionally, because the CSBS–AARMR database originates from state regulators, it does not raise the preemption concerns that pervade HR 1295.[203]

Finally, by its reliance on education, counseling, disclosures, and a database, HR 1295 fails to critically examine the nature of the mortgage broker-consumer relationship, including the inculcation of a sense of trust, virtually insurmountable asymmetries in information and power, and the disconnect between expectations about applicable legal duties and doctrinal reality. For this reason, HR 1295 is inferior to state mortgage broker licensing statutes that at least experiment with alternative ways to view the broker-consumer relationship. Such experiments are to be valued, not discouraged or preempted, because redefining of the mortgage broker-consumer relationship is necessary to fill in the gaps inherent in other antipredatory lending strategies.

III. PREEMPTION AND HERMENEUTICAL CRITICISMS OF PROPOSED FEDERAL REGULATION OF MORTGAGE BROKERS

At the Licensing Hearing, Housing and Community Subcommittee Chairman Robert Ney proclaimed multiple times that title V of HR 1295 was intended to establish "a floor . . . but not [a] ceiling" and did not preempt state laws with regard to education and licensing requirements for mortgage brokers.[204] Representative Ney even professed his inability to comprehend how one witness who raised

199. *See* discussion *supra* Part II.C.1–3.a.

200. *Licensing & Registration Hearing*, *supra* note 5, at 103–04 (statement of Joseph A. Smith, Jr., North Carolina Comm'r of Banks, CSBS).

201. *Id.* at 104 (clarifying that the proposed database would include "all individuals and companies currently required to be licensed or registered under state law").

202. *See id.* at 103.

203. *See* discussion *infra* Part III.A.

204. *Licensing & Registration Hearing*, *supra*, note 5, at 2 (statement of the Honorable Robert Ney, Chair, H. Subcomm. on Housing and Community Opportunity).

preemption concerns could so misread the bill.[205] In fact, the witness's intuition was insightful and Representative Ney's comments were disingenuous. To claim that HR 1295 does not preempt state regulation of mortgage brokers requires an intentional disregard of the exemptions from regulation granted in Title V and of the inescapable interconnection between the remedial provisions in Title I and regulation of broker conduct. Section A of this Part will demonstrate the preemption accomplished by HR 1295.

Also in connection with the preemption issue, section B of this Part considers the hermeneutical bias on which federal preemption is grounded, raises some ethical concerns that follow from it, and closes by noting the influence of that bias on legislative responses to predatory lending.

A. Preemption of State Regulation of Mortgage Brokers in Titles I and V of HR 1295

Initially it appears that HR 1295 allows states to enact mortgage broker regulations that are more restrictive than the bill establishes. The title to Subtitle A refers to "[m]inimum [s]tandards,"[206] and section 501(a) states that the federal requirements "shall apply only with respect to States that . . . have not enacted and do not have in effect [the] uniform State laws and regulations described in subsection (b)."[207] Thus, one would think that HR 1295 would have no effect on states that have enacted laws that meet or exceed the regulations prescribed in section 501(b). That conclusion would be wrong.

The preemptive effect of Title V originates in section 501(b)(2), which defines the term *mortgage broker* and declares that "the laws and regulations of a State shall exempt [certain categories of persons and organizations] from treatment as mortgage brokers."[208] The exemptions of section 501(b)(2) would impact every aspect of mortgage broker regulation by the states. If a person fits within one of those exemptions, states would be precluded from imposing any kind of regulatory requirements. States could not subject that person to background investigations or any other of the gatekeeping mechanisms; states could not impose a bonding requirement, impose sanctions for misconduct, or utilize any other administrative oversight mechanism; and states could not create contract- or agency-based duties in favor of consumers. It is difficult to imagine a preemptive tool more basic than the power to define whom the states can, and cannot, subject to regulation.

The preemptive effect of Title I is further displayed when the provisions of that title are read with attention to their connection to state licensing of mortgage brokers. Title I appears to focus on the regulation of terms and practices associated

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205. *Id.* The incredulity was directed at Daniel F. Hedges, Director, Mountain State Justice, Inc. As I hope the discussion of stealth preemption in this Article makes clear, Mr. Hedges's concerns were insightful and meritorious.

206. Responsible Lending Act, H.R. 1295, 109th Cong. tit. V, subtit. B (2005).

207. *Id.* § 501(a).

