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Why Reinvent the Wheel?—Protecting Consumers in the Wake of the Subprime Mortgage Meltdown Without the Consumer Financial Protection Bureau

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WHY REINVENT THE WHEEL?—PROTECTING CONSUMERS IN THE WAKE OF THE SUBPRIME MORTGAGE MELTDOWN WITHOUT THE CONSUMER FINANCIAL PROTECTION BUREAU

INTRODUCTION

The United States has arguably entered into the recovery period of what has become known as the Great Recession.[1] This Great Recession, the worst economic crisis faced in the United States since the Great Depression, witnessed the near collapse of the financial sector of the United States, a rapid decline in home values, and large increases in mortgage delinquencies and foreclosures.[2] While the exact causes of the crisis remain a topic of much debate, a rapid increase in the number of subprime mortgages offered by various financial institutions, coupled with the crash of the United States. housing market in late 2006 to early 2007 caused much of the chaos surrounding the Great Recession.[3]

Subprime mortgages are mortgages offered to less creditworthy borrowers at higher interest rates than traditional loans.[4] The number of subprime mortgages increased because of an influx of foreign cash into the United States, mostly from Asia and the Middle East, and extremely low rates of interest promulgated by the Federal Reserve Bank of the United States (Federal Reserve).[5] These factors drove down interest rates and caused banks to aggressively compete to attract borrowers.[6] As a result, credit was "cheap and

1. Mark Lieberman, *Leading Economists Declare End to Recession*, FOXBUSINESS.COM (Oct. 12, 2009), http://www.foxbusiness.com/story/markets/economy/leading-economists-declare-end-recession/; Catherine Rampell, *'Great Recession': A Brief Etymology*, N.Y. TIMES BLOG (Mar. 11, 2009 5:39 P.M.), http://economix.blogs.nytimes.com/2009/03/11/great-recession-a-brief-etymology/.

2. KATALINA M.BIANCO, CCH, THE SUBPRIME LENDING CRISIS: CAUSES AND EFFECT OF THE MORTGAGE MELTDOWN 2 (2008); Press Release, IHS Cambridge Energy Research Assocs., Inc., Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps are Not Taken (Feb. 13, 2009), http://www.cera.com/aspx/cda/public1/news/pressReleases/pressReleaseDetails.aspx?CID=10119.

3. Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Speech at Morehouse College: Four Questions About the Financial Crisis (Apr. 14, 2009) (transcript available at http://www.federalreserve.gov/newsevents/speech/bernanke20090414a.htm).

4. Dana Dratch, *Want a 'Subprime' Loan?: What to Watch Out for When Borrowing Money*, SEATTLE POST-INTELLIGENCER, Nov. 12, 2005, at C2.

5. BIANCO, *supra* note 2, at 4; Bernanke, *supra* note 3.

6. Bernanke, *supra* note 3.

easy [for households] to obtain," driving a housing boom throughout much of the country.[7] Unfortunately, much of this cheap credit was extended in a reckless manner.[8] Lending institutions acted carelessly because they believed home prices would continue to rise indefinitely and credit would remain cheap and easily accessible, allowing borrowers to refinance their homes if necessary.[9] These beliefs turned out to be false, but many lenders did not discover this fact until it was too late, and a crisis was triggered in the United States.[10]

The fallacy in this reasoning became apparent in early 2007 when housing prices began falling, and subprime borrowers could not keep up the payments on their mortgages.[11] Mortgage delinquencies skyrocketed, which only intensified the downturn in home prices.[12] Lenders, handicapped with severe losses and facing the possibility of insolvency, greatly reduced lending, which effectively froze the credit markets.[13]

In order to loosen the credit markets and prevent the collapse of these financial institutions, the federal government passed the Emergency Economic Stabilization Act of 2008.[14] This act provided funds to the Secretary of the Treasury "to immediately provide authority and facilities . . . to restore liquidity and stability to the financial system of the United States."[15] Additionally, the federal government attempted to reenergize the economy and encourage job creation through the American Recovery and Reinvestment Act of 2009.[16] As a result of these actions, many believe the recession has ended and the long, slow road toward recovery has begun.[17] This development allowed the federal government to shift the focus of its efforts. Instead of working to stimulate the economy and prop up the financial sector, Congress

7. *Id.*

8. *Id*.

9. *Id.*

10. *Id.*

11. Bernanke, *supra* note 3.

12. *Id*.

13. *Id.*

14. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008) (codified at 12 U.S.C. §§ 5201–5261).

15. *Id.* § 2(1), 122 Stat. at 3766.

16. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) (codified as amended in scattered sections of 26 U.S.C.). This economic stimulus bill was in addition to the Economic Stimulus Act passed one year earlier, which provided economic stimulus checks to individuals. Economic Stimulus Act of 2008, Pub. L. No. 110-185, § 101, 122 Stat. 613 (2008) (codified as amended in scattered sections of 26 U.S.C.).

17. *See* Lieberman, *supra* note 1. The propriety and effectiveness of these economic stimulus acts have been much debated; however, those issues are beyond the scope of this Comment.

and the Obama Administration began to look at what caused this crisis and consider proposals to prevent similar collapses in the future.[18]

President Barack Obama signed one such proposal, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), into law on July 21, 2010.[19] The goal of the Dodd-Frank Act is "To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices . . . ."[20]

To achieve this goal, the Dodd-Frank Act prohibits deceptive, unfair, and abusive practices in transactions involving consumer financial products or services.[21] Additionally, the Dodd-Frank Act creates the Bureau of Consumer Financial Protection (BCFP) as "an independent bureau to . . . regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."[22] Under the Dodd-Frank Act, the current financial regulatory system will be significantly overhauled.[23] The regulatory authority of the government agencies that currently regulate consumer lending will transfer to the BCFP.[24] The BCFP is given the power to "implement[] the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions."[25] Additionally, the BCFP will have power to commence civil actions for violations of the Dodd-Frank Act and eighteen other federal statutes.[26]

The purpose of this comment is to explore the necessity of the new federal bureau to protect consumers from lenders. Specifically looking at the Truth-in-Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA) amendments to TILA, and the Real Estate Settlement Procedures Act (RESPA), this comment examines whether the BCFP is necessary, or if subprime borrowers, armed with modified versions of our current federal laws and perhaps a new consumer protection law, could adequately protect

18. *See* Press Release, Dep't of the Treas., TG-189, ¶ 96-168, Administration's Regulatory Reform Agenda Moves Forward: Legislation for Strengthening Consumer Protection Delivered to Capital Hill (June 30, 2009), http://prod.resource.cch.com/resource/scion/document/default/%28%40%40BANK-ISSUE+NOTICE96-168%2909013e2c85801693?cfu=Legal.

19. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.) [hereinafter Dodd-Frank Act]; Kevin G. Hall, *Obama Signs Historic Financial Overhaul Bill*, ST. LOUIS POST-DISPATCH, July 22, 2010, at A9.

20. Dodd-Frank Act pmbl, 124 Stat. at 1376.

21. *Id.* § 1031(a), 124 Stat. at 2005.

22. *Id.* § 1011(a), 124 Stat. at 1964.

23. *See id.* §§ 1061–1067, 124 Stat. at 2035–56.

24. *See id.* § 1061(b), 124 Stat. at 2036.

25. Dodd-Frank Act § 1012(a)(10), 124 Stat. at 1965.

26. *Id.* §§ 1002(12), (14), 1054(a), 124 Stat. at 1957, 2028.

themselves through private litigation. Part I of this comment will provide a brief background of subprime lending and the United States housing bubble, as well as how these developments led to the near collapse of the United States financial system. Part II will examine the BCFP as it will exist under the Dodd-Frank Act, specifically focusing on the litigation authority delegated to the BCFP. Part III explores the consequences the BCFP will likely have on the availability and cost of consumer credit. Part IV will explain the provisions of TILA, including the HOEPA amendments and RESPA, exploring their requirements and the remedies they provide for subprime borrowers who are misled by their lenders. Finally, Part V contains an evaluation of the BCFP and offers constructive alternatives for achieving consumer protection and financial stability without this new governmental bureau.

