XI. Anti-Predatory Lending: Title XIV of the Dodd-Frank Act

A. Introduction

The Mortgage Reform and Anti-Predatory Lending Act ("Mortgage Reform Act"), incorporated as Title XIV of the Dodd-Frank Act, implements a variety of mortgage origination regulations aimed at eliminating practices believed to have contributed to the recent collapse of the real estate market.[1] The Mortgage Reform Act reflects the commonly held belief that mortgage brokers contributed to the collapse of the real estate market by originating questionable mortgages, many of which ultimately failed.[2] The Mortgage Reform Act addresses widespread mortgage origination practices, such as steering incentives and non-traditional mortgage arrangements, which were perceived to have facilitated high-risk lending and contributed to the recent economic collapse.[3] The ramifications of the Mortgage Reform Act are dramatic and the legislation is likely to fundamentally alter the mortgage brokerage industry.[4]

This article will examine the political and economic developments which preceded the Mortgage Reform Act and identify the perceived problems that the statute was intended to remedy. This article will then outline the most significant provisions of the statute, examine concerns surrounding the Mortgage Reform Act and identify possible consequences which may result from its enactment.

B. Historical Background

Beginning in the mid-1990's, the Federal Government implemented a variety of policies intended to increase the availability of home loans.[5] Increased pressure from the federal government to promote home ownership for lower income citizens, coupled with the

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[1] Jack Milligan, *A Massive Overhaul*, MORTGAGE BANKING, Sept. 2010, at 22-23.
[2] *Id* at 23, 26.
[3] Robert M. Jaworski, *Back to the Future with the Mortgage Reform and Anti-Predatory Lending Act*, LexisNexis, 2010 Emerging Issues 5346 (Oct. 6, 2010), at 1-2.
[4] Stephen F.J. Ornstein, Matthew S. Yoon & John P. Holahan, *Mortgage Reform and Anti-Predatory Lending Act*, LexisNexis, 2010 Emerging Issues 5294 (Sept. 9, 2010), at 1.
[5] Jaworski, *supra* note 3, at 1-2.

growth of mortgage-backed securities and the corresponding market demand for mortgages, gave rise to an increase in subprime mortgage lending.[6] The success of mortgage-backed securities increased the availability of credit[7] while also generating tremendous demand for mortgages in the secondary mortgage market.[8] Some argue that this increased demand for mortgages caused investment bankers and others to pressure mortgage brokers to push unsafe mortgages on unqualified consumers.[9]

Whatever the motivation, the 1990s and 2000s saw an increase in high-risk lending practices and the rise of innovative mortgage arrangements.[10] Many mortgage brokers relaxed income verification standards (often permitting borrowers to report their income without providing any documentation), resulting in the origination of mortgages for consumers who lacked the ability to repay.[11] Additionally, mortgage originators began offering new mortgage arrangements, such as pay-option adjustable rate mortgages and interest only mortgages, which carried with them greater risks than did traditional mortgage arrangements.[12]

Critics allege that many mortgage brokers misled or failed to inform consumers of the risks posed by mortgage products in an attempt to maximize sales.[13] Brokers often received commission based on the size of the loan, meaning that brokers were rewarded for selling larger, unfavorable mortgages.[14] Because brokers faced no personal consequences if a particular mortgage ultimately failed, brokers had an incentive to promote loans with expensive, unfavorable terms to consumers, regardless of whether the consumer could realistically afford to repay the loan.[15] After the collapse of the real estate market, many observers identified irresponsible mortgage origination practices as contributing to the failure.[16]

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[6] *Id.* at 2.
[7] *See* Alvin C. Harrell, *The Great Credit Contraction: Who, What, Where, When and Why*, 26 GA. ST. U. L. REV. 1209, 1227-31 (Summer 2010).
[8] Charles W. Murdock, *Why Not Tell the Truth?: Deceptive Practices and the Economic Meltdown*, 41 LOY. U. CHI. L.J. 801, 858-59 (Summer 2010).
[9] *Id.*
[10] Jaworski, *supra* note 3, at 2.
[11] Murdock, *supra* note 8, at 843-46.
[12] Milligan, *supra* note 1, at 23.
[13] Murdock, *supra* note 8, at 846-848, 858-62.
[14] *Id.* at 845-46.
[15] *Id* at 846.
[16] Milligan, *supra* note 1, at 26.

