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PREDATORY LENDING: PRACTICES, REMEDIES AND LACK OF ADEQUATE PROTECTION FOR OHIO CONSUMERS

I.	INTRODUCTION	608
II.	PREDATORY LENDING.....	608
	A. <i>Subprime Lending and Predatory Lending</i>	608
	B. <i>Common Predatory Lending Practices</i>	609
	C. <i>The Problem: Why Does Predatory Lending Occur?</i>	611
	D. <i>The (Un)Willing Players in the Predatory Lending Game</i>	613
III.	FEDERAL REMEDIES: LIMITED RELIEF FOR CONSUMERS.....	616
	A. <i>The Truth in Lending Act and Home Ownership Equity Protection Act</i>	616
	1. Little “True” Help in the Truth In Lending Act.....	616
	2. Is There Hope for HOEPA?	618
	B. <i>Real Estate Settlement Procedures Act</i>	621
	C. <i>Racketeering Influenced and Corrupt Organizations Act</i>	622
IV.	REMEDIES IN OHIO: CAVEAT EMPTOR	623
	A. <i>The Mortgage Loan Act: Limited Protection for Consumers</i>	624
	B. <i>Consumer Sales Practices Act</i>	625
V.	REMEDIES IN OTHER STATES	627
	A. <i>North Carolina: The Nation’s First Bill Regulating High-Cost Home Loans</i>	628
	B. <i>New York: New Regulations Protect Consumers</i>	630
	C. <i>Creative Litigation Techniques and Remedies in Other States</i>	632
VI.	TOWARD A NEW THEORY OF PROTECTION AGAINST PREDATORY MORTGAGE LENDING IN OHIO.....	634
VII.	CONCLUSION.....	636

I. INTRODUCTION

Catherine Thomas is an elderly disabled widow who lives in Cleveland, Ohio.¹ In 1998, an unsolicited salesman approached Ms. Thomas stating that he could get her a loan to replace her porch even though she had a current mortgage and little income. Ms. Thomas needed less than \$3,000 to fix her porch but the lender charged her more than \$5,000 in fees on the new loan, including a \$918 payment to the mortgage broker for securing the loan. The lender put a large fixed sum payment in the terms of the loan after Ms. Thomas, knowing she could not afford it, specifically asked that no large payment be included in her loan. No one informed Ms. Thomas that she had three days to cancel the loan, and her old porch was torn down without ever being replaced. Currently, Ms. Thomas cannot make the high monthly payments, is in danger of having her utilities terminated, is unable to afford food for herself, and may lose her home. She was the victim of predatory lending practices.

This note focuses on remedies available to borrowers who fall prey to predatory lending practices on their home equity loans where their homes are used as collateral. Home equity loans are “loans secured by a homeowner’s residence other than loans used solely to purchase or construct the residence, to refinance a purchase money loan, or to make home improvements.”² Home equity loans include first liens on a home (effectively a first mortgage) that are created as part of a refinancing package and subsequent mortgages on a home.

Following this introduction, Part II gives basic background information on predatory lending: what predatory lending is, examples of common predatory lending techniques, and, who benefits and who is hurt by predatory lending practices. Part III discusses and critiques current federal laws that borrowers have used to combat predatory mortgage lending practices. Part IV explains the current forms of relief available in Ohio and the limitations of these remedies. Part V discusses remedies in other states, focusing on North Carolina and New York. Part VI proposes changes in Ohio law to provide remedies for victims of predatory lending practices.

II. PREDATORY LENDING

A. *Subprime Lending and Predatory Lending*

The system of lending in America is based on two tiers. The first tier is loans made to people who represent good credit risks. These are prime loans. The second tier is subprime loans. Subprime lenders loan to those borrowers with past credit problems or low incomes at a higher cost than conventional mortgage loans.³ The

¹This story tells of an actual client of the Legal Aid Society in Cleveland, Ohio. The names of the parties have been changed because the lawsuit is not yet a matter of public record.

²Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government’s Promotion of Home Equality Financing*, 69 TUL. L. REV. 373, 377 (1994).

³COMMUNITY REINVESTMENT ASSOCIATION OF NORTH CAROLINA, INTRODUCTION TO PREDATORY LENDING POLICY 4. This publication is a pamphlet put out by the Community Reinvestment Association of North Carolina (CRA*NC) and lists no author or publishing date. CRA*NC can be contacted at 919/856-2143 for more information.

borrowers present a higher risk of defaulting on their loans and, therefore, are charged higher rates depending on their credit histories and income levels.

Subprime lending is, in theory, completely ethical.⁴ It allows people with less than perfect credit the ability to take out loans at higher interest rates based on their risk. The higher interest rates simply reflect the known risk that people with past credit problems have a higher chance of defaulting on their loans. Subprime lending allows borrowers whose loan applications were previously rejected by prime lenders an increased chance to secure a loan.

The transformation from subprime lending to predatory lending occurs when lenders employ unethical and/or illegal tactics to secure the loans or offer subprime loans to those who qualify for prime loans.

No working definition of predatory lending exists. Instead, the phrase has been used as a catch-all to describe practices by lenders that range from unethical to illegal.⁵ Because of this, the focus of this Note is on specific practices that commonly have been defined as “predatory.” Predatory lending could be viewed as the practice of deceptive mortgage lending where a lender charges fees and interest that are greater than the risk presented by the borrower.

B. Common Predatory Lending Practices

The three most common predatory lending practices are “stripping,” “flipping,” and “packing.” Stripping is actually equity stripping whereby a lender makes a loan that it knows the borrower cannot possibly repay, resulting in the foreclosure of the home and a loss of equity.⁶ Another method of stripping the equity out of a borrower’s home occurs through the process of “flipping” a loan. “Flipping” occurs when the lender gets the borrower to repeatedly refinance the original mortgage.⁷ The process sounds attractive because the lender offers the borrower the option of a new loan rather than foreclosure.⁸ What the homeowner may not understand, however, is that each time the mortgage is “flipped,” the lender adds and profits from additional fees that are imbedded in the new loan. Each time an old loan is “flipped,” it becomes a brand new loan. This process “bleeds the equity from the home exponentially in each refinancing without providing any benefit to the

⁴Subprime loans are also called high-cost loans because of the interest and fee costs associated with the loans. The terms are used interchangeably throughout the Note.

⁵The Community Reinvestment Association of North Carolina broadly defines predatory lending as “any unfair credit practice that harms the borrower or supports a credit system that promotes inequality and poverty.” INTRODUCTION TO PREDATORY LENDING POLICY, *supra* note 3, at 3. The Association for the Advancement of Retired Persons described predatory lending as “unethical, often, illegal ways using high-pressure sales tactics, pretending to help people obtain credit and charging extremely high costs and interest for their services.” AARP, http://www.aarp.org_getans/consumer/predatorylending (last visited Jan. 3, 2000).

⁶Michael D. Larson, *Borrower Beware: Bad Home Equity Loan can Lead to Foreclosure*, <http://www.bankrate.com/brm/news/loan/19990929.asp> (last visited Jan. 3, 2000).

⁷*Id.* Banking regulations in New York define the process of “flipping” as “making a high cost home loan to a borrower that refinances as existing mortgage loan when . . . such refinancing is unconscionable.” 3 N.Y.C.R.R. Part 41, § 41.5(4) (2000). Text of Part 41 may be found at <<http://www.banking.state.ny.us>>.

⁸Larson, *supra* note 6.

borrower.”⁹ In addition, most of the early payments the borrower makes go toward the interest rather than the principal part of the loan; likewise, most of the interest income for lenders is made early in the loan.¹⁰ In other words, any new loan is more profitable for the lender than an old loan. “Flipping” also allows the lender to charge the borrower points¹¹ so that the lender makes more money every time the loan is refinanced.¹² Another type of flipping takes place when a lender first makes a small loan with a borrower and then convinces the borrower to increase the loan, often securing the new loan with the mortgaged property. Often the mortgaged property, obtained with favorable terms for the buyer, is close to being paid off.

The third technique is called “packing.” Packing occurs when the lender adds other services on to the loan such as life insurance or disability insurance.¹³ These services usually do not protect the borrower against any risk relating to the loan.¹⁴ Lenders often convince borrowers to pay for credit insurance¹⁵ or other types of insurance on the loan that the borrower did not need, or ask, to have added.¹⁶ These additives are lucrative for the lender if the loan is refinanced because the lender does not need to refund any premiums paid by the borrower.¹⁷ Another type of “packing” is adding the balance of unpaid bills to the loan. A lender may add anything from unpaid credit card bills to utility bills to unpaid property taxes—often without the knowledge or consent of the borrower.¹⁸

⁹Real Estate Settlement Act Truth In Lending Act, CONG. TESTIMONY, September 16, 1998, *available in* Westlaw, 1998 WL 18089596 (testimony of Margot Saunders, Managing Attorney National Consumer Law Center) [hereinafter Testimony of Margot Saunders].