I. HISTORICAL BACKGROUND ON THE DEVELOPMENT OF SUBPRIME LENDING AND THE HOUSING BUBBLE

This section provides a brief overview of the historical background that led to the financial crisis, including the rise of subprime mortgages and the bursting of the United States housing bubble. A housing bubble is an economic bubble that occurs in real estate markets.[27] A real estate bubble is characterized by rapidly-rising real estate values to unsustainable levels.[28] Subsequently, prices fall, leaving mortgage debt in excess of property values.[29]

In the past two decades, the United States has been the recipient of a great deal of foreign savings, which flooded into our financial institutions and provided large amounts of capital used for making loans.[30] Former Federal Reserve Chairman Alan Greenspan argues this foreign investment was the driving factor behind decreasing interest rates and increasing housing prices.[31] However, in the wake of the dot-com bust and economic recession in 2001, the Federal Reserve cut the federal funds rates from 6.5% to 1%.[32] Richard W. Fisher, President and Chief Executive Officer of the Federal Reserve Bank of Dallas, admit the Federal Reserve's interest policy during the early 2000s was "misguided."[33] Mr. Fisher acknowledges the Federal Reserve's policy increased liquidity and speculation in the housing market, thus contributing to the housing bubble.[34]

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27. BIANCO, *supra* note 2, at 3.
28. *Id.*
29. *Id.*
30. Bernanke, *supra* note 3.
31. BIANCO, *supra* note 2, at 4.
32. *Id.*
33. *Id.*
34. *Id.* at 5.

Flush with cash and facing stiff competition, financial institutions began to aggressively lend to customers.[35] This competition, combined with low interest rates, made consumer credit cheap and easily obtained.[36] Consequently, mortgage lending greatly increased, further fueling the housing boom.[37] In the decade between 1994 and 2004, home ownership increased from 64% to a record-level 69.2%.[38] This increased demand drove an incredible 124% increase in home values between 1997 and 2006.[39] Kenneth Rogoff, professor of economics and public policy at Harvard University, explained that "At the heart of what happened [during the housing boom] is that we lost perspective on what was real and what was really [illusion] fueled by . . . low interest rates, [and an] influx of money" into the United States from emerging markets.[40]

Unfortunately, according to Federal Reserve Chairman Ben Bernanke, "[M]uch of this lending was poorly done, involving . . . little or no down payment by the borrower or insufficient consideration by the lender of the borrower's ability to make the monthly payments."[41] This poor lending came in the form of subprime mortgages.[42] As previously mentioned, subprime mortgages are loans made to borrowers with poor credit or other flaws, which prevent the borrowers from obtaining traditional loans.[43] The amount of subprime mortgages grew from $35 billion in 1995 to $807 billion in 2005.[44] In 1996, subprime mortgages made up 9% of the loans originated in the United States; however, by 2006, subprime mortgages accounted for 20% of the home loans made in the United States.[45]

As the prevalence of subprime mortgages grew, the standards to qualify for even a subprime mortgage fell, allowing more people into the market.[46] Lenders became careless because they made two assumptions: 1) They thought home prices would keep rising, allowing borrowers to build equity; and 2)

35. Bernanke, *supra* note 3.
36. *Id.*
37. *Id.*
38. BIANCO, *supra* note 2, at 6.
39. *Id.*
40. Press Release, IHS Cambridge Energy Research Assocs., Inc., *supra* note 2.
41. Bernanke, *supra* note 3.
42. *See* BIANCO, *supra* note 2, at 6.
43. Bernanke, *supra* note 3; Dale Ledbetter, *Understanding the Sub-prime Debacle*, *in* PRACTISING LAW INST., CORPORATE LAW & PRACTICE COURSE HANDBOOK, SER. NO. 1633 35, 39 (2007).
44. David Schmudde, *Responding to the Subprime Mess: The New Regulatory Landscape* 15 (Fordham Univ. Sch. of Law, Working Paper Series, 2009), *available at* http://ssrn.com/abstract=1333798. This computes to an increase in subprime lending of greater than 3500%.
45. BIANCO, *supra* note 2, at 6.
46. Schmudde, *supra* note 44, at 25.

They believed credit would remain readily accessible, enabling borrowers to refinance if the mortgage became too burdensome.[47]

Subprime mortgages carry significantly higher interest rates and fees than traditional mortgages, with interest rates sometimes reaching 10% to 11%, with fees exceeding $10,000.[48] Additionally, before the crisis, many subprime loans were extended for 100% of the value of the property; 80% of subprime loans carry adjustable rates.[49] Most subprime mortgages were extended without so much as confirming the borrower's income, and many borrowers who obtained subprime mortgages had credit scores of less than 580.[50] Furthermore, many subprime borrowers were qualified for loans using low introductory rates, which soon escalated, resulting in monthly payments the borrowers were unable to afford.[51]

While foreign cash and the decreasing interest rates drove a housing boom, these factors also caused returns on "safe" investments such as United States Treasury Bonds to fall.[52] This forced investors, searching for increased returns, toward more risky investments.[53] In an effort to assist investors, the financial industry created securities known as asset-backed or mortgage-backed securities, which combined many individual loans in complex ways.[54]

Asset-backed securities are securities:

> [P]rimarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders.[55]

Mortgage-backed securities are asset-backed securities representing "claims to the cash flows from pools of mortgage loans, most commonly on residential property."[56] Mortgage-backed securities are created by purchasing mortgage

47. Bernanke, *supra* note 3.

48. Schmudde, *supra* note 44, at 15–16. However, from 2001 to 2007 the average difference in interest rates between traditional mortgages and subprime mortgages fell from two and eight-tenths percentage points to one and three-tenths percentage points. This decrease reflects a decline in the "risk premium" lenders required for taking on subprime borrowers. BIANCO, *supra* note 2, at 6–7.

49. *Preserving the American Dream: Predatory Lending Practices and Home Foreclosures: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 110th Cong. 3 (2007) (statement of Sen. Chris Dodd, Chairman, S. Comm. on Banking, Housing, & Urban Affairs); Schmudde, *supra* note 44, at 15.

50. Schmudde, *supra* note 44, at 15.

51. *Id.* at 18–19.

52. Bernanke, *supra* note 3.

53. *Id.*

54. *See id.* (describing new securities made by bundling individual loans).

55. 17 C.F.R. § 229.1101 (2009).

56. *Mortgage-Backed Securities*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/answers/mortgagesecurities.htm (last visited Jan. 27, 2011).

loans from banks and mortgage companies, pooling those loans, and issuing securities.[57] This process, known as securitization, may be completed by governmental and quasi-governmental entities, as well as by private businesses.[58] The Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) issue most mortgage-backed securities.[59]

Traditionally, Fannie Mae and Freddie Mac provided liquidity to the standard mortgage market.[60] These government-sponsored entities would purchase the loans from the originating lenders and issue securities using the mortgages as collateral.[61] After selling the initial loan to Fannie Mae or Freddie Mac, the banks had cash that could be used to make a second loan.[62] Investors purchased the securities, relying on guarantees of timely payments provided by Fannie Mae and Freddie Mac.[63] This system worked quite well because the loans purchased were prime mortgages which met "well-defined lending standards."[64] Because loan default rates were low, investors came to see mortgage-backed securities as safe investments.[65]

In a quest for increased return on investment, however, "creative investment bankers began to develop more complex, sophisticated securities backed by mortgages."[66] Financial firms began to include adjustable-rate subprime mortgages in pools with prime mortgages, without properly disclosing the source of the subprime loans or that very little due diligence was completed to determine their quality.[67] Mortgage originators believed "Wall Street" would accept any product, and they obliged by making and selling more subprime mortgages.[68] Therefore, despite the belief that these mortgage-backed securities were safe, they proved to contain significant risks that neither the financial institutions that created them nor the investors who purchased them foresaw.[69]

57. *Id.*

58. *Id.*

59. *Id.*

60. Ledbetter, *supra* note 43, at 39.

61. *Id.*

62. *Id.*

63. *Id.*; *Mortgage Backed Securities*, *supra* note 56.