208. *Id.* § 501(b)(2).

with "higher-cost mortgages"[209] rather than on mortgage brokers, who are the subject of Title V.[210] Any such compartmentalization is artificial and masks the preemptive effect that Title I would have on state regulation of mortgage brokers.

The controlling provision in Title I with regard to federal preemption of state power to regulate mortgage brokers is section 106, which is entitled "Coordination with State Law."[211] Coordination must be understood as a euphemism for subordination, as the preemptive effect of section 106(1) is clearly stated: "The provisions of this title shall supersede any provision of the law of any State to the extent that such provision of law attempts, directly or indirectly, to regulate, or has the effect of regulating, mortgage lending activities . . . ."[212] The term "mortgage lending activities" is defined in section 106(1) to include nearly every conceivable activity "by or on behalf of a broker,"[213] and the term "law of any State" is defined so as to capture every form of law that might be enacted by any state or any of its political subdivisions.[214] In an uncharacteristically forthright admission, section 106(1) states that its preemptive effect applies "without respect to whether or the extent to which such provision of [state] law may afford greater protection, substantive or otherwise, to consumers."[215]

Section 106(1) also purports to establish exclusions from the preemptive effect of all the added sections, including an exemption for "[a]ny law of any State requiring the licensing, registration, or authorization of any person engaged in mortgage-lending activities."[216] However, this exemption itself contains an exception, which provides that "the law of any State will be preempted to the extent that such law conditions the issuance or maintenance of such a license, registration

209. *Id.* tit. I. HR 1295 contains a subtle change in the name applied to predatory loans made in the subprime market. Such loans are generally called "high-cost" loans. *See, e.g.*, Prohibit Predatory Lending Act, H.R. 1182, 109th Cong. § 2(a) (2005) (proposing a new subsection (aa) to be added as an amendment to section 103 of TILA that would define the term "[h]igh-[c]ost [m]ortgage"); Fair and Responsible Lending Act, H.R. 4471, 109th Cong. § 102(a) (2005) (proposing a new subsection (aa) to section 103 of TILA that would define the term "[h]igh-[c]ost [h]ome loan"); KY. REV. STAT. ANN. § 360.100(1) (LexisNexis 2006 Supp.) (listing the types of transactions that qualify as "high-cost home loans"). The use of the term "higher-cost loan" implies that the loan cost is not high as a categorical matter but is only comparatively high; furthermore, the term implies that the loan is high in comparison to other loans only because of the borrower's credit history. In other words, the loans are higher-cost because of risk-based pricing. The cost of predatory loans is set by what the predator can convince, coerce, or compel a consumer to pay, and predatory tools like steering, YSPs, and inexplicable origination fees establish that pricing in predatory loans is opportunistic, not risk based. The implication in the use of the phrase "higher-cost" loans in HR 1295 should be opposed.

210. H.R. 1295 § 501–515.

211. H.R. 1295 § 106.

212. *Id.* at §106(1) (proposing a new subsection (f)(1) to be added as an amendment to section 111 of TILA).

213. *Id.* (proposing a new subsection (f)(2)(A) to be added as an amendment to section 111 of TILA).

214. *Id.* (proposing a new subsection (f)(2)(B) to be added as an amendment to section 111 of TILA).

215. *Id.* (proposing a new subsection (f)(1)(B) to be added as an amendment to section 111 of TILA).

216. *Id.* (proposing a new subsection (f)(4)(B) to be added as an amendment to section 111 of TILA).

or other authorization, or the authority granted thereby, on compliance with any law that is otherwise preempted."[217] Given the extremely comprehensive nature of the activities that are expressly "otherwise preempted" by Title I,[218] it is unlikely that any exempted activity would have much regulatory importance.

Section 106(1) also removes private causes of action from a state's regulatory options by declaring that the provisions of Title I shall supersede state laws that attempt to regulate mortgage lending activities "by making any conduct in connection with any such activities subject to civil or criminal penalties."[219] Similarly, the section removes public civil sanctions by preempting the regulatory oversight mechanisms of license suspension, revocation, or nonrenewal. Just as the preemptive definition of *mortgage broker* in Title V negates a state's ability to regulate mortgage brokers through the gatekeeping mechanisms of licensing statutes, the preemptive definition of *mortgage lending activities* in Title I negates a state's ability to regulate brokers through administrative oversight mechanisms.