¹⁰Hearings Before the Senate Special Comm. on Aging, CONG. TESTIMONY, March 16, 1998, *available in* Westlaw, 1998 WL 8993162 (testimony of William Brennan, Jr., Director of the Home Defense Program of the Atlanta Legal Aid Soc’y) [hereinafter Testimony of William J. Brennan, Jr.].

¹¹A percent of the amount borrowed as an added on, and legal, fee.

¹²Hearings Before the Senate Special Comm. on Aging, CONG. TESTIMONY, March 16, 1998, *available in* Westlaw, 1998 WL 8993304 (testimony of “Jim Dough” a subprime industry insider). Mr. Dough also recounts the targeting of blue-collar and uneducated people, people on fixed incomes, non English-speaking people, and people with high equity homes. *Id.*

¹³Banking regulations in New York define “packing” as “the practice of selling credit life, accident and health, disability or unemployment insurance products or unrelated goods or services in conjunction with a high cost home loan without the informed consent of the borrower.” 3 N.Y.C.R.R. Part 41, §41.5(5) (2000).

¹⁴Richard A. Wright, *in* OHIO CONSUMER LAW 470 (Harold L. Williams, ed., 1999).

¹⁵This credit insurance often insures the lender, even though it is the borrower paying for it.

¹⁶Larson, *supra* note 6.

¹⁷Wright, *supra* note 14, at 471.

¹⁸*See* Williams v. Aetna Finance Co., 700 N.E.2d 859 (Ohio 1998) (stating that the lender added \$3,326.04 to the loan amount to pay off Ms. Williams’s credit card bills and also sold her life insurance and insurance on her television and stereo).

Other abuses include unfair balloon payments, mandatory arbitration clauses, high interest rates, inflated home appraisals, and yield spread premiums. Balloon payments are payments that are due in the middle or at the end of the loan that are larger than one monthly payment. Often the borrower's monthly payments pay for the interest, and the balloon payment is equal to or greater than the principal amount of the loan.¹⁹ Since the borrower obviously will not be able to pay such a large payment, she is forced to go back to the lender and refinance the loan or face foreclosure.

Arbitration clauses are becoming more popular in many types of consumer contracts as companies seek ways to avoid costly litigation. Mandatory arbitration clauses frequently require only the borrower to submit to arbitration and can force homeowners "to pay large sums for their concerns to be addressed by arbitrators who have no incentive to follow consumer protection laws and whose decisions are not reviewable by any court."²⁰

High interest rates become unethical when the rates exceed the risk the lender places on the borrower that the borrower will default on the loan. More than thirty states allow lenders to charge interest rates of thirty percent or higher.²¹ Delaware, Nebraska, Illinois and Utah allow finance rates of above 100%.²² So a \$50,000 loan in one of these states could, in theory, cost the borrower \$100,000.

Another predatory lending technique is inflated home appraisals. An unscrupulous appraiser will inflate the value of a home so that a mortgage can be made for a larger amount. For example, if a borrower's home is worth \$75,000 but appraised at \$80,000, the amount of the loan will be for \$5,000 more than it should be and the added fees will be based on an \$80,000 loan.²³

What is important to note about these predatory lending practices, and this list is by no means exhaustive, is that none of the practices is illegal per se. In fact, in most states, these practices are legal or at best partially regulated. As a result of these practices and the limited avenues of recourse, vulnerable homeowners are being duped, persuaded, or tricked out of their most precious possession—their homes.

C. The Problem: Why Does Predatory Lending Occur?

This country has experienced a sharp rise in subprime lending over the last twenty years. The subprime loan market increased from almost nothing to a booming \$500 billion industry from 1994 to 1999.²⁴ Nationwide, lenders issued

¹⁹See *Family Fin. Services, Inc. v. Spencer*, 677 A.2d 479 (Ala. 1993). A defendant to a foreclosure action made two loans with the same lender, both loans contained balloon payments larger than the principal amount of the loan. *Id.* at 481-82.

²⁰Testimony of Margot Saunders, *supra* note 9. Ohio law now says that mandatory arbitration clauses are unconscionable. See generally *Williams*, 700 N.E.2d at 859.

²¹The cap in Ohio is between twenty-one to twenty-five percent for most mortgage loans.

²²MICHAEL HUDSON, PREDATORY FINANCIAL PRACTICES, AARP Public Policy Institute, 14 (Winter, 1998).

²³These terms seem irrational; however there is documented evidence that this practice is widespread and a number of theories are emerging. That discussion is beyond the scope of this Note.

²⁴Larson, *supra* note 6.

more than ninety percent of all subprime loans after 1992²⁵ and \$125 billion worth in 1997.²⁶ Not coincidentally, the foreclosure rate on houses has also increased exponentially—by more than 200 percent since 1980.²⁷ In 1997, over a half million foreclosures occurred.²⁸ Advocates believe one of the most significant reasons for this trend is the huge number of subprime loans made by lenders who base loans on the amount of homeowners' equity without considering borrowers' ability to pay.²⁹

Today, thirty-eight percent of families with incomes below the federal poverty standards own their own home.³⁰ These homeowners generally do not have cash on hand to pay for costly home improvements. They may also have poor credit history making them ineligible for prime loans. Thus, subprime loans are an attractive vehicle to finance repairs. Unfortunately, people who borrow at subprime rates often do not understand the implications of using their homes as collateral for the loan.³¹

Predatory mortgage lending occurs due to many factors that make the abuse profitable.³² Subprime lenders receive up to six times better returns than do the best banks.³³ The equity in homes, even foreclosed homes, is attractive to lenders. This is a result of the appreciation of some property values and the payment of mortgages "which over time results in the reduction of the principal balance on the mortgage loan."³⁴ Subprime lenders argue that they do not focus on the equity in a home because if the borrower defaults and the house is foreclosed, the lender loses money.³⁵ The lender, however, can retain title to the foreclosed house and sell it later for a profit due to real estate appreciation. Along the same lines, the borrower's property is sold to the lender for less than fair market value, so the lender benefits from the equity when it later resells the property.³⁶ In addition, lenders often sell off

²⁵*Id.*

²⁶*FTC Testifies on Enforcement and Education Initiatives to Combat Abusive Lending Practices* (March 16, 1998), <http://www/debtconsolidation.com/credlaw/subprimemortgage>.

²⁷Kathleen E. Keest, *House Rich Elderly: Easy Target for Mortgage Scams*, NAT'L BAR ASSOC. MAG., Jan.-Feb., 1994, at 14.

²⁸Testimony of Margot Saunders, *supra* note 9.

²⁹*Id.*

³⁰Testimony of Margot Saunders, *supra* note 9.

³¹Often the houses are completely mortgage-free which makes refinancing a riskier proposition because the houses were owned in the clear and now the homeowner may risk foreclosure.

³²The industry argues that predatory mortgage lending is rare. Studies indicate that home loan abuses are common throughout the country and the losses may reach into the billions of dollars and include perhaps more than a million victims. HUDSON, *supra* note 22, at 11.

³³Thomas Goetz, *Sharks, Inc.*, VILLAGE VOICE, July 15, 1997, at 33, 34.

³⁴Testimony of William J. Brennan, Jr., *supra* note 10.

³⁵Hugh Miller, *Attacking the Myth of Predatory Lending*, AMERICAN BANKER, June 15, 1999, at 5A.

³⁶Testimony of Margot Saunders, *supra* note 9.

mortgages to other companies,³⁷ and since the person who receives the mortgage may not be responsible for any wrongdoings of the original holder of the mortgage, the original lender has already seen its profit, even if the property is foreclosed.

Opportunities for predatory lending may arise because of interrelated social and economic trends. One trend is the “urban-flight” phenomenon of many banks, coupled with a disparity in lending among the minority communities. Some banks do not offer loans to homeowners in urban areas because they do not have branches or market in those areas.³⁸ This “credit-vacuum” allows predatory lenders to target urban areas, knowing “that the residents are a captive market with no access to reasonably-priced credit.”³⁹

Borrowers with poor credit may fall prey to predatory lenders because they do not have any experience with ethical lenders, do not know their legal rights, and/or do not know to “shop” for the best loan. In the United States, there are twenty-five million people with little or no credit history, twenty to thirty million more have marred credit reports, and seven million filed for bankruptcy between 1990 and 1997.⁴⁰ These people seek lending alternatives when they are turned down for prime-rate loans and may be targets for predatory practices. Often borrowers cannot understand the complex loan transactions,⁴¹ making them vulnerable to abuse. All these factors create a marketplace that makes it attractive for unscrupulous lenders to prey on unsuspecting and trusting homeowners.⁴²

D. *The (Un)Willing Players in the Predatory Lending Game*

The willing players in the predatory lending game are the few subprime lenders who employ unethical and, at times, illegal techniques. Although the percentage of lenders in the industry that employ predatory lending techniques is unknown, the consensus is that a few rotten apples spoil the whole industry barrel.⁴³ Extant evidence suggests that lenders of all sizes engage in predatory practices, including large multi-state lenders.⁴⁴

³⁷In 1998 FirstPlus Financial Group, Inc., a subprime lender, sold off \$900 million worth of mortgages. *Business Brief*, WALL ST. J., Dec. 31, 1998, available in Westlaw, 1998 WL-WSJ 18997393.