64. Schmudde, *supra* note 44, at 32.

65. *Id.*

66. *Id.* at 33. For a brief overview of the development of complex mortgage-backed securities, see *id.* at 33 n.92.

67. Ledbetter, *supra* note 43, at 43.

68. *Id.* at 41–43.

69. Bernanke, *supra* note 3.

In early 2007, it became apparent that the two assumptions upon which bankers handed out loans with reckless abandon were not well founded.[70] The credit boom began to fall apart when housing prices started dropping and subprime borrowers were unable to stay current on their mortgage payments.[71] As a result of this phenomenon, mortgage delinquencies and defaults rose, exacerbating the fall in home values.[72] Investors were spooked and began pulling back from the credit markets while lenders, facing incredible mortgage losses, dramatically cut back their lending.[73] This, in turn, led to the demise of several major financial firms and froze the credit markets.[74]

II. THE BUREAU OF CONSUMER FINANCIAL PROTECTION: STRUCTURE AND FUNCTION

In the wake of this crisis United States House Representative for Massachusetts, Barney Frank, introduced House Resolution 4173 on December 2, 2009.[75] The resolution passed the House on December 11, 2009.[76] On April 15, 2010, United States Senator for Connecticut, Christopher Dodd, introduced his own financial reform bill, Senate Resolution 3217, known as the Restoring American Financial Stability Act of 2010.[77] Rather than passing Senate Resolution 3217, the Senate instead passed an amended version of H.R. 4173 on May 20, 2010.[78] Subsequently, a joint conference committee of congressional negotiators reconciled the differences between the version of the bill passed by the House in December of 2009 and the amended Senate version.[79] The conference report was filed with the House on June 29, 2010 and agreed to on June 30, 2010.[80] The Senate agreed to the conference report on July 15, 2010.[81] President Obama signed the Dodd-Frank Act into law as Public Law Number 111-203 on July 21, 2010.[82]

70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.*
74. Bernanke, *supra* note 3, at 2–3.
75. Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009) (as introduced in House, Dec. 2, 2009).
76. 155 CONG. REC. H14,747–H14,804 (daily ed. Dec. 11, 2009).
77. Restoring American Financial Stability Act of 2010, S. Res. 3217, 111th Cong. § 1(a) (2010) (as introduced in Senate, Apr. 15, 2010).
78. Restoring American Financial Stability Act of 2010, S. Res. 3217, 111th Cong. § 1(a) (2010) (as passed by Senate, May 20, 2010). *See also* 156 CONG. REC. S4027–S4078 (daily ed. May 20, 2010).
79. H.R. REP. NO. 111-524 (2010).
80. *Id.*; 156 CONG. REC. H5212–H5222 (daily ed. June 30, 2010).
81. 156 CONG. REC. S5870–S5933 (daily ed. July 15, 2010).
82. Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

The purpose of the Dodd-Frank Act is to promote financial stability, reform the mortgage markets, protect consumers and investors, and prevent a future financial meltdown.[83] The law, which is over 2,000 pages in length,[84] is considered "the most sweeping overhaul of the financial system since the New Deal."[85] The bill expands the grasp of federal banking and securities regulation, subjecting a significantly larger cross-section of financial companies as well as derivatives markets to regulation by the federal government.[86] The bill seeks to end the idea of "too big to fail," by creating a council of regulators with power to identify risks in the financial sector and constrain or even dismantle troubled businesses without the use of taxpayer funds.[87] The "Volcker Rule," another addition to the bill, "restricts the ability of banks whose deposits are federally insured from trading for their own benefit."[88] In addition, the Dodd-Frank Act creates the Bureau of Consumer Financial Protection to oversee financial products and services.[89]

The BCFP began with a proposal from the Obama Administration to create a Consumer Financial Protection Agency (CFPA) as a centerpiece of its financial industry overhaul.[90] In the House of Representatives, Representative Frank first introduced the CFPA as House Resolution 3126 on July 8, 2009.[91] Subsequently, House Resolution 3126 was folded in as Title IV of the Wall Street Reform and Consumer Protection Act of 2009.[92] Senator Dodd's original financial reform bill also contained the CFPA, but the final version of Senator Dodd's bill, which ultimately became the Dodd-Frank Wall Street

83. *Id.*

84. *Id.*

85. Annalyn Censky, *Obama on New Law: "No More Taxpayer Bailouts"*, CNNMONEY.COM (July 21, 2010, 12:46 PM), http://money.cnn.com/2010/07/21/news/economy/obama_signs_wall_street_reform_bill/index.htm.

86. *Financial Regulatory Reform*, NYTIMES.COM (July 21, 2010), http://topics.nytimes.com/topics/reference/timestopics/subjects/c/credit_crisis/financial_regulatory_reform/index.html.

87. Dodd-Frank Act § 111, 124 Stat. at 1392. *See also Financial Regulatory Reform*, *supra*, note 86.

88. Dodd-Frank Act § 601, 124 Stat. at 1596. The "Volcker Rule" is named for former Federal Reserve Chairman Paul A. Volcker, who introduced the rule in early 2010. *Financial Regulatory Reform*, *supra* note 86.

89. Dodd-Frank Act § 1011(a), 124 Stat. at 1964.

90. Annemarie Schumacher, *Bankers Wonder About Congress' Regulation Plans*, ST. LOUIS BUS. J., Nov. 20, 2009, at 24.

91. 155 CONG. REC. H7836–H7837 (daily ed. July 8, 2009). *See also H.R. 3126: Consumer Financial Protection Agency Act of 2009*, NYTIMES.COM, http://politics.nytimes.com/congress/bills/111/hr3126 (last visited Feb. 6, 2010).

92. Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. §§ 4001–4901 (2009) (as introduced in House Dec. 2, 2009).

Reform and Consumer Protection Act of 2010, replaced the CFPA with the BCFP, an independent bureau housed within the Federal Reserve.[93]

President Obama, when introducing his version of the CFPA, stated the purpose of the agency, proclaiming

> This agency will have the power to set standards so that companies compete by offering innovative products that consumers actually want—and actually understand. Consumers will be provided information that is simple, transparent, and accurate. You'll be able to compare products and see what's best for you. The most unfair practices will be banned. Those ridiculous contracts with pages of fine print that no one can figure out—those things will be a thing of the past. And enforcement will be the rule, not the exception.[94]

Treasury Secretary Timothy Geithner also spoke out in favor of the CFPA, stating

> This agency will have only one mission—to protect consumers—and have the authority and accountability to make sure that consumer-protection regulations are written fairly and enforced vigorously. Consumer protection will have an independent seat at the table in our financial regulatory system. By consolidating accountability in one place, we will reduce gaps in federal supervision and enforcement, drive greater clarity in the information consumers receive around products they are sold, set higher standards for those who sell those products and promote consistent regulation across the system.[95]

In the Obama Administration's version of the CFPA, the CFPA would have had the power to prohibit certain consumer financial products or services or certain features of those products, impose additional disclosure requirements on consumer financial products or services providers, and require providers to offer "plain vanilla" products the CFPA designed.[96] Additionally, the Obama Administration's bill would have required lenders to make "reasonable

93. *Compare* Binyamin Appelbaum & Brady Dennis, *Dodd Bill Would Redo Entire Regulatory System*, WASH. POST, Nov. 11, 2009, at A18, *with* Dodd-Frank Act, Pub. L. No. 111-203 § 1011(a), 124 Stat. at 1964.