Preemption of state regulation over mortgage brokers is necessary for HR 1295 to protect the bill's many lender and broker protection provisions from erosion by state law. Examples of provisions in Title I that consumer advocates would certainly bring to the attention of state legislatures, if that option were not precluded, include the following provisions: (1) a safe harbor against claims of asset-based lending that utilizes a lenient presumption of "payment ability";[220] (2) a safe harbor against claims of loan flipping that utilizes a lenient definition of "reasonable tangible benefit to the consumer,"[221] which is supplemented by a generous "rule of construction";[222] (3) a safe harbor against claims of steering;[223] (4) a limitation on the recovery of legal fees for loan flipping;[224] (5) a cap on damages that can be awarded in a class action lawsuit[225] and a requirement that predatory "pattern[s] and practice[s] were willful";[226] and (6) reinforcement of the holder-in-due course defense for assignees of higher-cost mortgages,[227] including a generous presumption of due diligence and a limitation of damages.[228] These

217. *Id.*

218. *Id.*

219. *Id.* (proposing a new subsection (f)(1)(A)(ii) to be added as an amendment to section 111 of TILA).

220. *Id.* § 103(g) (proposing an amendment to section 129(h) of TILA).

221. *Id.* § 103(i) (proposing a new subsection (r)(2) to be added as an amendment to section 129 of TILA, listing nine situations that would qualify the mortgage as one having such a benefit).

222. *Id.* (proposing a new subsection (r)(5) to be added as an amendment to section 129 of TILA). The rule creates a presumption that there has not been a violation of the law, even in the absence of any of the nine situations. *See supra* note 221.

223. *Id.* § 103(r) (proposing a new subsection (x)(2)(B) to be added as an amendment to section 129 of TILA).

224. *Id.* § 103(i) (proposing a new subsection (r)(6) to be added as an amendment to section 129 of TILA, prohibiting recovery of legal fees if a "reasonable offer to remedy the violation" was made and refused).

225. *Id.* § 105(b) (proposing a new subsection (j)(1) to be added as an amendment to section 130 of TILA).

226. *Id.* (proposing a new subsection (j)(2) to be added as an amendment to section 130 of TILA).

227. *See id.* § 105(e)(2)(B) (proposing an amendment to section 131(d)(1)(A) of TILA).

228. *See id.* (proposing an amendment to section 131(d)(1)(C)–(2) of TILA).

substantive provisions impact state mortgage broker licensing statutes by insulating brokers from claims that could otherwise be used to trigger license suspension, revocation, or nonrenewal, from the imposition of administrative remedies, and from a private right of action by a consumer against a surety bond. These direct impacts belie the claim that the licensing and the "minimum" standards of Title V merely establish a floor and not a ceiling.[229]

B. Hermeneutical Bias and Proposals for Federal Regulation of Mortgage Brokers

Part II of this Article called attention to the functional limitations inherent in education, counseling, and mandatory disclosures as methodologies for combating predatory lending. These methodologies are examined here again to call attention to the conceptual limitations that flow from a hermeneutical bias and accompanying anthropology. The first limitation is that the concepts of personal autonomy and free will inherent in the liberal hermeneutics restricts the types of responses to predatory lending that are considered "proper." This, in turn, precludes mortgage lending and brokering advocates—and too many legislators—from recognizing the viability of other regulatory proposals, including changes to the legal concept of the mortgage broker-consumer relationship. Second, the conclusive status currently afforded to the liberal hermeneutics sends undesirable ethical signals to mortgage brokers and validates behaviors that harm too many consumers. As one's way of seeing the world is not neutral, the hermeneutics's influence on mortgage brokers and the resulting consumer harm are connected. Indeed, as ethicists have pointed out, "[o]ur seeing shapes our way of being,"[230] and "our epistemology is quietly transformed into our ethic."[231] So long as brokers are free to hide behind the shields of individualism, autonomy, and will theory, the ethical dimension of their behavior need not be identified or called into the public debate. This hermeneutical bias is an additional reason to oppose the current federal proposals to regulate mortgage brokers.

Many mortgage lending industry participants favor uniform federal regulation that would eliminate the "patchwork" of state laws they see as imposing inconsistent and ill-conceived substantive limitations on loan terms and procedures.[232] The mortgage industry values uniform laws because they promote efficiency by reducing compliance burdens and costs.[233] Lending industry advocates

229. *Licensing & Registration Hearing*, *supra* note 5, at 2 (statement of the Honorable Robert Ney, Chair, H. Subcomm. on Housing and Community Opportunity).