³⁸This effectively means that access to prime loans is diminished for those who may qualify but do not live in the “right” neighborhood. See Frank Lopez’s discussion of reverse redlining in his Note, *Using the Fair Housing Act to Combat Predatory Lending*, 6 GEO. J. ON POVERTY L. & POL’Y 73 (1999).

³⁹Testimony of William J. Brennan, Jr., *supra* note 10.

⁴⁰Goetz, *supra* note 33, at 34.

⁴¹Loan transactions are so complex that many borrowers at both the prime and subprime level do not understand the terms. Lenders should review the loan terms for a full comprehension of the loan.

⁴²Other factors exist that are too numerous to mention in a Note focused on remedy rather than reason.

⁴³Glenn Kalinoski, *Proposed NY Law Creates a Call for Enforcement, Not New Regs*, ORIGINATION NEWS, Nov. 1, 1999, at 43.

⁴⁴See generally Goetz, *supra* note 33, at 33 (his article provides an interesting discussion on the role large financial institutions play in the subprime lending industry).

Mortgage brokers also play a role in predatory lending. A mortgage broker is someone who brings a borrower and lender together to obtain a mortgage loan and renders the settlement services.⁴⁵ The mortgage broker is often the person who solicits the mortgage, processes the loan application, and negotiates the terms of the loan.⁴⁶ He or she may be in charge of all of the loan processes from beginning to end except for the financial backing of the actual loan. In 1988, mortgage brokers secured twenty percent of home loans; these brokers now number more than 100,000 and bring in over fifty percent of home loans.⁴⁷ In many states, mortgage brokers need to be licensed but are not regulated. In North Carolina, for example, cosmetologists have higher licensing standards than do brokers.⁴⁸ This lack of standards creates enforcement problems. Brokers often receive compensation for services they did not perform or payment in amounts that exceed the value of the services they performed.⁴⁹ One controversial payment that brokers often receive is a yield-spread premium. A yield-spread premium is inflated interest on a loan that is used to cover the cost of the broker's fee.⁵⁰ For example, a borrower may qualify for a loan at a 10% annual percentage rate (hereinafter A.P.R.). The broker negotiates the loan at a higher rate of 10.25% and then splits the interest premium with the lender.⁵¹ A broker may then argue that she has no fiduciary duty to the borrower and escape liability to the borrower for any wrongdoing.⁵² Since no federal regulation governing mortgage brokers exists, a broker who gets into trouble in one state can easily set up shop in another state.⁵³

Federal legislation regulating high-cost loans or laws making it illegal for lenders to employ many common predatory lending practices are limited.⁵⁴ The Clinton Administration has made minority homeownership a priority but it has done nothing to

⁴⁵24 C.F.R. § 3500.2 (1998). This section is part of the Real Estate and Settlement Procedures Act.

⁴⁶INTRODUCTION TO PREDATORY LENDING POLICY, *supra* note 3, at 9.

⁴⁷Mary Kane, *The Money Pit: Abuses by Mortgage Brokers Leave Some Homeowners Deeper in Debt*, PLAIN DEALER, Dec. 14, 1998, at 1C.

⁴⁸*Id.* In Ohio, mortgage brokers are licensed under Ohio Revised Code § 1322 but are not highly regulated. Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland, (Jan. 13, 2000).

⁴⁹Kane, *supra* note 47, at 1C.

⁵⁰Wright, *supra* note 14, at 493.

⁵¹*See* INTRODUCTION TO PREDATORY LENDING POLICY, *supra* note 3, at 9.

⁵²*See generally* INTRODUCTION TO PREDATORY LENDING POLICY, *supra* note 3, at 9.

⁵³Wright, *supra* note 14, at 493.

⁵⁴One problem cited by housing advocates are Fair Housing Administration Loans (FHA Loans). These loans are insured against default, so if a borrower defaults, the lender fully recovers. Sabrina Eaton, *Housing Advocates Call for Changes in FHA Loan Terms*, PLAIN DEALER, Oct. 29, 1997, at 5B. This does nothing to curtail the abusive loan practice of lending based on the equity in a house (rather than the borrower's ability to repay). The insurance also adds to the number of abandoned homes in a given neighborhood, thereby decreasing the value of other homes in the neighborhood. *Id.*

curb predatory lending practices.⁵⁵ In fact, North Carolina and New York are the only states that have passed legislation regulating high-cost loans and outlawed common predatory lending techniques.⁵⁶ Georgia, in contrast, allows interest rates on mortgages to reach an A.P.R. of 60% and also allows easy foreclosure of borrower's homes.⁵⁷ Ohio has no law that effectively protects consumers from the most commonly used predatory mortgage lending practices.

Victims of predatory lending tend to be elderly, minorities, and urban homeowners.⁵⁸ The elderly may be the principal targets of predatory lenders because they often own their houses outright or have substantial equity in their homes, may need extensive work that they cannot afford done to their homes, and may have medical debts they need paid.⁵⁹ Fifty-eight percent of elder Americans who are below the federal poverty guidelines own their own home.⁶⁰ Many of these homeowners may not understand the loan transactions or realize that they are victims of fraud.⁶¹

The subprime industry appears to disproportionately target minority groups, presumably because of this group's lessened access to prime rate loans and other services.⁶² The industry argues that they do not target minority neighborhoods, but the application and lending patterns suggest that some lenders do focus on these neighborhoods.⁶³ In a three-year study of lenders in major metropolitan areas of America, researchers discovered that twenty-nine percent of all African-American applications were made to subprime lenders, while eighty-six percent of Caucasian applications were made to prime lenders.⁶⁴ One Ohio consumer advocacy group has likened the trend of abuse to a dump of toxic waste on minority neighborhoods.⁶⁵

⁵⁵Bill Dedman, *Study Discerns Disadvantage for Blacks in Home Mortgages*, N.Y. TIMES, Nov. 14, 1999, at 18.

⁵⁶The 1999 North Carolina bill and its contents are discussed in Part V.

⁵⁷Testimony of William J. Brennan, Jr., *supra* note 10.

⁵⁸This does not mean that most subprime borrowers are elderly or minorities. This just means that the majority of victims fit in this category.

⁵⁹Testimony of William J. Brennan, Jr., *supra* note 10. "The common characteristics of these victims are a need for money (either real or suggested by the lender) combined with a lack of financial sophistication, often exacerbated by diminished mental capacity." *Id.*

⁶⁰Keest, *supra* note 27, at 14.

⁶¹HUDSON, *supra* note 22, at 13.

⁶²Testimony of William J. Brennan, Jr., *supra* note 10. In Chicago, for example, the subprime lending rate increased by 3,000% in African-American neighborhoods versus a 150% increase in Caucasian neighborhoods. Gwendolyn Glenn, *Subprime Lending Concentrated in Chicago's Minority Areas*, REAL ESTATE FINANCE TODAY, Dec. 3, 1999, at 15.

⁶³Glenn, *supra* note 62, at 15.

⁶⁴Mark Anderson, *Subprime Lending to Minority Groups Rises, Study Finds*, WALL ST. J., Nov. 25, 1998, at B11-A. Although this data is only suggestive of marketing techniques that effectively target minorities, I was unable to locate any data that refuted a correlation between subprime market targeting and the number of loans actually made to minorities.

⁶⁵Quote taken from conversation with Metropolitan Strategy Group.

III. FEDERAL REMEDIES: LIMITED RELIEF FOR CONSUMERS

The federal government offers few protections for victims of predatory lending practices. No federal law exists that regulates mortgage brokers. Likewise, no federal law exists that makes it explicitly illegal to “flip,” “strip,” or “pack” high-cost mortgage loans. The federal laws that do exist are complicated to understand and litigate, and many contain loopholes or provisions that allow certain types of predatory practices to continue unabated. This section will focus on the current status of the federal laws that offer relief to victims of predatory lending practices.

A. *The Truth in Lending Act and Home Ownership Equity Protection Act*

Many “predatory lending” cases brought in federal court allege violations of the Truth In Lending Act (hereinafter TILA) or the Home Ownership and Equity Protection Act (hereinafter HOEPA).