94. Press Release, Dep't of the Treas., *supra* note 18.

95. *Id.*

96. David S. Evans & Joshua D. Wright, *The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit* 4 (Geo. Mason U. Law & Econ., Research Paper Ser. No. 09-50, Jan. 7, 2010), *available at* http://ssrn.com/abstract=1483906. Thomas W. Hough believes this position stems from a misunderstanding of the White House Proposal. Interview with Thomas W. Hough, Chief Exec. Officer, Carrollton Bank, in St. Louis, Mo. (Jan. 25, 2010) (on file with author). He does not believe banks would have been required to offer the "plain vanilla" products. *Id.* Mr. Hough is also Chairman of the Illinois Bankers' Association. *IBA Board of Directors*, ILL. BANKERS ASS'N., http://www.ilbanker.com/leadership_board_directors.asp (last visited Jan. 30, 2011). Carrollton Bank is a community bank established in 1877 in Carrollton, Illinois that currently has $790 million in assets. CARROLLTON BANK, THE CARROLLTON BANK STORY 3–6 (2010), *available at* http://www.carrolltonbanking.com/pdfs/cbStory.pdf.

disclosures" and would have expressly allowed state and local governments to impose additional restrictions on consumer financial products, beyond those imposed by the federal government.[97] This would have essentially made federal regulation the regulatory floor and "end[ed] federal preemption of state consumer protection for nationally chartered financial institutions."[98]

The Treasury Department and the House Democrats, including Representative Frank recognized some of these provisions were unlikely to be approved by Congress.[99] As a result, House Resolution 4173 modified several of President Obama's original provisions.[100] These modifications, many of which were carried through to the Dodd-Frank Act, resulted in President Obama getting approximately 90% of the reforms he proposed.[101] Despite backing off some of President Obama's more controversial proposals, the Dodd-Frank Act is expected to have a significant impact on lending in this country.[102]

One difference between the Obama Administration's proposal and the final financial reform bill regarded the CFPA. Rather than creating the CFPA as an independent agency, the Dodd-Frank Act creates the BCFP as an independent bureau housed within the Federal Reserve.[103] The purpose of the BCFP is to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."[104] A Director, appointed by the President with the advice and consent of the Senate, will head the BCFP.[105] The Director will serve for five years and may only be removed prior to the end of his term for "inefficiency, neglect of duty, or malfeasance in office."[106] During his term, the Director is barred from holding any position within "any Federal reserve bank, Federal home loan bank, covered person, or service provider."[107] The BCFP will have the responsibility to carry out the consumer financial protection functions currently held by: 1) the Board of Governors [of the Federal Reserve]; 2) the Comptroller of Currency; 3) the Director of the Office of Thrift Supervision; 4) the Federal Deposit Insurance Corporation; 5)

97. Evans & Wright, *supra* note 96, at 35.

98. *Id*. at 3.

99. David S. Evans & Joshua D. Wright, *A Response to Professor Levitin on the Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit* 4 (Geo. Mason Univ. Law & Econ., Research Paper Ser. 09-56, Nov. 4, 2009), *available at* http://ssrn.com/abstract=1499261.

100. *See id.*

101. Stephanie Condon, *Obama: Financial Reform Deal Has 90 Percent of What I Proposed*, CBS NEWS (June 25, 2010), http://www.cbsnews.com/8301-503544_162-20008823-503544.html.

102. *See* discussion *infra* Part III (discussing the economic impact of the Dodd-Frank Act).

103. Dodd-Frank Act, Pub. L. No. 111-203, § 1011(a), 124 Stat. 1376, 1964 (2010).

104. *Id.*

105. *Id.* § 1011(b)(2), 124 Stat. at 1964.

106. *Id.* § 1011(c)(1), (3), 124 Stat. at 1964.

107. *Id.* § 1011(d), 124 Stat. at 1964.

the Federal Trade Commission's functions under the enumerated consumer protection laws; 6) the National Credit Union Administration (NCUA); and 7) the Secretary of Housing and Urban Development (HUD) relating to the Real Estate Settlement Procedures Act of 1974, the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, and the Interstate Land Sales Full Disclosure Act.[108] The duties transferred to the BCFP include "all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines."[109] Additionally, the BCFP may "implement[] the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions."[110]

The Dodd-Frank Act also makes it unlawful for any covered person "to offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise commit any act or omission in violation of a Federal consumer financial law; or to engage in any unfair, deceptive, or abusive act or practice."[111] Consumer financial products or services include "any financial product or service that is described . . . under [the Act]" and "(A) . . . is offered or provided for use by consumers primarily for personal, family, or household purposes; or (B) . . . is delivered, offered, or provided in connection with a consumer financial product or service."[112]

The BCFP is further provided with authority to take action "to prevent a covered person or service provider from committing or engaging in an unfair,

108. Dodd-Frank Act § 1061(b), 124 Stat. at 2036.

109. *Id.* § 1061(a)(1), 124 Stat. at 2036.

110. *Id.* § 1012(a)(10), 124 Stat. at 1965.

111. *Id.* § 1036(a)(1), 124 Stat. at 2010.

112. *Id.* §§ 1002(5), (15)(A), 124 Stat. at 1957–60. "Financial product or service" is defined in the Dodd-Frank Act to mean: 1) extending credit and servicing loans; 2) "extending or brokering leases of personal or real property"; 3) providing real estate settlement services; 4) "engaging in deposit-taking activities, transmitting or exchanging funds"; 5) "selling, providing, or issuing stored value or payment instruments"; 6) "providing check cashing, check collection, or check guaranty services"; 7) "providing payments or other financial data processing products or services to a consumer by any technological means"; 8) "providing financial advisory services . . . to consumers on individual financial matters"; 9) "collecting, analyzing, maintaining, or providing consumer report information or other account information"; 10) "collecting debt related to any consumer financial product or service"; and 11) "such other financial product or service as may be defined by the [BCFP], by regulation, for purposes of [Title X of the Dodd-Frank Act], if the Bureau finds that such financial product or service . . . is entered into or conducted as a subterfuge or with a purpose to evade any Federal consumer financial law; or permissible for a bank or for a financial holding company to offer or to provide under any provision of a Federal law or regulation applicable to a bank or a financial holding company, and has, or likely will have, a material impact on consumers." *Id.* § 1002(15), 124 Stat. at 1958–60.

deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service."[113] The BCFP, however, is not given authority to declare acts or practices unfair "unless the Bureau has a reasonable basis to conclude that . . . the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and . . . such substantial injury is not outweighed by countervailing benefits to consumers or to competition."[114]

The BCFP has various tools to prevent unfair, deceptive, or abusive acts, including assessing civil monetary penalties, instituting adjudicatory hearings, or even commencing civil lawsuits.[115] The Bureau may "conduct hearings and adjudication proceedings . . . in order to ensure or enforce compliance with the provisions of [Title X of the Dodd-Frank Act] . . .; and any other federal law that the [BCFP] is authorized to enforce, including an enumerated consumer law" or regulations promulgated under those acts.[116]

Additionally, the BCFP may commence a civil action "to impose a civil penalty or to seek all appropriate legal and equitable relief including a permanent or temporary injunction as permitted by law" for violations of a federal consumer financial law.[117] Federal consumer financial law includes "the provisions of [Title X of the Dodd-Frank Act], the enumerated consumer laws, the laws for which authorities are transferred [to the BCFP], and any rule or order prescribed by the [BCFP]."[118] The enumerated consumer laws include the following: the Alternative Mortgage Transaction Parity Act of 1982; the Consumer Leasing Act of 1976; the Electronic Fund Transfer Act; the Equal Credit Opportunity Act; the Fair Credit Billing Act; the Fair Credit Reporting Act; the Homeowners Protection Act of 1998; the Fair Debt Collection

113. Dodd-Frank Act § 1031(a), 124 Stat. at 2005. A "covered person" within the meaning of the Dodd-Frank Act means "any person that engages in offering or providing a consumer financial product or service; and any affiliate of [that] person . . . if such affiliate acts as a service provider to such person." *Id.* § 1002(6), 124 Stat. at 1956. A "person" means an "individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity." *Id.* § 1002(19), 124 Stat. at 1961. A "service provider" within the Dodd-Frank Act means "any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service . . . that participates in designing, operating, or maintaining the consumer financial product or service; or processes transactions relating to the consumer financial product or service . . . ." *Id.* § 1002(26), 124 Stat. 1562–63.