230. PALMER, *supra* note 23, at xi.

231. *Id.* at 21.

232. *Licensing & Registration Hearing*, *supra* note 5, at 7 (statement of Teresa A. Bryce, Senior Vice President and Director of Legal and Corporate Affairs, Nexstar Financial Corporation) (noting the "particularly burdensome" nature of state-level licensing of mortgage banking companies and the absence of "reciprocity provisions" among state regulators).

233. *See id.* ("[N]ew [s]tate requirements raise the cost of mortgage originations and threaten to dampen competition and innovation of mortgage markets within [s]tates.").

have long threatened that failure to achieve this efficiency will increase the cost of credit, result in credit rationing, or both.[234]

It is here that the mortgage lending industry's hermeneutical bias can be detected. The first aspect of that bias is the presence of an embedded warrant[235] that efficient distribution of credit is an ultimate value. The second aspect is acceptance of an anthropology that depends on highly questionable assumptions about human behavior. Both assumptions require critical evaluation.

Mortgage lending industry representatives and advocates often support their call for uniform laws by pointing to modern developments affecting financial services.[236] "Efficient" laws are required to accommodate nationwide lenders who utilize centralized call centers and the Internet to make loans on a nationwide basis and to accommodate the national and international sources of capital that fund those loans.[237] Lending industry advocates portray nonuniform state regulation as being as obsolete and outdated , and they invoke efficiency as the final word.[238] In other words, transactional efficiency becomes "prescriptive and normative,"[239] instead of informative.[240]

"Efficiency" should have no such talismanic power. First, it can be argued that efficiency is not a value at all. It may be a means to some end that is a value, but standing alone efficiency is indeterminate. Efficiency in credit availability must therefore be compared with other efficiencies, such as the efficient protection of consumers, neighborhoods, and cities from the damage done by predatory lenders and brokers. In 2000, Iowa Attorney General Tom Miller, in testimony before hearings convened by the Senate Committee on Banking, Housing, and Urban Affairs, perceived the derivative nature of efficiency in his statement that "[d]rying

234. *Id.*; *see also id.*, *supra* note 5, at 51 (statement of Joseph L. Falk, Chair, Government Affairs Comm., NAMB) ("[Falk discussed] the need for, and impact of, national minimum licensing . . . standards . . . to assist in combating abusive lending.").

235. *See* WAYNE C. BOOTH ET AL., THE CRAFT OF RESEARCH 120 (2d ed. 2003) (explaining that a warrant is an idea that a person assumes to be so basic, so indisputable, and so pervasively accepted that one need not bother to state that ideal expressly).

236. *Licensing & Registration Hearing*, *supra* note 5, at 45–46 (statement of Teresa A. Bryce, Senior Vice President and Director of Legal and Corporate Affairs, Nexstar Financial Corporation) (stating that some states require mortgage companies to maintain an "employee or branch physically in the state[,] . . . [which] may unduly restrict lenders who centralize applications in a call center or utilize technologies such as the [I]nternet").

237. *Id.*

238. *Id.* at 46 ("[State laws] are being promulgated with an out-dated view of mortgage origination process and do not recognize the various channels today's sophisticated residential real estate finance system has available to it in transferring national and international capital to homebuyers anywhere in the country").

239. *See* Sargent, *supra* note 18, at 35.

240. *See id.* at 54 ("Law and economics['] . . . expansive and exclusionist prescriptive claims for how society and the economy should operate largely collapse because its value-neutrality, indifference to ends, and radical individualism provides no insight into what is required for the happiness in which humans can truly flourish.").

up productive credit would be of grave concern; drying up destructive credit is sound economic and public policy."[241]

Additionally, the mortgage lending industry's assertion that nonuniform laws regulating mortgage lending must be eliminated to preserve credit availability and "low cost"[242] is not supported by experience. Empirical studies do not establish a reduction in credit availability because of state regulation.[243] As for maintaining the low cost of subprime loans, the prevalence of steering and of nonrisk-based loan pricing undercuts any claim that loans currently being offered are low cost. Furthermore, even if one were to accept merely for the sake of argument that nonuniform regulation would have some negative effect on credit availability or price, that effect must be compared with the benefit of reducing the harmful outcomes of predatory lending.