Congress enacted the TILA in 1968 to stabilize the economy by increasing the informed use of credit, strengthening competition among lenders, enabling consumers to shop for the most favorable credit terms, and protecting consumers from inaccurate and unfair billing.⁶⁶ TILA requires that creditors in certain transactions make disclosures that include the amount financed, the number and amount of payments, the A.P.R., the due dates of payments, etc.⁶⁷

Congress, recognizing the need for protection of mortgage loans, enacted the HOEPA in 1994.⁶⁸ HOEPA specifically regulates high-cost, closed-end loans, or closed-end loans with excessive costs and fees by setting guidelines for lenders.⁶⁹ Many thought that HOEPA would reduce the astronomical growth of the subprime lending industry and protect consumers from predatory lending practices.⁷⁰ Advocates complain that HOEPA has done little to curb predatory lending practices and offers little relief for victims of lending abuses.

1. Little “True” Help in the Truth In Lending Act

TILA is a statute that courts construe liberally in favor of consumers.⁷¹ TILA is a strict liability statute, which means that a court will not consider the lender’s intent, only whether the lender violated the Act.⁷² This is helpful for litigation purposes because it may be difficult to prove that a lender willfully violated TILA. TILA is purely a disclosure statute and therefore does not regulate the structure of loans. For

⁶⁶See 15 U.S.C.A. § 1601(a) (West 1999).

⁶⁷See 15 U.S.C.A. §§ 1631(a)-(b), 1638(a) (West 1999).

⁶⁸Home Ownership and Equity Protection Act of 1994, Subtitle B of Title I of the Reigle Community Development and Regulatory Improvement Act, Pub. L. No. 103-325 (Sept. 23, 1994).

⁶⁹TRUTH IN LENDING 503 (Kathleen E. Keest & Gary Klein eds., 3rd ed. 1995).

⁷⁰*Id.*

⁷¹Turner v. E-Z Check Cashing of Cookeville, TN, Inc., 35 F. Supp. 2d 1042, 1047 (M.D. Tenn, 1999).

⁷²Newton v. United Companies Financial Corp., 24 F. Supp. 2d 444, 451 (E.D. Pa. 1998).

example, TILA does not place any caps on the interest rates or discount points the mortgage lender is allowed to charge the borrower.⁷³

If a lender violates TILA by not disclosing required information, the penalty for this violation is twice the amount of the finance charge.⁷⁴ If the lender violates TILA more than once, the borrower is entitled to damages for the initial offense and every subsequent violation of the Act.⁷⁵ The damage awards are cumulative and each award is capped at \$1,000.⁷⁶

The other relief TILA offers is rescission. TILA allows for rescission of the offending loan for up to three years if the borrower can prove material violations.⁷⁷ In this case, a borrower is no longer liable for the loan,⁷⁸ but is required to return the proceeds of the loan.⁷⁹ A successful litigant may also be awarded attorneys' fees and costs under TILA.⁸⁰

TILA does not provide adequate relief as illustrated by the story of Verna Emery.⁸¹ Ms. Emery refinanced an existing loan to receive \$200 cash.⁸² The loan ended up costing her three times as much as a new loan would have cost.⁸³ The court calculated the A.P.R. on the loan as above 110%.⁸⁴ The lender was not required by the Truth in Lending Act to disclose the A.P.R. on the TILA form because the Act does not cover refinancing.⁸⁵ The presiding judge commented "so much for the Truth in Lending Act as a protection for borrowers."⁸⁶

⁷³United Companies Lending v. McGehee, 686 So. 2d 1171 (Ala. 1996).

⁷⁴15 U.S.C. § 1640(a)(2).

⁷⁵Shepard v. Quality Siding & Window Factory, Inc., 730 F. Supp. 1295 (D. Del. 1990). The court awarded the plaintiff damages for the initial TILA disclosure violation and also damages for the lender's subsequent violation of TILA because they did not accept a valid rescission of the loan. *Id.* at 1308.

⁷⁶*Newton*, 24 F. Supp. 2d at 451. The court here is referring to the relief available under HOEPA. A \$2,000 cap may seem small but it is a \$1,000 increase over prior TILA relief. The Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29 § 6 (Sept. 30, 1995).

⁷⁷15 U.S.C. § 1635 (2000).

⁷⁸*See Shepard*, 730 F. Supp. at 1295.

⁷⁹Subsequent problems and foreclosure actions often arise because the borrower no longer has the loan proceeds and cannot afford to pay back what she owes the offending lender.

⁸⁰Carolyn L. Carter & Richard K. Schwartz (rev.), in *OHIO CONSUMER LAW 537* (Harold L. Williams ed., 1999).

⁸¹*Emery v. American General Finance*, 71 F.3d 1343, 1346 (7th Cir. 1995).

⁸²*Id.*

⁸³*Id.*

⁸⁴*Id.*

⁸⁵*Id.* This problem also arises under state mortgage loan statutes (including Ohio's) that treat the refinancing of a loan as a first-lien on property and do not cover those first-lien loans.

⁸⁶*Emery*, 71 F.3d at 1346. Many unscrupulous lenders also use TILA forms to "pack" loans and hide complex terms. The TILA disclosures are also inadequate to inform consumers

Another criticism of the Truth In Lending Act is that Congress designed it for those consumers who are more likely to shop around and receive the best rate on a mortgage loan. Following that logic, it may be said that those who probably most benefit from TILA are prime-rate borrowers. Unfortunately many victims of predatory lending do not shop around simply because prime-rate lending options do not exist in the areas where these borrowers live.⁸⁷ Subprime borrowers may also be less-educated, have language barriers, and/or not understand the complicated TILA disclosures.⁸⁸ These borrowers may not know that they have a right to rescind and, once a TILA defense is used in a foreclosure or bankruptcy case, it may be too late to rescind the mortgage loan.

Perhaps the largest obstacle that TILA presents is its limited remedies. One thousand dollars for each violation plus attorney's fees and costs may not be a large enough incentive for borrowers to bring suit or for lawyers to accept their claims. The combination of limited relief and complicated law deters litigation. Moreover, while rescission may sound like a quick and effective remedy, the borrower may not have the funds to repay what was received on the loan. Another obstacle to relief is the requirement that the borrower has only one year from the date of the TILA violation to sue.⁸⁹ This short time period renders TILA less effective as many TILA violations are not noticed until the borrower has filed bankruptcy or is in court defending against a foreclosure.

2. Is there Hope for HOEPA?

The Federal Trade Commission (FTC) recently settled with six subprime lenders for violations of HOEPA in the amount of \$572,500.⁹⁰ These lenders allegedly engaged in unlawful practices of charging prepayment penalties and balloon payments.⁹¹ One lender allegedly charged a borrower 122% in interest, and four lenders allegedly engaged in a "pattern or practice" of lending money to borrowers they knew could not satisfy the loan.⁹²

Congress enacted HOEPA as a part of TILA in 1994, specifically in response to the growing national concern about predatory lending practices.⁹³ HOEPA's

about complex loan terms and overcome other fraud. TRUTH IN LENDING 505 (Kathleen E. Keest & Gary Klein eds., 3rd ed. 1995).

⁸⁷See Lopez, *supra* note 38, at 84-85.

⁸⁸*Id.*

⁸⁹15 U.S.C. § 1640. In Ohio, that time is tolled from the day the borrower discovers or should have discovered the fraud or nondisclosure. *Hamilton v. Ohio Sav. Bank*, 637 N.E.2d 887 (Ohio 1994).

⁹⁰Brian Collins, *FTC Catches Seven Abusive B&C Lenders*, NATIONAL MORTGAGE NEWS, Aug. 2, 1999, at 2.