C. Mortgage Reform Act: Title XIV of the Dodd-Frank Act

The Mortgage Reform Act was signed into law on July 21, 2010 as Title XIV of the Dodd-Frank Act.[17] The Dodd-Frank Act implements sweeping financial reforms and a new regulatory framework for financial services and institutions aimed at securing increased financial stability.[18] The Mortgage Reform Act imposes new duties upon mortgage originators and seeks to root out deceptive and predatory lending practices.[19] The following sections summarize the key provisions of the Mortgage Reform Act.

1. Definition of "Mortgage Originator"

The Mortgage Reform Act defines a "mortgage originator" as "any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain: (i) takes a residential mortgage application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or, (iii) offers or negotiates terms of a residential mortgage loan."[20] Anyone who "performs purely administrative or clerical tasks" is not included in this definition.[21]

2. Steering Incentives

The Mortgage Reform Act provides that "no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan."[22] In the past, many unfavorable

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[17] John L. Ropiequet, Christopher S. Naveja & Jason B. Hirsh, *An Introduction to the Dodd-Frank Act—The New Regulatory Structure For Consumer Finance Emerges*, BANKING & FIN. SERVICES POL'Y REP., Aug. 2010, at 1.
[18] *Id.*
[19] Joy H. Sperling, Lisa M. Gonzalo & David I. Shiefelbein, *Dodd-Frank Act Ushers in New Regulations for Mortgage Originators*, Mondaq Ltd., (Sept. 1, 2010), available at http://www.mondaq.com/unitedstates/article.asp?article_id=108992.
[20] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1401, 124 Stat 1376 (2010) (to be codified at 15 U.S.C. §1602(cc)(2)(A)(i-iii) ("Dodd-Frank Act").
[21] *Id.* §1401 (to be codified at 15 U.S.C. §1602(cc)(2)(C)).
[22] *Id.* §1403 (to be codified at 15 U.S.C. §1639(B)(c)(1)).

terms common in subprime mortgages increased the total value of the mortgage, thereby increasing demand in the secondary market.[23] Mortgage originators were often paid higher commissions for mortgages based on the total value of the loan, creating an incentive to increase the value of mortgages by including expensive, unfavorable terms.[24] Some commentators argue that these incentives often caused mortgage originators to push mortgages with unfavorable terms on consumers in an attempt to maximize the originator's commission.[25] The anti-steering provisions are aimed at eliminating such incentives. Notably, mortgage originators may still receive increased commissions based on the principal amount of the mortgage[26], as well as commissions "based on the number of residential mortgage loans originated within a specified period of time."[27]

3. Anti-Steering Directives

Additionally, the Mortgage Reform Act prohibits "mortgage originators from steering any consumer" toward certain types of mortgages.[28] Under these provisions, a mortgage originator may not encourage a consumer to agree to a mortgage which "the consumer lacks a reasonable ability to repay"[29] or that "has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms)."[30] Moreover, mortgage originators may not employ "abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age."[31]

The anti-steering provisions impose a duty on mortgage originators to not "mischaracteriz[e] the credit history of a consumer or the residential mortgage loans available to a consumer" or "mischaracteriz[e]. . . the appraised value of the property securing

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[23] Murdock, *supra* note 8, at 859.
[24] *Id.* at 858.
[25] *Id.* at 845-46, 858.
[26] Dodd-Frank Act, § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(1)).
[27] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(4)(D)).
[28] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(3)(A-C)).
[29] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(3)(A)(i)).
[30] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(3)(A)(ii)).
[31] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(3)(C)).

the extension of credit."[32] The Federal Reserve Board has been charged with the task of developing regulations to determine what particular practices are covered under these prohibitions.[33] Additionally, the statute grants the Federal Reserve Board the general power to regulate or restrict any "terms, acts or practices relating to residential mortgage loans that the Board finds to be abusive, unfair, deceptive, [or] predatory" insofar as such regulations are "necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers."[34]