The most obvious effect of promoting the availability of "bad credit" via predatory loans is the personal loss, both economic and noneconomic, experienced by consumers. At a minimum, the economic losses include the stripping of equity that took years to accumulate.[244] All too frequently, these economic losses also include foreclosure and personal bankruptcy, both of which are at record levels.[245] However, economic loss is just the beginning of the destructive effects of predatory loans, as individuals also incur a variety of noneconomic losses. Loss of one's home has psychological effects on individuals and families. Loss of one's home also involves exclusion from the American dream of home ownership, which for many is the most direct means of accumulating wealth and entering the middle

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241. *Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 54 (2001) (statement of the Honorable Thomas J. Miller, Att'y Gen. of Iowa).

242. *See supra* note 234 and accompanying text.

243. *See* ROBERTO G. QUERCIA ET AL., CTR. FOR COMTY. CAPITALISM, THE IMPACT OF NORTH CAROLINA'S ANTI-PREDATORY LAW: A DESCRIPTIVE ASSESSMENT 1 (2003), http://www.planning.unc.edu/pdf/CC_NC_Anti_Predatory _Law_Impact.pdf (finding no change in the cost of "subprime credit"); KEITH ERNST ET AL., CTR. FOR RESPONSIBLE LENDING, NORTH CAROLINA'S SUBPRIME HOME LOAN MARKET AFTER PREDATORY LENDING REFORM iii (2002), http://www.responsiblelending.org/pdfs/HMDA_Study_on_NC_Market.pdf (finding that subprime lending is "thriv[ing]" in North Carolina).

244. ERIC STEIN, COAL. FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY LENDING 2 (2001), http://www.responsiblelending.org/pdfs/Quant10-01.pdf (estimating that "U.S. borrowers lose $9.1 billion annually to predatory lending practices").

245. U.S. Courts, Bankruptcy Statistics, http://www.uscourts.gov/bnkrpctystats/bankruptcystatistics.htm (follow "calendar year" hyperlink; then follow "2004–2005 calendar year comparison" hyperlink) (last visited Sept. 17, 2007); Press Release, RealtyTrac, National Foreclosures Increase in Every Quarter of 2005 According to RealtyTrac U.S. Foreclosure Market Report (Jan. 23, 2006), http://www.realtytrac.com/news/press/pressrelease.asp?pressreleaseID=86 (announcing a report "which showed that 846,982 properties nationwide entered some stage of foreclosure in 2005, and a 25 percent increase in the number of new foreclosures from the first quarter to the fourth quarter"). RealtyTrac recently announced that foreclosures in September 2007 were "up 99% from the number reported in September 2006." Press Release, RealtyTrac, Foreclosure Activity Decreases 8 Percent in September (Oct. 11, 2007), http://www.realtytrac.com/Content/Management/pressrelease.aspx?ChannelID=9&ItemID=3414&accnt=64847.

class.[246] The loss of one's home not only requires relocation to another dwelling but may also require one's children to change school districts. Further, older consumers face the trauma of losing the home in which they have lived for decades.

In addition to personal losses, promoting the availability of credit on predatory terms also produces social losses. An individual consumer's loss of a home becomes a neighborhood loss, as foreclosed homes decrease the surrounding homes' property values. Foreclosed homes, often remaining unoccupied for extended periods of time, also become community losses, as they become targets of vandalism and criminal activity, frustrating neighborhood revitalization efforts.[247] Furthermore, foreclosed homes decrease the community tax base.[248] The effect of decreased tax revenues is aggravated by accompanying increases in expenditures required for public safety services to neighborhoods and for social services provided to former homeowners as a result of their displacement. These "externalities" of predatory lending,[249] which are not external at all, are too often conveniently disregarded by proponents of lax regulation.

Another aspect underlying the argument in favor of minimal regulation is that the consumer's interests—indeed, society's interests—are maximized if each consumer is able to decide individually whether a proposed loan is good or bad, suitable or unsuitable. This premise assumes that the parties to any exchange act rationally in their pursuit of maximum personal utility. The rational actor model produces an anthropology often summarized in the term *homo economicus*.[250] To the extent that this anthropological assumption is invalid, especially in the subprime lending market where predatory lending is often found, so is the argument against regulation to curb abuses.

One prerequisite of the *homo economicus* anthropology is that the decisions of both parties to the transaction, the consumer and the mortgage broker, are rational because each acts on information about the exchange that is at least reasonably available to both. In other words, there is no artificial restriction on information availability. Unfortunately, that assumption is often unwarranted. Because of age,

246. *See* STEIN, *supra* note 244, at 3 n.4 ("[H]omeownership represents the best possible opportunity for families to build wealth and economic security and take their first steps into the middle class.").