⁹¹*Id.*

⁹²*Id.*

⁹³TRUTH IN LENDING 503 (Kathleen E. Keest & Gary Klein eds., 3rd ed. 1995).

protections are triggered by a closed-end⁹⁴ residential mortgage loan with an A.P.R. exceeding ten percent above treasury rates or points and fees above eight percent of the total loan.⁹⁵ HOEPA limits prepayment penalties and prohibits balloon payments on short-term loans, negative amortization, more than two periodic payments prepaid from the proceeds, and higher rates after default.⁹⁶ A lender is also prohibited from engaging in a pattern or practice of making HOEPA loans based on the equity in a house, as opposed to the homeowner's ability to pay the loan.⁹⁷

HOEPA extends the available remedies granted by offering greater relief to victims and provides greater deterrence to predatory mortgage lenders.⁹⁸ HOEPA's relief includes actual damages, statutory damages (capped at \$2,000 for every violation), costs associated with litigation, and attorneys' fees.⁹⁹ There are also enhanced remedies for material violations of HOEPA and the burden is on the lender to prove that its violations are not material.¹⁰⁰ The opportunity for rescission under HOEPA supplements what was originally allowed under TILA. Rescission is allowed for the failure to make required HOEPA disclosures or for the "inclusion of prohibited terms" such as balloon payments or negative amortization.¹⁰¹

Although HOEPA was designed to increase the remedies available under TILA, practitioners have had difficulty bringing lawsuits using HOEPA. Unscrupulous lenders configure loans to fall just below the A.P.R. or "points and fees trigger."¹⁰² Then lenders "flip" the loans so they can still profit from the loan.¹⁰³ HOEPA also does not cover open-ended loans (unlike TILA). Predatory lenders may convert a closed-end loan into an open-ended line of credit to escape HOEPA's regulations.¹⁰⁴

⁹⁴A closed-end loan is a loan with fixed payments and a fixed term. Jean Constantine-Davis, *Hoeping for Better Days: The Home Ownership and Equity Protection Act of 1994*, PRACTISING LAW INSTITUTE, Apr.-May 1999, at 247.

⁹⁵15 U.S.C. § 1602(aa) (Points and fees are: 1) all the items included in the finance charge for the loan besides interest and time-price differential; 2) all compensation paid to mortgage brokers; and 3) real estate charges other than escrow charges for future payment of taxes). 15 U.S.C. §§ 1602 (aa)(4)(A)-(C). Points and fees are often very difficult to figure out and add to the difficulty of figuring out whether a certain loan triggers HOEPA. Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland (Jan. 13, 2000).

⁹⁶See 15 U.S.C. § 1639(c)-(g) (2000). See also Constantine-Davis, *supra* note 94, at 251.

⁹⁷15 U.S.C. § 1639(h) (2000). Constantine-Davis, *supra* note 94, at 251.

⁹⁸*Id.*

⁹⁹15 U.S.C. § 1640(a)(4).

¹⁰⁰*Id.*

¹⁰¹Constantine-Davis, *supra* note 94, at 262.

¹⁰²Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland (Jan. 13, 2000). The New York Banking Department finds the federal levels under HOEPA ineffective. Proposed New Part 41, New York Banking Regulations, Regulatory Impact Statement, ¶ 3 (proposed 12/29/99).

¹⁰³See *The Case Against Predatory Lending*, at <http://www.cra-nc.org> (last visited Jan. 20, 2000).

¹⁰⁴TRUTH IN LENDING, *supra* note 93. Open-ended loans are loans where the creditor contemplates repeated transactions, the loan prescribes the terms of such transactions, and the

HOEPA is the only express federal regulation of predatory lending practices. Fair housing advocates argue that HOEPA needs revision. The fee thresholds are high and the “points and fees” triggers are difficult to understand. Advocates press for reform saying Congress should expand HOEPA to: prohibit balloon payments on all loans; decrease the triggering A.P.R. and “points and fees” rate; regulate mortgage brokers; prohibit mandatory arbitration clauses; prohibit prepayment penalties; regulate “flipping” by limiting the frequency with which a loan may be refinanced; and include open-end credit under the Act’s provisions.¹⁰⁵

Consumer advocates argue that HOEPA’s current regulation of balloon payments is inadequate. The prohibition on balloon payments should not be limited to short-term loans but also to regular long-term mortgage loans. They contend that the A.P.R. and “points and fees” rate should be decreased to make it more difficult for the unscrupulous lender to slide in under the threshold amount. The practice of “flipping” should be regulated so loans that are refinanced are done so for the legitimate purpose of helping borrowers lower their periodic payments.

Congress is aware of the problem of mortgage brokers. This concern is evinced by the inclusion of the compensation paid to mortgage brokers into the “points and fees” provision.¹⁰⁶ The provisions do not require, however, that lenders unambiguously disclose to borrowers the amount mortgage brokers will receive for their work nor do they outlaw kickbacks. Revisions should be made to HOEPA to effectuate Congress’ original intent to legislate against predatory lending practices.

HOEPA requires that a complainant seeking relief prove that the lender engaged in a “pattern and practice” of discrimination. “Pattern and practice” has been interpreted to mean that HOEPA prohibits “wide-ranging and institutionalized practices of a lender in making loans as a matter of course without considering repayment ability and based only on the collateral value of the property.”¹⁰⁷ An individual consumer seeking relief has to show enough evidence of a lender’s practices to meet that high threshold. This includes finding other borrowers who experienced the same situation. This requirement is cost and time prohibitive for many consumers and litigators. In 1998, the Federal Reserve Board and the Department of Housing and Urban Development (hereinafter HUD) recommended that Congress consider eliminating the “pattern and practice” language from HOEPA so that individual consumers may have a remedy based on their own loan.¹⁰⁸ Until then, a borrower bringing suit will have to meet the “pattern and practice” evidence requirement. If Congress expands HOEPA, the Act has the potential to become nationwide consumer protection.

loan has a finance charge that may be computed on the outstanding unpaid balance. 15 U.S.C. § 1602(i). Examples include credit cards and lines of credit from banks for home improvements.

¹⁰⁵*The Case Against Predatory Lending*, *supra* note 103. In 2000, the New York State Banking Department passed regulations that include the regulation of high-cost open-ended loans to “prevent the abusive practices of structuring the loan as open-ended to avoid compliance with this regulation.” Proposed New Part 41, New York Banking Regulations, Regulatory Impact Statement, ¶ 3 (proposed 12/29/99).

¹⁰⁶15 U.S.C. § 1602(aa)(4) (2000).

¹⁰⁷*Newton*, 24 F. Supp. 2d at 456.

¹⁰⁸*Id.*

B. Real Estate Settlement Procedures Act

Congress passed the Real Estate Settlement Procedures Act (hereinafter RESPA) in 1974 to protect consumers by regulating unnecessary settlement fees.¹⁰⁹ RESPA covers most purchase loans, refinances, home improvement loans, and open lines of credit.¹¹⁰ In part, RESPA requires that lenders provide borrowers with a “good faith estimate” of settlement costs and a statement regarding whether the lender plans on transferring the loan to another finance company.¹¹¹ Section eight of RESPA prohibits “kickbacks” or “fee-splitting.”¹¹² These practices are usually attributed to mortgage brokers. Kickbacks are monies given to mortgage brokers in exchange for referring a customer to a lender. The kickbacks are sometimes hidden in the amount of the loan. For example, a lender will tell a mortgage broker that it will lend at a rate of 13%. The broker will then tell the customer that the loan’s interest rate is 13.25%. That extra amount is a “kickback.” The mortgage broker and lender may also engage in “fee-splitting” and share the extra .25%. RESPA allows for treble damages if a person is convicted for a violation of section eight.¹¹³ A borrower seeking relief from a section eight violation of RESPA has one year to file a complaint with HUD.¹¹⁴

Similar to TILA, RESPA does not place any caps on the amount of interest a lender is allowed to charge.¹¹⁵ Another potential problem is that if a lender’s offices are not approved by HUD, the lender is not regulated by HUD.¹¹⁶ This means that some lenders may not be subject to RESPA’s provisions. In addition, advocates complain that HUD is not strictly enforcing RESPA, allowing lenders and brokers to escape punishment.¹¹⁷ There is no private remedy if a lender fails to provide the borrower with the estimate of settlement costs.

It is unclear whether section eight of RESPA prohibits yield-spread premiums. The Eleventh Circuit held that a broker’s fee was not an allowable part of the market price paid by the borrower for the loan.¹¹⁸ Congress has stated, however, that it never intended for payments to mortgage brokers for rendered services to violate

¹⁰⁹RESPA: *More About RESPA*, <http://www.hud.gov> (last modified Dec. 4, 1996). RESPA is located at 12 U.S.C.A. § 2601 to 12 U.S.C.A. § 2617 (2000).

¹¹⁰RESPA: *More About RESPA*, <http://www.hud.gov> (last modified Dec. 4, 1996).

¹¹¹*Id.* Interestingly, no explicit penalty exists if the lender does not provide the consumer with this information. *Id.*

¹¹²*Id.*

¹¹³*Id.* The maximum criminal penalties are a \$10,000 fine and one year in prison. RESPA: *More About RESPA*, <http://www.hud.gov> (last modified Dec. 4, 1996).

¹¹⁴RESPA: *More About RESPA*, <http://www.hud.gov> (last modified Dec. 4, 1996). RESPA’s statute of limitations is not subject to tolling. *Wright, supra* note 14, 494.

¹¹⁵*McGehee*, 686 So. 2d at 1177.

¹¹⁶*Id.*

¹¹⁷INTRODUCTION TO PREDATORY LENDING POLICY, *supra* note 3, at 9.