114. *Id.* § 1031(c)(1), 124 Stat. at 2006.

115. *See generally id.* §§ 1051–1058, 124 Stat. at 2018–35 (outlining the authority of the Commission to make and enforce rules using fines, an administrative hearing process, and civil litigation).

116. *Id.* § 1053(a), 124 Stat. at 2025.

117. *Id.* § 1054(a), 124 Stat. at 2028.

118. Dodd-Frank Act § 1002(14), 124 Stat. at 1957.

Practices Act; Subsections (b) through (f) of section 43 of the Federal Deposit Insurance Act; Sections 502 through 509 of the Gramm-Leach-Bliley Act; the Home Mortgage Disclosure Act of 1975; the Home Ownership and Equity Protection Act of 1994; the Real Estate Settlement Procedures Act; the S.A.F.E. Mortgage Licensing Act of 2008; the Truth in Lending Act; the Truth in Savings Act; Section 626 of the Omnibus Appropriations Act, 2009; and the Interstate Land Sales Full Disclosure Act.[119]

The court in a proceeding brought under federal consumer financial law is given jurisdiction to grant any appropriate legal or equitable remedies.[120] Such relief may include "rescission or reformation of contracts; refund of moneys or return of real property; restitution; disgorgement or compensation for unjust enrichment; payment of damages or other monetary relief; public notification regarding the violation, including costs of notification; limits on the activities or functions of the person; and civil money penalties."[121] The courts, however, are not authorized to impose exemplary or punitive damages.[122]

The civil monetary penalties the BCFP or the courts may assess are divided into three tiers.[123] Tier one imposes a penalty not to exceed $5,000, for each day a "violation of a law, rule, or final order or condition imposed in writing by the Bureau."[124] The second tier imposes a penalty not to exceed $25,000, for reckless violations of any federal consumer financial law.[125] Tier three imposes a civil penalty up to $1,000,000 per day, for knowingly violating a federal consumer financial law.[126]

III. EFFECT OF THE BCFP ON CONSUMERS

The proposal to create the CFPA, and by extension the creation of the BCFP, has been praised by some while criticized by others. Critics argue this new bureau will do nothing but limit the credit available to consumers and raise the costs of obtaining that credit.[127] Credit is vitally important to the economy of the United States. Consumers need credit to provide liquidity when cash is unavailable and to spread the cost of large purchases such as homes, vehicles, and educations over time.[128] Credit drives a substantial

119. *Id.* § 1002(12), 124 Stat. at 1957.
120. *Id.* § 1055(a)(1), 124 Stat. at 1957.
121. *Id.* § 1055(a)(2), 124 Stat. at 2030.
122. *Id.* § 1055(a)(3), 124 Stat. at 2030.
123. Dodd-Frank Act § 1055(c), 124 Stat. at 2030.
124. *Id.* § 1055(c)(2)(A), 124 Stat. at 2030.
125. *Id.* § 1055(c)(2)(B), 124 Stat. at 2030.
126. *Id.* § 1055(c)(2)(C), 124 Stat. at 2030.
127. *See, e.g.*, Evans & Wright, *supra* note 96, at 3.
128. *Id.* at 6–7. As noted previously, the BCFP was developed as an alternative to the CFPA. The BCFP, however, will function in a manner substantially similar to how the CFPA would have operated. As a result, the effect of the BCFP on consumer lending will be the same as the

portion of consumer spending, which is the lifeblood of the economy.[129] For the most part, consumers are responsible in their use of credit, and its availability allows consumers to increase their standard of living.[130] There are some consumers, though, who do not responsibly use credit, taking on large amounts of debt they are unable to repay.[131] It is for this reason that extending credit is a risky business for lenders who are uncertain whether the consumers will be able to repay the principal of the loan.[132]

Due to the importance of credit to the economy and the risks associated with extending credit, it is important to ensure the availability of credit while providing regulation to ensure credit is dispensed in a responsible manner. Some economists argue that "stronger consumer protection regulation could make these consumers better off by regulating the design of these products, mandating various disclosures, restricting consumer choice, and 'nudging' consumer toward certain standardized financial products."[133] On the other hand, ill-considered consumer protections "could reverse the increase in the availability and democratization of credit that consumers have benefited from over the last thirty years."[134]

Some critics, including Professors David Evans and Joshua Wright, argue that the reforms offered by the Dodd-Frank Act fall into the latter category of ill-considered consumer protections that would limit the availability of consumer credit.[135] They contend that the BCFP is likely to create a bureaucratic and legal disaster.[136] Other critics argue the reforms offered by the BCFP are duplicative of existing consumer protections and will dampen the availability of credit to consumers.[137] The BCFP, according to Evans and Wright, will also significantly increase the cost of providing credit to consumers.[138] Lenders will encounter significant uncertainty about the requirements of the BCFP and regulations promulgated by the BCFP.[139] Sorting out these requirements will require countless hours of research and significant expenditures for legal advice. Additionally, lenders may face an

projected effect of the CFPA. *Compare* Dodd-Frank Act §§ 1001–1100H, 124 Stat. at 1367–2113, *with* Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. §§ 10051–10302 (2009) (as passed by the House of Representatives on Dec.11, 2009).

129. Evans & Wright, *supra* note 96, at 48.

130. *Id.* at 8–9.

131. *Id.* at 8.

132. *Id.* at 9.

133. *Id.* at 29.

134. Evans & Wright, *supra* note 96, at 43.

135. *See, e.g.*, *id.* at 43 (listing the ways in which the CFPA will limit consumer access to credit).

136. *Id.* at 37–38.

137. Interview with Thomas W. Hough, *supra* note 96.

138. Evans & Wright, *supra* note 96, at 39–40.

139. *Id.* at 37–38.

onslaught of litigation or the assessment of penalties.[140] Courts also will be faced with the difficult task of defining unfair, deceptive, and abusive practices.[141] Loans will require additional paperwork, and new products will be subjected to an expensive and comprehensive review process.[142] The lenders will seek compensation for these additional requirements and will likely pass the costs of compliance onto consumers, raising the cost of obtaining credit.[143]

In addition to additional costs associated with obtaining credit, consumers are likely to have more difficulty obtaining credit under the BCFP. Customers whose credit scores and circumstances place them on the borderline of a particular bank's lending requirements are likely to find a reduction in available loans under the BCFP.[144] The reason is that bankers will deem these borderline loans too risky and decline to extend them for fear of facing fines or litigation.[145] Furthermore, the BCFP, using its authority to ban products it deems unfair or deceptive, may prevent certain innovative products from being offered.[146] Determining that a product is unfair or deceptive in the abstract fails to account for consumers making logical choices to accept the risk of a product to achieve particular end goals.[147] Thus, the BCFP will limit consumer autonomy and choice by limiting the availability of innovative consumer financial products.[148]

IV. CURRENT CONSUMER PROTECTION LAWS AVAILABLE TO SUBPRIME BORROWERS

The BCFP's benefits do not outweigh its risks, and given the likely effect that it will have on lending, it is unnecessary. The BCFP is unnecessary because individuals wronged by predatory lenders already have a mechanism for redressing their injuries through civil actions that the Dodd-Frank Act tasks

140. *Id.*

141. *Id.* at 37.

142. *Id.* at 38.

143. Evans & Wright, *supra* note 96, at 39–40. For an estimate of the cost increase caused by passage of the BCFP, see *id.* at 43–47.