247. *See* Kathleen C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355, 358–60 (2006).

248. *Id.* at 359.

249. *See id.* at 359–60 ("Although precise calculation of the externalities predatory lending imposes on cities may be impossible, there is no doubt that predatory lending has an impact extending beyond the borrowers themselves.").

250. For a description of *homo economicus,* see JOHNSTON, *supra* note 20, at 49–50 (describing *homo economicus* as a wealth or utility maximizer and criticizing the isolation and compartmentalization of life with conflicting value systems that follow). *See also* Sargent, *supra* note 18, at 39, 46–47 (stating that the term "purports . . . to be a description of the autonomous individual's practice of making rational choices that maximize her preferences" and criticizing the anthropology that results from the view of human nature that follows from *homo economicus*). Some persons might criticize the characterization of liberalism in this Article as a caricature that does not reflect the more nuanced view of neo-liberalism. Such a criticism misses the point that what matters for this discussion is the way that members of Congress understand liberalism, not academics.

education level, English language proficiency, race, or disconnection from traditional banking services,[251] victims of predatory lending frequently lack knowledge about the complexities of mortgage based financing and either do not appreciate that they need an advocate, do not know how to find one, or do not think they can afford one.

In fact, the realization that such information disparity exists explains the origin of the education, counseling, and disclosure methodologies for combating predatory lending. By providing consumers with access to information, these methodologies are thought to validate the rational actor model of *homo economicus*.[252] That conclusion is unjustified given mortgage brokers' ability to manipulate the loan application and loan closing processes. Such manipulations can prevent consumers from accessing these sources of information on a timely basis, if at all, or can negate the effect of any information a consumer may have acquired. So long as the responsibility for making disclosures is left in the hands of brokers and lenders whose interests are threatened by informed consumers, the purpose of disclosures will not be realized.

Even if information disparity was not a problem, a second flaw in this anthropology is the assumption that *homo economicus* makes rational choices in pursuit of individual preferences. This assumption is unwarranted for two reasons. First, human rationality is both bounded[253] and exploitable.[254] An availability heuristic, an optimism heuristic, and an anchoring heuristic combine to cause consumers to underestimate the risk of default and its repercussions and to limit a loan consumer's "rational pursuit" of a loan.[255] It could be argued that these heuristics prove too much as they would apply to all transactions, not just to consumers seeking mortgage loans. What makes these heuristics stand out in predatory lending is that mortgage brokers intentionally capitalize on them to

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251. *See, e.g.*, Pearl Chin, Note, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 728 (2004) (noting the use of "payday lenders" by low income groups because of their lack of access to "traditional financial institutions"); Kristin Brandser Kalsem, *Bankruptcy Reform and the Financial Well-Being of Women: How Intersectionality Matters in Money Matters*, 71 BROOK. L. REV. 1181, 1229–30 (2006) (describing how predatory lenders target disenfranchised groups).

252. *See supra* note 250 and accompanying text.

253. *See, e.g.*, Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 214–16 (1995) (explaining that human rationality is "bounded by limited information and limited information processing"); David A. Strauss, *Common Law, Common Ground, and Jefferson's Principle*, 112 YALE L.J. 1717, 1730–31 (2003) (noting that the human ability to solve complex legal problems is bounded).

254. *See, e.g.*, Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1373 (2004) (noting that credit card contracts are "shaped around consumers' systematic deviations from perfect rationality"); Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 709, 757–59 (2006) (noting that consumers make decisions in a cognitive and emotional context).

255. Forrester, *supra* note 89, at 384–85 (describing heuristics that affect decisionmaking and their relationship to predatory lending); *see also* McCoy, *supra* note 21, at 726–34 (using mathematical and statistical models to show weaknesses of the rational actor concept inherent in *homo economicus* and to establish that while utility theory may have acquired a normative nature, it is not descriptive of human behavior).

produce "sub-optimal decisions by homeowners"[256] with regard to property that likely comprises the consumer's largest asset and fulfills the consumer's basic human need for housing.