¹¹⁸*Culpepper v. Inland Mortgage Company*, 132 F.3d 692 (11th Cir. 1998). The holding is narrow and probably only applies to the facts of the instant case.

RESPA.¹¹⁹ In the meantime, however, yield-spread premiums remain common in mortgage lending¹²⁰ and probably will flourish until courts decide whether RESPA prohibits the fee.

C. Racketeering Influenced and Corrupt Organizations Act

Litigators, looking for tools to combat predatory lenders, are beginning to employ what is commonly known as the “Mafia Act,” the Racketeering Influenced and Corrupt Organizations Act (hereinafter RICO). Congress passed RICO to combat organized criminal activity by providing for a civil cause of action for people whose property or business was harmed by criminal activity.¹²¹ To state a claim under RICO, a complainant must prove that the accused committed at least two acts of racketeering within a ten-year period and that those acts were committed by an enterprise through a pattern of racketeering.¹²² Racketeering activity is defined as “conduct which violates any of the enumerated state and federal statutes, including . . . mail fraud, wire fraud and extortion.”¹²³

Causes of action under RICO for predatory lending practices have proven difficult to win. Similar to HOEPA, plaintiffs must establish that the lender engaged in a “pattern” of activity. In *Emery v. American General Finance*, the plaintiff alleged that her lender’s practice of “flipping” her loan violated RICO.¹²⁴ The court held that the plaintiff failed to allege a RICO violation because RICO is meant for worse actions than fraudulent behavior.¹²⁵ The court also noted that the plaintiff’s failure to show specific enough evidence of misleading transactions involving other customers amounted to a failure to allege a pattern of racketeering activity.¹²⁶

In contrast, in *National Bank & Trust Co. v. Haroco, Inc.* the court held that the defendant violated RICO by charging a rate higher than prime, after contracting to charge the prime rate.¹²⁷ Although this is not specifically a case of predatory lending against individual consumers, it does demonstrate an area where RICO has been used to combat the practices of unscrupulous lenders. RICO may be a good vehicle for relief because it affords successful complainants the opportunity to collect treble

¹¹⁹H.R. Conf. Rep. No. 105-769, at 572 (1998) *also available at* 1998 WL 691055 (1998).

¹²⁰Alvin C. Harrell, *Subprime Lending Developments with Implications for Creditors and Consumers*, 52 CONSUMER FIN. L.Q. REP. 238, 244 (1988). Although the mortgage broker must disclose any yield-spread premium, the disclosure is not required to be easily understood. In one instance a yield-spread premium was marked on a borrower’s loan forms by a “ysppoc” and the amount was identical to the broker fee already paid to the broker. Mary Kane, *Mortgage Brokers Face Lawsuits*, PLAIN DEALER, Dec. 14, 1998, at 1C. The borrower thought the amount was a restatement of the broker’s fee, not an additional charge. *Id.*

¹²¹*Emery*, 71 F.3d at 1349 (Coffey, J., dissenting). RICO is located at 18 U.S.C. § 1961 (2000) et seq.

¹²²*Emery*, 71 F.3d at 1349 (Coffey, J., dissenting).

¹²³18 U.S.C.A. § 1961(1).

¹²⁴938 F. Supp. 495, 496 (N.D. Ill. 1996).

¹²⁵*Id.* at 499.

¹²⁶*Id.*

¹²⁷473 U.S. 606 (1985), *aff’g* 747 F.2d 384 (7th Cir. 1984).

damages, costs and attorneys' fees.¹²⁸ The difficulty of establishing a pattern of racketeering activity, however, may be enough to keep most litigators away.

The previous list of relief provided by federal laws is not exhaustive.¹²⁹ TILA with HOEPA, RESPA, and RICO are a sample of commonly used federal remedies. Advocates insist that more needs to be done to protect consumers nationwide and that regulation of an industry with little noticeable success in self-regulation is necessary to protect vulnerable consumers.

IV. REMEDIES IN OHIO: CAVEAT EMPTOR

In 1998, the Ohio Supreme Court affirmed a judgment that consisted of \$15,000 in compensatory damages, \$56,230 in attorney's fees, and \$1.5 million in punitive damages to a victim of predatory mortgage lending.¹³⁰ Salesman Christopher Blair convinced Mildred Williams, an elderly homeowner, to take out a series of loans from Aetna Finance Company to make improvements on her mortgage-free home and use the home as security for the loans.¹³¹ Aetna applied the balance of each previous loan to each new loan, thereby generating loan fees for themselves and funds for Blair to complete additional home repairs.¹³² Williams stopped paying on the loans because the contracted work was not being done.¹³³ Williams alleged violations of Ohio's Home Solicitation Sales Act, Consumer Sales Practices Act, civil conspiracy, and breach of contract.¹³⁴ The award was based on the finding of a conspiracy between Aetna and Blair.¹³⁵

Because federal remedies are somewhat limited, it is necessary to look to the states to see if relief is available on the state level. In Ohio, however, the remedies are also limited, so Ohio attorneys must often rely on federal remedies. The two most extensive Ohio statutes regulating mortgage loans are the Mortgage Loan Act and the Consumer Sales Practices Act.

A. *The Mortgage Loan Act: Limited Protection for Consumers*

At first glance the Mortgage Loan Act (hereinafter MLA) seems to be the solution for protecting borrowers from predatory mortgage lending practices. The

¹²⁸*Emery*, 71 F.3d at 1349 (Coffey, J., dissenting).

¹²⁹The Community Reinvestment Act (CRA) was originally enacted to allow community groups to hold their neighborhood banks accountable for lending to minorities. In 1999, Congress substantially reduced the power of the CRA. Richard A. Oppel, Jr., *Big Gains By Gramm in Diluting Lending Act*, N.Y. TIMES, Oct. 23, 1999, at C4. Fair housing advocates complain that the revamped Act does little to punish banks that fail to maintain satisfactory community lending ratings. *Id.* The CRA was once hailed as new way to regulate covered lenders but advocates now worry that it will not have a substantial effect on lending practices. *Id.*

¹³⁰*Williams*, 700 N.E.2d at 861.

¹³¹*Id.* at 861-62.

¹³²*Financing: Home Equity Loan Fraud*, REAL EST. L. REP., June 1999, at 1.

¹³³*Williams*, 700 N.E.2d at 862.

¹³⁴*Id.*

¹³⁵*Id.* at 870.

MLA regulates loans made by finance companies for over \$5,000 or for any amount secured by real estate. The MLA limits loan origination fees, interest rates (capped at 21%- 25%), points and fees, default charges, and insurance products.¹³⁶

Relief available under the MLA was significantly modified when the Ohio General Assembly passed Senate Bill 189 in June 1996.¹³⁷ Previous to Senate Bill 189, the MLA allowed successful plaintiffs to recover twice the interest and all other charges contracted for in the loan, plus all interest charges in excess of the allowed maximum rate.¹³⁸ Since a June 1996 amendment, the remedy is limited to the amount of interest paid by the borrower.¹³⁹ The amendment is looked upon as a victory for the loan industry in Ohio. Since the remedy is limited to the amount of interest paid by the borrower, the lender will not lose any of the principal.¹⁴⁰ The deterrent effect of the MLA is negligible since “only the loss of profits is risked for charging and collecting illegal amounts” from borrowers.¹⁴¹ The borrower is still required to pay future interest on the loan because the MLA does not provide for rescission. Borrowers who default quickly on their loans receive very little under the MLA and borrowers who have paid a substantial amount of the loan are less likely to seek legal assistance.¹⁴² This, coupled with the requirement (for violation of certain sections of the MLA) that the lender acted “willfully,”¹⁴³ leaves little relief for the Ohio borrower under the MLA.

Federal law preempts many state laws which put a cap on interest rates,¹⁴⁴ including Ohio’s MLA. Unscrupulous lenders may try to skirt the MLA’s regulations by refinancing an original loan. A loan that refinances the total amount of the original mortgage into a new loan results in a first lien on the property. The MLA may cover a first mortgage, but evidence exists that “federal preemption remove a particular lender in whole or part from MLA usury regulation.”¹⁴⁵ Lenders either target those homeowners who have paid off their mortgages, refinance first mortgages with home repair loans,¹⁴⁶ or completely refinance the existing mortgage so it becomes a first lien on the property. These lenders are then able to avoid both

¹³⁶See Wright, *supra* note 14, at 433-51.

¹³⁷*Id.* at 481.

¹³⁸*Id.*

¹³⁹*Id.*

¹⁴⁰*Id.* at 481-82.

¹⁴¹Wright, *supra* note 14, at 482.

¹⁴²*Id.* at 481.