144. Interview with Thomas W. Hough, *supra* note 96.

145. *Id.*

146. Evans & Wright, *supra* note 96, at 36.

147. *Id.* at 41. Judge Richard Posner argues this is what happened during the subprime mortgage crisis. Richard A. Posner, Op-Ed., *Treating Financial Consumers as Consenting Adults*, WALL ST. J., July 23, 2009, at A15. According to Judge Posner, "It cannot just be assumed that most people who during the housing boom bought homes with adjustable-rate mortgages, or mortgages with prepayment penalties, or mortgages that required a low or even no down payment, were fools or victims of fraud." *Id.* At the time these loans were made, the government denied that the rapid increase in home prices was a bubble and interest rates were low, and for that reason, many Americans chose—logically—to borrow. *Id.*

148. Evans & Wright, *supra* note 96, at 43.

the BCFP with enforcing.[149] This Comment does not take the position that consumers do not need protection or that the current state of the law provides sufficient protection. Instead, this Comment considers whether the new government bureau will actually improve protection of consumers injured by predatory or less than forthcoming lenders.

As mentioned above, the Dodd-Frank Act enumerates several federal laws and provides the BCFP with authority to pursue civil lawsuits for violations of those laws.[150] Several of these enumerated laws, however, already allow individuals to pursue civil suits for violations of those statutes.[151] Therefore, the BCFP simply creates a duplicative right of redress.

Currently, a subprime borrower who feels he has been misled by a lender or has been the victim of predatory lending can seek redress through the court system. In fact, the subprime mortgage meltdown has spawned a wave of litigation under laws already in force.[152] These plaintiffs have numerous possible causes of action, including those based upon violations of the federal statutes enumerated in the Dodd-Frank Act—specifically, TILA and RESPA.[153] In addition, consumers have the ability to combine these claims

149. Another reason the BCFP is unnecessary is that the current regulatory structure of the United States, specifically the Federal Trade Commission, with a few modifications is fully capable of regulating financial products and services to prevent a future collapse of the financial market as was experienced during 2007–2008. However, Jon Leibowitz, Chairman of the Federal Trade Commission, when testifying before Congress explained, "Many of the rulemaking, enforcement, education, and research functions of the [BCFP] are functions that the FTC currently performs with respect to entities under its jurisdiction." *Proposed Consumer Financial Protection Agency: Implications for Consumers and the Federal Trade Commission Before the H. Comm. on Energy & Commerce, Subcomm. on Commerce, Trade, & Consumer Protection*, 111th Cong. 15 (2009) (statement of Jon Leibowitz, Chairman, Fed. Trade Comm'n), *available at* www.ftc.gov/os/2009/07/090708Acfpatestimony.pdf. The FTC Act prohibits unfair or deceptive acts or practices in or affecting commerce except for banks, savings and loan institutions, and certain credit unions, which are exempted from regulation by the FTC. *Id.* at 2. If Congress's goal in creating the BCFP was to provide one agency with the responsibility for regulating consumer financial products, Congress could have simply removed the banking exemptions from the FTC act allowing the FTC to regulate all consumer financial products, rather than creating an entirely new bureau.

150. Dodd-Frank Act, Pub. L. No. 111-203 §§ 1002(12), 1002(14), 1054(a), 124 Stat. 1376, 1957, 2028 (2010).

151. *E.g.*, 15 U.S.C. §§ 1640(a), 2605(f), 2607(d)(5) (2006).

152. *See* Brian E. Robison, *Litigation in the Wake of the Subprime Lending Collapse: What Has Happened and Where We Are*, 14 No. 4 ANDREWS DERIVATIVES LITIG. REP. 22 (Jan. 7, 2008) (detailing the numerous types of actions that have resulted from the subprime crisis); Schmudde, *supra* note 44, at 63 (providing a similar list of lawsuits brought due to the subprime lending crisis).

153. Allison Torres Burtka, *Predatory-Lending Litigation Looms*, TRIAL, May 2008, at 16, 16; Arielle L. Katzman, Note, *A Round Peg for a Square Hole: The Mismatch Between Subprime Borrowers and Federal Mortgage Remedies*, 31 CARDOZO L. REV. 497, 498 (2009).

with others based on state consumer protection acts and state common law fraud, which are beyond the purview of the BCFP.[154]

Since the beginning of 2007, 866 subprime mortgage-related cases have been filed in federal court—290 in 2007 and 576 in 2008.[155] Twenty-four percent of the suits filed in 2008 were borrower class actions.[156] In 2007, borrower class actions accounted for 43% of subprime-related litigation.[157] These suits have been filed against mortgage brokers, lenders, appraisers, title companies, and numerous other players in the mortgage origination and securitization market.[158] Twenty-eight percent of these class actions alleged inadequate disclosures, and 12% alleged discriminatory lending practices in 2007 and 2008.[159] However, the most common claims found in these borrower class actions involve improper charges or payments made during the loan origination process.[160]

It has been argued that the current federal consumer protection statutes were not developed for the subprime market and that the redress available under these statutes does not provide adequate protection for consumers because subprime mortgages are complex transactions.[161] Even if all the required disclosures regarding the terms and costs of the loans are presented to the borrowers, the borrowers lack the wherewithal and skill necessary to properly evaluate the loan and make an informed decision about whether they can or cannot afford the loan.[162] This portion of the Comment will briefly explain the requirements of TILA, including the HOEPA amendments and RESPA, as well as the provisions in these acts that allow consumers to bring private lawsuits for their violations. It will then consider the shortfalls of these statutes in the subprime-lending context.

A. The Truth-in-Lending Act (TILA)

TILA, passed in 1968, is a consumer credit law intended to protect consumers by requiring lenders to make certain disclosures in credit transactions.[163] TILA mandates that mortgage lenders disclose certain information, including the amount financed, the finance charge represented as

154. Katzman, *supra* note 153, at 539–40.

155. JEFF NIELSON ET AL., NAVIGANT CONSULTING, SUBPRIME MORTGAGE AND RELATED LITIGATION 2008: SEEKING RELIEF 4 (2009).

156. *Id.*

157. JEFF NIELSON ET AL., NAVIGANT CONSULTING, SUBPRIME MORTGAGE AND RELATED LITIGATION 2007: LOOKING BACK AT WHAT'S AHEAD 2 (2007).

158. NIELSON ET AL., *supra* note 155, at 5.

159. *Id.* at 10.

160. *Id.*

161. Katzman, *supra* note 153, at 511.

162. *Id.* at 509–10.

163. 15 U.S.C. § 1601(a) (2006).

an annual percentage rate (APR), and the number and amount of payments required to repay the loan before the credit is actually extended.[164] The purpose of TILA is to ensure that borrowers have all the necessary information to calculate the true cost of the loan and to enable borrowers to compare loans across lenders.[165] TILA also imposes limits on the interest rate that can be charged on mortgages.[166]

If a creditor fails to satisfy the requirements of TILA or Regulation Z (the Federal Reserve's guideline for complying with TILA), the borrower may bring a civil action, which may take the form of a class action lawsuit.[167] Borrowers who bring successful TILA claims are entitled to receive actual damages, statutory damages of up to $4,000, reasonable costs of bringing the action, and reasonable attorney's fees.[168] In order to recover actual damages, courts require the borrowers to establish that the TILA violation was the proximate cause of the actual damages.[169] This requires the plaintiff to establish that: "(1) he read the TILA disclosure statement; (2) he understood the charges being disclosed; (3) had the disclosure statement been accurate, he would have sought a lower price; and (4) he would have obtained a lower price."[170]

Additionally, in certain circumstances, borrowers are able to rescind the loan for TILA violations.[171] Within three business days of the consummation of the loan or the delivery of proper TILA disclosures, whichever is later, the borrower can rescind a loan for any reason.[172] If the borrower can prove "[he or she] received inaccurate material disclosures, [was] not provided material disclosures, or [was] not notified of the right to rescind,"[173] the borrower can rescind the loan for a period of three years.[174] Unfortunately, the right of rescission does not currently apply to residential mortgage transactions.[175]

On its face, TILA appears to have substantial power to protect consumers and ensure they know what they are getting themselves into when entering a

164. *Id.* § 1638(a).