Additionally, the Mortgage Reform Act allows borrowers to hold mortgage originators liable for violations of the statute's anti-steering directives.[35] Prior to the Mortgage Reform Act, consumers could hold only "creditors" (as defined by the Truth In Lending Act), not mortgage originators, liable for statutory violations.[36] Under the Mortgage Reform Act, mortgage originators may be ordered to pay "the greater of actual damages or an amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation. . . ."[37]

The anti-steering provisions of the Mortgage Reform Act have been criticized as being extraordinarily vague.[38] Because the steering provisions are excessively broad and fail to offer specific guidance regarding compliance, mortgage brokers are left guessing what is or is not permitted under the new law.[39] The combination of the prospect of personal liability for violating the anti-steering provisions, coupled with the uncertain terms used in defining a mortgage originator's duties with regard to those provisions, leaves a mortgage originator in the undesirable position of facing severe

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[32] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(3)(D)(i-ii)).
[33] *Id*. § 1403 (to be codified at 15 U.S.C. §1639(B)(c)(3)).
[34] *Id.* § 1405(a) (to be codified at 15 U.S.C. § 1639(B)(e)(1)).
[35] *Id.* § 1404 (to be codified at 15 U.S.C. § 1639(B)(d)(1)).
[36] Jaworski, *supra* note 3, at 8.
[37] Dodd-Frank Act, § 1404 (to be codified at 15 U.S.C. § 1639(B)(d)(2)).
[38] *See* Stuart Saft, *Anti-Predator Act? It's More Anti-Lender*, American Banker, Sept. 1, 2010.
[39] *See id.* ("Unfortunately, there is no definition of unfair, deceptive or abusive, and what is 'understandable' will be left for a judge to determine. How lenders will be able to satisfy the regulators, judges and juries that they satisfied these subjective standards is a mystery"); Milligan, *supra* note 1, at 26.

consequences if the originator's good faith conduct is later determined to be a violation of the statute.[40]

4. Verification of a Consumer's Ability to Repay

The Mortgage Reform Act requires that all mortgage originators "mak[e] a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan."[41] In order to determine whether a potential borrower is capable of repayment, a mortgage originator should consider the prospective borrower's "credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status and other financial resources other than the consumer's equity in the dwelling or real property. . . ."[42] Furthermore, rather than rely on a prospective borrower's statements regarding the borrower's income, the statute requires that a mortgage originator examine the borrower's "Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets."[43]

5. Safe Harbor Provision and Qualified Mortgages

The statute also permits "[a]ny creditor…and any assignee of [a residential mortgage] loan" to "presume that the loan has met the [ability to repay] requirements of subsection (a), *if the loan is a qualified mortgage.*"[44] In order to be classified as a "qualified" mortgage, a mortgage must meet a slew of requirements.[45] The requirements include that the "the regular periodic payments for the loan may not . . . result in an increase of the principal balance . . . or.

[40] *See* Saft, *supra* note 38; Milligan, *supra* note 1, at 26.
[41] Dodd-Frank Act, § 1411 (to be codified at 15 U.S.C. § 1639(C)(a)(1)).
[42] *Id*. § 1411 (to be codified at 15 U.S.C, § 1639(C)(a)(3)).
[43] *Id*. § 1411 (to be codified at 15 U.S.C. § 1639(C)(a)(4)).
[44] *Id*. § 1412 (to be codified at 15 U.S.C. § 1639(C)(b)(1) (emphasis added).
[45] *Id*. § 1412 (to be codified at 15 U.S.C. § 1639(C)(b)(2)(A)(i-ix)).