¹⁴³*Id.* at 483. “Willful” is not defined in the MLA. An Ohio court held that the inclusion of MLA prohibited language in boilerplate language of a contract does not necessarily equal willfulness. *Leacock v. Household Realty Corp.*, 1992 WL 1216123 (9th Dist. Ct. App., 1992), *citing* *ITT Fin. Servs. v. Martin*, No. 89-1470 (C.P., Montgomery Dec. 22, 1989).

¹⁴⁴Forrester, *supra* note 2, at 398.

¹⁴⁵Wright, *supra* note 14, at 436.

¹⁴⁶*Id.* at 464.

the supervision of the MLA licensing requirements and liability under the MLA.¹⁴⁷ For those loans that are secured by first liens on a borrower's property, lenders may rely on 12 U.S.C.A. § 1735f-7a (Depository Institutions Deregulation and Monetary Control Act of 1980) to preempt the MLA's and Ohio's limits on "the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved."¹⁴⁸ Because of this pre-emption, virtually no state regulation of first-lien loans exists.

Although mortgage brokers were previously subject to the MLA, amendments to the Ohio Revised Code in 1996 excluded mortgage brokers from MLA licensing.¹⁴⁹ Now mortgage brokers' only obligation is to register under a different section of the Code (section 1322) and they are exempt from MLA regulations. The Mortgage Brokers' Act (section 1322 of the Ohio Revised Code) does not limit brokers' fees.¹⁵⁰ In addition, because federal law may preempt state law, and no federal law explicitly regulates mortgage brokers, little regulation of brokers exists.

B. Consumer Sales Practices Act

Most states have some type of regulation governing unfair and deceptive acts and practices (hereinafter UDAP) to protect consumers from unscrupulous sales practices. In some states these acts cover predatory practices. In Pennsylvania, the UDAP prohibits "stripping" and allows for triple the amount of equity stripped.¹⁵¹ In New Hampshire, "packing" is a UDAP violation.¹⁵² This is not the case in Ohio. In Ohio, financial institutions are exempt from the Consumer Sales and Practices Act—Ohio's UDAP (hereinafter CSPA). In addition, real property transactions in Ohio are exempt from CSPA,¹⁵³ which means that mortgage loans are not covered. Just the same, CSPA does afford some relief to victims of predatory lending.

¹⁴⁷*Id.*

¹⁴⁸*Id.* at 464-65 (citing 12 U.S.C.A. § 1735f-7a).

¹⁴⁹Wright, *supra* note 14, at 436. See OHIO REV. CODE ANN. § 1321.52(A)(1)(b) (West 2000).

¹⁵⁰See OHIO REV. CODE ANN. §§ 1322.01-.99 (West 1994).

¹⁵¹*In re Bryant*, 111 B.R. 474 (Bankr. E.D. Pa 1990) (holding that a real estate agent violated the state's UDAP when he persuaded a homeowner facing foreclosure to sell her home to him, rent it from him, and eventually repurchase it; the agent failed to return most of the proceeds of the house sale to the homeowner). This case demonstrates another predatory lending practice. A homeowner facing foreclosure or bankruptcy sells her house to a real estate "agent" thinking the agent will allow her to repurchase the house, and then the agent absconds with the sale proceeds.

¹⁵²*Therrien v. Resource Fin. Group, Inc.*, 704 F. Supp. 322 (D.N.H. 1989) (a lender restructuring a loan so the size of the loan is increased by double charging loan fees, adding title insurance, and padding the loan with an escrow payment account violated the New Hampshire Consumer Protection Act).

¹⁵³The CSPA is a valuable litigation tool against some predatory lending practices, such as home improvement scams. This Note is concerned only with loans secured by real property.

Ohio originally passed CSPA in 1972 to protect consumers from deceptive, unfair, or unconscionable acts and practices.¹⁵⁴ CSPA applies to suppliers' practices in a consumer transaction and prohibits many acts including: representation of a used product as a new product,¹⁵⁵ phony special offers,¹⁵⁶ misrepresentation on the need for repairs,¹⁵⁷ pyramid schemes,¹⁵⁸ excessive prices,¹⁵⁹ and taking advantage of consumers.¹⁶⁰ CSPA's comprehensive coverage also includes the incorporation of other statutes (e.g. TILA, RESPA) into CSPA, allowing for enhanced remedies.¹⁶¹ For example, a violation of Ohio's Home Solicitation Sales Act is also a violation of CSPA and allows for cumulative relief under both acts.¹⁶²

A successful complainant in a CSPA suit has the right to select the remedy that suits best.¹⁶³ CSPA allows for relief by either rescission or damages.¹⁶⁴ If the borrower elects rescission, the borrower is eligible for the return of the dollar amount paid under the contract.¹⁶⁵ Possible relief for an injured party includes actual damages,¹⁶⁶ statutory and treble damages,¹⁶⁷ declaratory judgments or injunctions,¹⁶⁸ and attorney's fees.¹⁶⁹

As mentioned, CSPA does *not* cover transactions involving the transfer of real property.¹⁷⁰ CSPA does cover mixed transactions "involving both the transfer of personal property or services and the transfer of land."¹⁷¹ For instance, CSPA covers

¹⁵⁴OHIO REV. CODE ANN. §§ 1345.01 et seq. (West 1994); 1972 H.B. 103, eff. 7-14-72; Gail White, *Consumer Sales Practice Act*, in OHIO CONSUMER LAW 85 (Harold L. Williams ed., 1999).

¹⁵⁵OHIO REV. CODE ANN. § 1345.02(B)(3) (West 1994).

¹⁵⁶OHIO REV. CODE ANN. § 1345.02(B)(4) (West 1994).

¹⁵⁷OHIO REV. CODE ANN. § 1345.02(B)(7) (West 1994).

¹⁵⁸OHIO REV. CODE ANN. § 1321.02(D) (West 1994).

¹⁵⁹OHIO REV. CODE ANN. § 1345.03(B)(2) (West 1994).

¹⁶⁰OHIO REV. CODE ANN. § 1321.52(B)(1) (West 1994).

¹⁶¹White, *supra* note 154, at 85.

¹⁶²*Id.* Ohio courts differ on whether a violation of TILA is a per se violation of CSPA. *Id.* at 87.

¹⁶³*Id.* at 96.

¹⁶⁴OHIO REV. CODE ANN. § 1345.09(A) (West 1994). The discussion of remedies is purposefully brief since most victims of predatory mortgages in Ohio will not be able to assert the CSPA as either a cause of action or a defense.

¹⁶⁵White, *supra* note 154, at 97.

¹⁶⁶OHIO REV. CODE ANN. § 1345.09(A) (West 1994).

¹⁶⁷OHIO REV. CODE ANN. § 1345.09(B) (West 1994).

¹⁶⁸OHIO REV. CODE ANN. § 1345.09(D) (West 1994).

¹⁶⁹OHIO REV. CODE ANN. § 1345.09(F) (West 1994).

¹⁷⁰White, *supra* note 154, at 56.

¹⁷¹*Id.*

the sale or refinancing of a homeowner's property if the transaction also involves the sale of home improvement services. This application is limited, however, because CSPA precludes financial institutions from liability. If a homeowner refinances her home with any financial institution, even if it is a mixed transaction, that lender is exempt from the CSPA. This exemption renders the CSPA ineffective in providing protection for consumers from most predatory mortgage lending practices.

In some cases, a consumer may be able to recover under CSPA by incorporating the theory of derivative liability. A financial institution may be liable for the acts of a supplier if the institution finances the supplier's transactions.¹⁷² A lender may be liable for the CSPA violations of an unscrupulous mortgage broker. The borrower, however, may only be able to recover limited damages. In *Hardeman v. Wheels, Inc.*, Ohio courts found a lender liable but did not award the maximum CSPA remedies—treble damages, punitive damages, and attorneys' fees.¹⁷³ In *Williams*, the borrower was able to claim CSPA damages under a theory of derivative liability. The court found that the lender, Aetna, was liable for the actions of the mortgage broker who solicited the loan from Williams.¹⁷⁴ The court found Aetna accountable as a holder of a consumer credit contract rather than as a financial institution.¹⁷⁵ The court argued that Aetna's liability extended to the actual damages suffered by Williams but did not decide Aetna's liability for punitive damages under the CSPA.¹⁷⁶

A borrower may also have a cause of action under the CSPA if the lender does not have an office in Ohio.¹⁷⁷ So if a non-Ohio company that does not have offices located in Ohio solicits a homeowner and commits a violation, the homeowner may claim damages under the CSPA.¹⁷⁸

V. REMEDIES IN OTHER STATES

States have taken several measures to address predatory lending practices. While North Carolina and New York are the only states to enact wide-ranging regulations to combat predatory lending, other states have introduced legislation. Many states have realized what advocates say the Ohio legislature has not, or will not, recognize. That is, predatory mortgage lending is a growing epidemic and the way to best combat the abuse is through regulation.