Predatory brokers and lenders promote sub-optimal decisions through "push marketing" techniques that are designed to "exploit[] anomalies in consumer behavior."[257] These techniques include loss aversion,[258] preference ordering,[259] psychological lock in,[260] and the framing effect of reference dependence.[261] Predatory lenders exploit these techniques to manipulate consumers into signing loan agreements with abusive terms.[262] Prospect theory and behavioral economics establish the limitation of the rational actor premise of the *homo economicus* anthropology.

The liberal hermeneutics has also been criticized on sociological grounds. First, liberalism's emphasis on autonomous individualism has been criticized for its atomizing effect, by which self-absorption and isolation displace interest in communal well-being and social participation.[263] This isolation in turn has been seen as threatening liberty by diminishing participation in public discourse and ceding authority to a managerial model of government.[264] Finally, this emphasis on individualism has been described as revisionist history describing a "[w]ay [w]e [n]ever [w]ere"[265] and as less than fully faithful to the economic writings from which it claims derivation.[266]

Through this emphasis on individualism, the liberal hermeneutics produces tangible and undesirable ethical ramifications. Because lenders and brokers view the world as populated by persons who fit the *homo economicus* anthropology, and thus are both able and expected to look after themselves, the ethics standards developed for differentiating between acceptable and unacceptable behavior adhere to that view. Brokers and lenders are thus "free" to bargain for whatever terms a consumer can be convinced to accept. Operating under the banners of free

256. McCoy, *supra* note 21, at 725.

257. *Id.*

258. *Id.* at 727–29.

259. *Id.* at 728–29.

260. *Id.* at 735.

261. *Id.* at 729–32.

262. *Id.* at 735, 739 (calling for the application of a "suitability standard" to predatory lending in the subprime loan market, akin to the duty of suitability that securities brokers have applied for some time).

263. ROBERT N. BELLAH ET AL., THE GOOD SOCIETY 118 (1991) ("[C]urrent generations, who are considered to be obligated only to maximize their own welfare, are cut off from a sense of responsibility to the future.").

264. ROBERT N. BELLAH ET AL, HABITS OF THE HEART: INDIVIDUALISM AND COMMITMENT IN AMERICAN LIFE 211 (1985) (stating that powerful governments and corporations "mediate[ ]" life in contemporary America and that dependence on this mediation "is not going to disappear[, and] [w]e will either humanize them or they will tyrannize over us").

265. *See* STEPHANIE COONTZ, THE WAY WE NEVER WERE: AMERICAN FAMILIES AND THE NOSTALGIA TRAP 69–70 (1992) (debunking the myth of the self-sufficient individualist).

266. *See* JOHNSTON, *supra* note 20, at 109 (summarizing the historical critical methods applied to economics and key economic theorists Adam Smith, David Ricardo, Thomas Malthus, John Stuart Mill, Karl Marx, Alfred Marshall, John Maynard Keynes, and Milton Friedman).

bargaining and personal responsibility, a broker need not think it unethical to recommend a loan with a short-lived teaser interest rate and to disregard the significantly higher, and potentially unaffordable, payments that will soon come due. Similarly, a broker need not think it impermissible to propose a loan with a balloon feature even though the broker knows the consumer does not understand that the consumer will be locked into fee-laden refinancing. Also, a broker need not have any ethical concerns about the unsuitability of a loan for the consumer's situation, or about the broker's receipt of a yield spread premium for steering the consumer to a higher loan rate than is warranted by the consumer's credit rating. So long as a broker resists sinking to the level of illegality, fraud, duress, and unconscionability, *caveat emptor* rules. The consumer is held to have understood the legal and economic consequences of the deal on par with the most sophisticated and predatory broker. Whether the consumer's decision to agree to a loan is actually the product of actual bargaining or of rational decisionmaking is irrelevant. If the consumer gets stuck with a deal that serves the interests of the creditor far more than those of the consumer, that consumer is the one to blame for not living up to the *homo economicus* standard and for not driving a better bargain.

It is not only mortgage brokers and lenders, however, whose behavior is affected by the liberal hermeneutics. Legislators are also prone to accepting that view uncritically, and as a result, they give consideration only to legislative proposals that are consistent with the view. Consumer education, counseling, and disclosures are acceptable approaches because they work within the arm's length model of the relationship between a consumer and a mortgage broker. The liberal hermeneutics thus produces a legislative myopia that renders other proposals invisible, such as a proposal for a suitability requirement or a proposal to redefine the consumer-broker relationship to include contractual or agency duties.