. . . allow the consumer to defer repayment of principal,"[46] the mortgage may not include "a scheduled payment that is more than twice as large as the average of earlier scheduled payments,"[47] the mortgage may "not exceed thirty years,"[48] and "the total points and fees payable in connection with the loan [may] not exceed 3 percent of the total loan amount."[49]

When issuing a non-qualified mortgage, the mortgage originator faces a substantial risk of liability based on the originator's duty under the statute to ensure that the borrower is capable of repayment.[50] The presumption that these qualified mortgages have met these requirements, however, significantly reduces the mortgage originator's risk of liability.[51] Along with the presumption that a "qualified mortgage" complies with the ability to repay directives outlined in the Mortgage Reform Act, the statute also exempts "qualified" mortgages from other regulations (such as the prohibition on prepayment fees)[52] that are applicable to mortgages not classified as "qualified."[53] The Mortgage Reform Act's reduced regulation of "qualified mortgages" provides mortgage originators with a strong incentive to originate qualified, rather than non-qualified, mortgages.[54]

Many observers see the definition of "qualified mortgage" as an attempt by Congress to promote traditional mortgage arrangements.[55] Critics argue that the Mortgage Reform Act's distinction between qualified mortgages (which generally resemble traditional mortgages issued only to highly qualified borrowers) and all other mortgages will impede creativity in the mortgage broker industry and will stifle attempts to meet the needs of borrowers through innovative mortgage arrangements.[56] Some commentators argue that, as a result of increased regulation and more stringent mortgage

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[46] *Id*., § 1412 (to be codified at 15 U.S.C. § 1639(C)(b)(2)(A)(i)(I-II)).
[47] *Id*., § 1412 (to be codified at 15 U.S.C. § 1639(C)(b)(2)(A)(ii)).
[48] *Id*., § 1412 (to be codified at 15 U.S.C. § 1639(C)(b)(2)(A)(viii)).
[49] *Id*., § 1412 (to be codified at 15 U.S.C. § 1639(C)(b)(2)(A)(vii)).
[50] Jaworski, *supra* note 3, at 3.
[51] *Id*. at 3.
[52] Dodd-Frank Act, § 1414 (to be codified at 15 U.S.C. § 1639(C)(c)(1)(A)).
[53] *See* Jaworski, *supra* note 3, at 3-4.
[54] *Id.* at 3-4.
[55] *Id.* at 1-2.
[56] Milligan, *supra* note 1, at 23-24.

origination requirements, the statute will create more difficulty for consumers seeking to secure mortgage loans.[57]

These critics' primary concern is that the increased restrictions on the types of loans that may be made available to consumers, coupled with the added duties placed upon mortgage originators, may make obtaining a mortgage more difficult for marginally qualified borrowers or those who do not qualify for a "qualified mortgage."[58] One possible consequence of further restricting credit available for prospective home buyers is that property values may continue to decrease.[59] Additionally, some critics have noted the irony in the statute's conservative approach to lending,[60] given that the federal government has long been an ardent proponent of expanding the pool of homeowners and increasing the availability of credit for lower income prospective home buyers.[61] Ultimately, the increased regulation of mortgage origination carries the risk of worsening the credit crunch.[62]

D. Conclusion

The Mortgage Reform Act marks a dramatic shift in the law regarding mortgage origination and mortgage brokerage.[63] In an attempt to address perceived problems among mortgage originators, Congress enacted a law which fundamentally altered the standard practices within the mortgage broker industry which had developed in the mortgage industry over the past decade.[64] The Mortgage Reform Act seeks to protect customers from dishonest, unfair lending practices and to promote economic stability. Critics charge that the statute is misguided, and will serve only to further restrict access to credit and hurt future borrowers.[65] Whatever the

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[57] *Id.* at 24, 27*; See also* Ornstein, *supra* note 4, at 1.
[58] Milligan, *supra* note 1, at 24, 27; Jaworski, *supra* note 3, at 9.
[59] Jaworski, *supra* note 3, at 9.
[60] Milligan, *supra* note 1, at 27 (quoting a Jack Piatt, a partner at K&L Gates, as stating that, with regard to increasing the availability of credit for low income borrowers, "Congress is schizophrenic on this issue.")
[61] Jaworski, *supra* note 3, at 1.
[62] *Id.* at 9.
[63] Milligan, *supra* note 1, at 23.
[64] Jaworski, *supra* note 3, at 2.
[65] *See* Saft, *supra* note 38; Milligan, *supra* note 1, at 24.

consequences, the statute is certain to have a long-lasting and profound impact on home ownership and lending practices.

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