165. *See id.* § 1601(a).

166. 12 C.F.R. § 226.32(a)(3) (2010). These limits were such that they failed to prevent the rates charged on subprime mortgages. Schmudde, *supra* note 44, at 49.

167. 15 U.S.C. § 1640(a); Richard J. Link, Annotation, *Civil Remedies for Violations of Credit Transactions Provisions of Truth In Lending Act (TILA) (15 U.S.C.A. §§ 1601 et seq.), as Amended by Truth In Lending Simplification and Reform Act of 1982*, 113 A.L.R. FED. 173, 185–86 (1993).

168. 15 U.S.C. § 1640(a).

169. Peters v. Jim Lupient Oldsmobile Co., 220 F.3d 915, 917 (8th Cir. 2000).

170. *Id.*

171. 15 U.S.C. § 1635.

172. *Id.* § 1635(a); Katzman, *supra* note 153, at 529.

173. Katzman, *supra* note 153, at 529.

174. 15 U.S.C. § 1635(a), (f).

175. *Id.* § 1635(e)(1).

loan. TILA, though, has several shortcomings. TILA disclosures provided to borrowers, especially in the context of subprime or adjustable rate mortgages, are so complex they cannot be understood without great explanation.[176] Additionally, TILA only applies to creditors, but oftentimes, especially with subprime borrowers, mortgage brokers who do not meet the definition of creditors nevertheless handle the loan origination and communicate directly with the client.[177] The statutory damages provided by TILA, meant to provide incentives for private enforcement, actually provide only "meager damages," allowed only if a borrower can satisfy statutory requirements designed for prime borrowers.[178] Proving actual damages under TILA is also problematic for subprime borrowers. The second prong, which requires the borrower to prove that he understood the charges being discussed in the disclosures, undermines the argument that the layperson borrower was unable to understand the disclosures.[179] The third and fourth prongs fail to account for the fact that subprime borrowers, because of their low credit scores, have fewer options available for financing.[180]

The fact-sensitive inquiry required to recover actual damages also provides a substantial barrier for proceeding with class action suits.[181] The Federal Rules of Civil Procedure require a prospective class to establish, among other things, that there are matters of law and fact common to the class before the court can certify a class.[182] By requiring plaintiffs to establish the facts surrounding the disclosures, the understanding of the disclosures, and reliance on the disclosures, it will be extremely difficult for a court to find a commonality of facts sufficient to certify a class.[183] Additionally, as mentioned above, the right of rescission provided by TILA does not apply to residential mortgage transactions, effectively barring subprime borrowers from using the most beneficial provision of TILA to obtain relief.[184] As a result of these shortcomings, Congress determined that additional legislation was necessary and passed the Home Ownership and Equity Protection Act.[185]

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176. Schmudde, *supra* note 44, at 49–50.

177. Katzman, *supra* note 153, at 524–25.

178. *Id.* at 527. The statutory damages are bonus damages for the plaintiff meant to encourage private enforcement as well as to punish and deter defendants from taking the prohibited action in the future. Dryden v. Lou Budke's Arrow Fin. Co., 630 F.2d 641, 647 (8th Cir. 1980).

179. Katzman, *supra* note 153, at 528.

180. *Id.*

181. *Id.* at 528–29.

182. FED. R. CIV. P. 23(a).

183. Katzman, *supra* note 153, at 528–29.

184. *Id.* at 530.

185. Riegle Community Development and Regulatory Improvement (Home Ownership and Equity Protection) Act of 1994, Pub. L. No. 103-325, 108 Stat. 2160 (codified at 15 U.S.C. §§ 1601–1649).

B. Home Ownership and Equity Protection Act (HOEPA)

The HOEPA amended TILA in 1994 to cover first-lien loans and require additional safeguards on high-cost loans.[186] HOEPA mandates additional disclosure requirements, including full disclosure of interest rates and written notice of fees and costs three days prior to closing.[187] HOEPA bans specific types of terms and practices like prepayment penalties, balloon payments, and calling loans prior to their due date.[188] Furthermore, HOEPA requires lenders to take into consideration the borrower's ability to repay the loan before extending credit and provides regulatory authority to the Federal Reserve.[189] HOEPA also provides causes of actions for consumers to pursue against lenders.[190]

The HOEPA requirements, while containing many useful parts and much needed regulatory authority, have failed to provide sufficient protection for subprime borrowers because the requirements do not apply to residential mortgage transactions.[191] Additionally, despite its ability to regulate under HOEPA, the Federal Reserve did not pass any regulations until 2008, after the subprime mortgage crisis began.[192]

C. Real Estate Settlement Procedures Act (RESPA)

RESPA was enacted in 1974, six years after TILA, to help consumers shop for settlement services and to eliminate kickbacks and referral fees that increased the cost of settlement services.[193] RESPA requires certain disclosure requirements for the lender in residential transactions. "These disclosures include: A special information booklet; a good faith estimate of charges; actual settlement costs; escrow payments scheduled for the first year of the mortgage."[194] Lenders must disclose any ownership interest they have in businesses that they recommend to consumers as well.[195] Additionally, RESPA requires the lender to notify the buyer whether the lender plans to

186. Katzman, *supra* note 153, at 508; Schmudde, *supra* note 44, at 50. It is important to note that HOEPA does not apply to home purchase loans, but rather loans secured by the borrower's primary residence. 15 U.S.C. § 1602(aa)(1) (2006).

187. *Id.* § 1639(a)–(b).

188. *Id.* § 1639(c), (e); Schmudde, *supra* note 44, at 50.

189. 15 U.S.C. § 1639(h), (l). *See also* Katzman, *supra* note 153, at 508; Schmudde, *supra* note 44, at 50.

190. 15 U.S.C. § 1640. *See also* Katzman, *supra* note 153, at 523.

191. 15 U.S.C. § 1602(aa)(1). *See also* Katzman, *supra* note 153, at 523–24.

192. Schmudde, *supra* note 44, at 50.

193. Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533, 88 Stat. 1724 (codified at 12 U.S.C. § 2601(b) (2006)).

194. Schmudde, *supra* note 44, at 50. *See also* 12 U.S.C. §§ 2603–2606.

195. 12 U.S.C. § 2607; 25 C.F.R. § 3500.15 (2010).

service the loan in house or transfer it to another lender, and to notify the borrower if the loan is sold or assigned.[196]

RESPA enables borrowers to bring civil actions for monetary damages based on kickbacks and unearned fees, servicing violations, and seller-required title insurance.[197] If a buyer is able to show that referring parties provided kickbacks or split settlement fees with one another, the borrower can hold the parties jointly and severally liable for three times the amount of any charge paid for settlement services, along with court costs and attorney's fees.[198]

Some have argued that RESPA fails to provide relief for many subprime borrowers because RESPA was meant to regulate the process of closing a loan, not the substantive terms of the loan.[199] Others have argued that RESPA cost estimates are inaccurate and difficult for inexperienced borrowers to understand.[200] Also, despite the treble damage provision, it has been argued that successful suits under RESPA will result in only small recoveries that do not justify the cost of bringing the action.[201] Furthermore, RESPA does not allow for rescission, which limits its effectiveness in helping consumers.[202]

V. EVALUATION OF THE BCFP AND RECOMMENDATIONS FOR CONGRESSIONAL ACTION

Given the weaknesses of the current laws and the vast expanse of the crisis caused by subprime mortgages, it is understandable that members of Congress and the Obama Administration, as part of their financial reform package, created a new "agency" to promulgate rules and regulations, pursue civil lawsuits, and assess civil monetary penalties. People are angry and feel that "Main Street," acting through its representatives in Washington, D.C., should push back and punish those on "Wall Street" who caused the collapse.[203] While this sentiment is shared by many, and understandably so, the BCFP is not the solution to the subprime problem.