One final observation about the liberal hermeneutics bears mention: it validates a limited view of the role of law and of the meaning of justice. Under the liberalism model, the emphasis is on providing a matrix of laws that will support the negotiation, execution, and enforcement of bargain promises. The fairness of the transaction is a matter generally left to be determined by the parties rather than by a public body, be it a court or legislature. Procedural justice is seen as an appropriate concern; substantive or distributive justice generally is not. The unfortunate result of that view is that the law is capable of shielding consumers from predatory lenders and brokers.

For any problem or issue, one would expect several hermeneutical approaches to be identified and applied. This expectation is not borne out with regard to the proposals for federal regulation of high-cost loans in general or of mortgage brokers in particular. Even proposals that genuinely seek to protect consumers from predatory terms and practices are often bound to the liberal hermeneutics and the *homo economicus* anthropology.[267] An alternative hermeneutics and anthropology, which does not just judge the individual but also focuses on communitarian

267. *See* Sargent, *supra* note 18, at 39 (citations omitted).

concerns, is *homo salutaris*.[268] For *homo salutaris*, personal well-being is not measured solely in terms of maximized individual utility, and communal well-being is not defined simply as an aggregate of individual utilities.[269] Instead, the *homo salutaris* hermeneutics sees individuals as existing in a community and sees personal well-being as inseparable from communal well-being.[270] For *homo salutaris*, communal values are constitutive of human well-being, not derivative.[271]

Introducing a *homo salutaris* hermeneutics into the discussion of mortgage brokers regulation and of federal preemption of state regulation enlarges the debate and provides a structure for introducing additional and competing values. Issues that are perceived dimly, or not at all because of the arm's length bargaining model assumed by the liberal hermeneutics, find expression under a *homo salutaris* hermeneutics. The *homo salutaris* hermeneutics also enlarges the range of regulatory tools that can be considered. Instead of limiting tools to those that tweak the arm's length bargaining model, such as education, counseling, and disclosures, the *homo salutaris* hermeneutics critically examines the arm's length bargaining model itself. Finally, the introduction of the *homo salutaris* hermeneutics opens the door to the introduction of other hermeneutical approaches. Alternative hermeneutics would provide additional ways to frame the important questions involved in mortgage broker regulation, as well as other aspects of predatory lending. The undeniable results, it seems, would be fuller examination of the issues than exists today and better public policy decisions.

IV. CONCLUSION

This Article considered proposals for federal regulation of mortgage brokers on two levels. One level is deconstructive. On that level, this Article contends that the constituent provisions of two bills introduced in Congress to create federal-level regulation of mortgage brokers lack utility because they only partially duplicate provisions already found in state mortgage broker licensing laws. Thus, they contribute nothing new to controlling the behavior of predatory brokers. At the same time, the federal proposals fail to include many of the broker regulation mechanisms that state licensing laws do contain.

The second level on which the proposals for federal regulation were considered is integrative, as they were analyzed with regard to their implications for the preemption debate and with regard to the hermeneutical bias that currently frames and limits proposals to combat predatory lending. This Article demonstrates that the preemptive effect of federal regulation involves more than simply those provisions expressly directed at mortgage broker licensing. Other provisions contained in regulations aimed at high-cost loans in general also significantly impact a state's ability to determine who can be subjected to licensure requirements and what steps

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268. *See* JOHNSTON, *supra* note 20, at 122–23.
269. *See id.* at 123.
270. *Id.*
271. *Id.*

a state can take to oversee broker behavior once a license is granted. The outcome is a stealth preemption of state authority.

This Article also found that the bills are grounded on and perpetuate a hermeneutical bias in favor of economic liberalism. The dominant status of that bias is unmerited for several reasons: it is based on a faulty anthropology, it validates undesirable ethics, and its question-framing power restricts the field of "permissible" responses to predatory lending. These defects are highlighted by the introduction of an alternative hermeneutics, *homo salutaris*, which sees communitarian concerns as constitutive rather than simply derivative of individual utility.

The proposals for federal regulation of mortgage brokers most recently introduced in Congress should not be supported, and the proposals that are certain to be introduced in the 110th Congress and beyond should be examined closely for the failings and traps identified in this Article. Even those proposals that might purport to establish minimum regulatory standards should be examined critically to ensure that there is no interference with the gatekeeping, regulatory oversight or relationship-defining functions of state mortgage broker licensing statutes. Only then will consumers have a chance to be protected from predatory mortgage brokers.

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