TILA, HOEPA, and RESPA are federal statutes which currently provide redress for injured borrowers. These acts also are included in the Dodd-Frank Act's enumerated consumer laws under which the BCFP can institute civil

196. 12 U.S.C. § 2605.

197. 12 U.S.C. §§ 2605(f), 2607(d)(1).

198. *Id.* § 2607(d)(2), (5). *See* Katzman, *supra* note 153, at 513 n.100 (describing a conflict among courts regarding the application of the treble damage provisions).

199. Katzman, *supra* note 153, at 512.

200. Schmudde, *supra* note 44, at 50.

201. Katzman, *supra* note 153, at 513.

202. *Id.* at 512.

203. *See* Ron Resnick, *Another View: Why No Restrictions on Leverage?*, DEALBOOK (July 19, 2010, 9:30 AM), http://dealbook.blogs.nytimes.com/2010/07/19/another-view-why-no-restrictions-on-leverage/.

lawsuits.[204] However, as discussed above, each of these acts has inherent weaknesses, which prevent subprime borrowers from obtaining complete relief. A bureau of the federal government bringing the lawsuit, rather than an individual plaintiff or group of plaintiffs, will not rectify these weaknesses. Just as it is difficult for a consumer bringing a TILA action to establish that he understood the disclosures, it will be difficult for the BCFP to establish that the borrower read and understood the disclosures. Throughout the past four decades since TILA was enacted, Congress, in an effort to improve loan disclosure to consumers, has passed several additional bills increasing the number of disclosures provided to buyers.[205] This layering of legislation on top of legislation has resulted in borrowers being bombarded with documents at closing which make the task of understanding the terms of the loan arduous and time-consuming—effectively negating the consumer's ability to truly understand the loan.[206] This new bureau, with power to prescribe additional disclosures, will not solve this problem; in fact it will compound the problem. Additionally, allowing a governmental agency to bring a lawsuit will not change the fact that TILA's rescission provisions do not apply to residential mortgage transactions. Nor will it allow the provisions of HOEPA to apply to residential mortgage transactions.

Therefore, rather than creating the BCFP, Congress and the Obama Administration should have thoroughly reviewed the existing federal consumer protection laws and focused on improving the remedies already available to subprime consumers under those acts. Borrowers would be better served by amending TILA, HOEPA, and RESPA to require simpler disclosures and better communication of the most essential terms of the loan, including principal amount, interest rate, repayment terms, and fees. Perhaps disclosures could be accompanied by a letter stating, in simple terms, the following: "You are borrowing _____ dollars, at an interest rate of _____%. The loan will be repaid by payment of _____ dollars each month for _____ consecutive months. Over the lifetime of the loan you will be paying _____ dollars, total."[207] If the loan has an adjustable rate, additional language should be added, denoting that the "APR is subject to increase to a maximum rate of _____%"; explaining when the APR can be increased; and providing a series of calculations

204. Dodd-Frank Act, Pub. L. No. 111-203, §§ 1002(12), 1053(a), 1054(a), 124 Stat. 1957, 2025, 2028 (2010).

205. Interview with Thomas W. Hough, *supra* note 96.

206. *Id*.

207. Much of this information is currently required to be disclosed under 12 C.F.R. §§ 226.5(a), 226.6 (2009). Section 226.5 requires creditors to make TILA disclosures "clearly and conspicuously in writing, in a form that the consumer may keep." *Id.* § 226.5. However, it would be beneficial to mandate that this disclosure be in the form of a letter using the simple language above because different lenders may understand "clearly and conspicuously" differently. Mandating this language would help consumers compare loan options quickly and easily.

denoting the amount of monthly payments and total amount paid based upon the maximum interest rate.[208]

Additionally, Congress should consider requiring the lender to walk through the terms of the loan with the consumer, advising them to seek outside counsel if they do not understand the provisions of their prospective loan. Another recommendation proposed by scholars is to require some form of credit counseling for borrowers before they can obtain a mortgage loan, similar to that required before filing for bankruptcy.[209] These changes would provide a great deal more protection than simply allowing a new government agency to bring the same flawed causes of action consumers can already bring themselves.

However, even if Congress determined that amending TILA, HOEPA, and RESPA did not go far enough, there are still steps that Congress could have taken short of creating a new bureau to aid in protecting consumers. Congress could have passed new legislation to provide these protections. In the Dodd-Frank Act, the BCFP is provided with the authority to take action "to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service."[210] Banning unfair, deceptive, and abusive practices is a reasonable step toward preventing the abuses that gave rise to the financial crisis. However, instead of using the BCFP as the mechanism for preventing such practices, Congress should have simply banned those acts and practices and provided a private right of action for individual victims. The private right of action could have provided for actual damages, substantial statutory damages, treble damages, and even rescission or reformation of the mortgage agreement. Instead of providing that the bureau has the power to assess civil monetary penalties, the legislation could have provided for punitive or exemplary damages for egregious violations. Allowing a private right of action with the possibility of punitive damages would have adequately served the purposes the BCFP is meant to serve—protection of consumers and deterrence of predatory behavior—without most of the negatives associated with the BCFP.

Another complication of the BCFP is the cost of administering the bureau. As detailed above, the new bureau will likely increase the costs of making

208. Mr. Hough mentioned that these requirements would help improve standard prime transactions. However, with the complexity that often accompanies subprime mortgages, simple disclosures like those described above may not be possible. Interview with Thomas W. Hough, *supra* note 96.

209. ROBERT J. SHILLER, THE SUBPRIME SOLUTION 123–28 (2008).

210. Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 1376, 2005 (2010).

loans to banks and other mortgage lenders.[211] This will have a significant impact on the number of loans made and the interest rates charged on those loans.[212] The decrease in loans and increase in interest rates will in turn have significantly impact home ownership. However, if Congress, instead of creating the BCFP, passed a statute banning unfair or deceptive practices and allowed a private right of action, the costs of making loans would only increase for those lenders using unfair or deceptive practices, and only those lenders would have to recoup the additional costs through increased fees or interest rates. This would make loans from these lenders less attractive than other lenders—achieving a deterrent effect and preventing deceptive loans from being made. Those lenders who make proper disclosures and operate legally and ethically would be able to continue those practices free from an increased regulatory burden. All lenders did not cause the financial crisis, so the focus of Congressional action should have been on those that did cause the crisis.

CONCLUSION

The Great Recession has been difficult for everyone. The federal government chose to bail out numerous failing financial institutions that made loans without regard for the risks associated with them. Many people, both prime and subprime borrowers, have lost their homes to foreclosure. Countless more have found themselves behind on mortgages and owing more on their home than it is worth. This is a tragic situation, and steps should be taken to prevent a similar crisis from occurring in the future. However, the BCFP is not the solution consumers need. The protections offered by the BCFP are duplicative of previous consumer protections and will likely result in credit being scarcer and more expensive.

Instead of creating the BCFP, Congress should have reviewed the existing consumer protection laws and passed amendments or further legislation allowing subprime borrowers who were the victims of predatory lenders to obtain sufficient remedies on their own through civil litigation. The amendments or new causes of action should have punished dishonest, deceitful lenders by providing punitive damages for egregious breaches and allowing rescission of unfair and abusive contracts. Congress should also have simplified disclosures and perhaps mandated credit counseling for consumers before they obtain mortgage loans. Those changes would have fulfilled the

211. Evans & Wright, *supra* note 96, at 39–40.

212. *Id.* Modifying current federal consumer protection laws or passing a new consumer protection law would likely still require lenders to incur additional costs to determine if their practices are unfair or deceptive. Additionally, courts would still be required to decipher the meaning of those terms. However, these costs would likely be less than those associated with creating an entirely new government bureau.

goals of the BCFP without creating the bureaucratic and legal quagmire that comes with it.

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