A. North Carolina: *The Nation's First Bill Regulating High-Cost Home Loans*

In Orange County, North Carolina, it is relatively easy to get a good home loan, unless you are African-American. Income disparity is not the reason why African-Americans in the county are turned down for home loans at a rate 3.4 times higher

¹⁷²*Id.* at 58.

¹⁷³565 N.E.2d 849, 850 (Warren 1988), *cert. denied*, 493 U.S. 848 (1989).

¹⁷⁴700 N.E.2d at 868.

¹⁷⁵*Id.* at 869.

¹⁷⁶*Id.* at 870. The Ohio Supreme Court affirmed that Aetna was liable for punitive damages under the theory of civil conspiracy. *Id.*

¹⁷⁷Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland (Jan. 13, 2000).

¹⁷⁸Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland (Jan. 13, 2000).

than Caucasian applicants.¹⁷⁹ In 1997, African-American borrowers earning 120 percent or more of the median income in the area were turned down at a rate 5.6 times higher than their Caucasian counterparts.¹⁸⁰ Fair housing advocates believe that these numbers reflect that prime-rate lenders do not market to minorities thereby forcing them to turn to alternative lenders.

In 1997, subprime lenders made more than \$3 billion in loans in North Carolina.¹⁸¹ More than half of these subprime borrowers experienced some form of predatory lending.¹⁸²

In response to the concern that predatory lending practices were a growing problem, North Carolina became the first (and so far only) state to specifically regulate high-cost loans. On July 22, 1999, the General Assembly of North Carolina passed Senate Bill 1149 (hereinafter H.R. 1149).¹⁸³ The purpose of H.R. 1149 is to “modify permissible fees which may be charged in connection with home loans secured by a first mortgage or first deed of trust, to impose restrictions and limitations on high-cost home loans, to revise the permissible fees and charges on certain loans, to prohibit unfair or deceptive practices by mortgage brokers or lenders, and to provide for public education and counseling about predatory lenders.”¹⁸⁴ The Act prohibits the following: 1) lending without home-ownership counseling; 2) lending without regard to the borrower’s ability to repay; 3) financing of points and fees into the loan; and 4) benefiting from refinancing existing high-cost home loans.¹⁸⁵ All borrowers must receive counseling that informs them about the loan and whether the loan is the best available for the borrower.¹⁸⁶ Lenders in North Carolina are required to look at a borrower’s ability to repay the loan and are no longer able to charge points and fees to refinance an existing high-cost home loan into a new high-cost home loan. The Act also limits high-cost home loans by prohibiting nearly all forms of balloon payments.¹⁸⁷ The Act prohibits negative amortization, increased interest rates, advance payments, deferral fees,¹⁸⁸ other charges payable to third parties (“packing”),¹⁸⁹ and the practice of “flipping.”¹⁹⁰ The

¹⁷⁹David Schulman, *Home Loans Show Bias*, CHAPEL HILL NEWS, Oct. 20, 1999, available at <http://www.news-observer.com>. Also noticeable in the area was the low number of minority applicants for prime-rate loans. *Id.*

¹⁸⁰*Id.* The BB&T bank turned down eight out of a total of twenty minority applicants in 1997 and only rejected seven of the 244 Caucasian applicants. *Id.*

¹⁸¹INTRODUCTION TO PREDATORY LENDING POLICY, *supra* note 3, at 5.

¹⁸²*Id.*

¹⁸³H.R. 1149 (N.C. 1999).

¹⁸⁴*Id.*

¹⁸⁵*Id.* at § 24-1.1(E)(c)(1)-(5).

¹⁸⁶*Id.* at § 24-1.1E(c)(1).

¹⁸⁷*Id.* at § 24-1.1E(b)(2).

¹⁸⁸H.R. 1149 at § 24-1.1E(b)(3)-(6). Negative amortization is when a loan contains a payment schedule with regular periodic payments that start small and then the principal balance of the loan increases over time. *Id.* at § 24-1.1E(b)(3).

¹⁸⁹*Id.* at § 24-1.1(E)(c)(3)(c).

drafters of the bill were concerned with federal preemption of the new law so they did not cap the interest rates or points.¹⁹¹ Lastly, the bill exempts reverse mortgages and open-ended loans.¹⁹²

North Carolina fair housing advocates were particularly worried about mortgage brokers and the ability to charge borrowers' high fees. Legislators have realized that those who make and broker loans must be regulated to protect consumers. To that end, legislation is pending that would amend current regulation of mortgage brokers. On April 13, 1999, Senate Bill 866 (hereinafter H.R. 866) was introduced to the General Assembly. H.R. 866 provides that all lenders and brokers doing business in North Carolina must be licensed.¹⁹³ The prospective lender or broker must pay yearly licensing fees and provide a \$25,000 (personal) or \$50,000 (corporate) bond to be used in case of litigation.¹⁹⁴ The provisions would prevent a broker from acting as a lender during the same transaction,¹⁹⁵ and require brokers and lenders to keep records and submit annual reports.¹⁹⁶ The proposed H.R. 866, if passed, will supplement H.R. 1149 by prohibiting discrimination on the basis of age, sex, race, ethnicity, religion, or handicap and also prohibit making loans for the purpose of foreclosing on the borrower's home.¹⁹⁷ Any lender or broker found in violation of the proposed bill may be held jointly and severally liable for actual damages and attorneys' fees.¹⁹⁸

North Carolina is the nation's leader in protecting consumers from predatory mortgage lending practices. Although the effects of current and pending legislation may not be felt for many years, advocates hope that the new laws will protect vulnerable borrowers from unscrupulous lenders.

¹⁹⁰*Id.* at § 24-10.2.

¹⁹¹Brian Collins, *States Promote Own Lending Laws*, NAT'L MORTGAGE NEWS, Sept. 6, 1999, at 7.

¹⁹²H.R. 1149 at § 24-(1.1E)(4). This means that unscrupulous lenders may try to convince borrowers to accept open-ended loans so they are exempt from following the new provisions. Reverse mortgages are loans whereby an elderly homeowner may borrow money against the equity in her home, and the principal and interest do not come due until the homeowner sells the house, moves into a long-term nursing home, or dies. Jean Reilly, *Reverse Mortgages: Backing Into the Future*, 5 ELDER L.J. 17 (1997).

¹⁹³H.R. 866 at § 53-233(b) (N.C. 1999).

¹⁹⁴*Id.* at §§ 53-236(A)(1)-(2). This bond does not preclude a borrower from recovering under other forms of available relief. *Id.*

¹⁹⁵*Id.* at § 53-237(E). This prevents a person/company from receiving double fees by acting as both a broker and a lender on the same transaction.

¹⁹⁶*Id.* at §§ 53-237(F), (G).

¹⁹⁷H.R. 866 at §§ 53-238(5a), (5c). The provision states that the presumption exists that a lender made a loan with the intent to foreclose on the borrower's home if: 1) a lack of substantial benefit to the borrower exists, 2) it is not probable that the borrower will be able to pay on the loan, or 3) the lender has a significant number of foreclosures on previous loans. *Id.* at §§ 53-238 (5c)(a)-(c) (N.C. 1999).

¹⁹⁸*Id.* at §§ 53-240A(b), (c).

B. New York: New Regulations Protect Consumers

Following North Carolina's lead, New York has acted on the problem of predatory lending. In 1999, New York settled a lawsuit with the largest subprime lender in the state, Delta Funding Corporation of Woodbury (hereinafter Delta).¹⁹⁹ The Attorney General's office accused Delta of targeting low income neighborhoods and lending to people based on the equity in their homes, rather than the ability to repay the loans.²⁰⁰ Delta did not admit to engaging in abusive practices, but did agree to pay \$12 million, to stop "flipping" and "stripping," to open their books to a neutral monitor for three years, and to provide \$6 million to restructure the loans of certain borrowers.²⁰¹ The Stipulated Order on Consent, filed by both parties, stated the following terms: 1) Delta is refrained from discriminating based on the race or ethnicity of the borrower; 2) all mortgage broker fees must be reasonable in relation to the amount of the loan; and 3) Delta is prohibited from making a HOEPA loan without regards to the ability of the borrower to repay the loan.²⁰² The Order also regulated Delta's practices relating to post-default interest, HOEPA loans, and to the Equal Opportunity Credit Act and RESPA.²⁰³ Within those provisions were limitations on mortgage brokers and yield-spread premiums.²⁰⁴

The settlement with Delta is purported to be the first time that New Yorkers recovered money from a lender engaged in predatory mortgage lending.²⁰⁵ This settlement demonstrates both the lender's interest in an out-of-court resolution as well as New York's dedication to protecting vulnerable consumers.

The New York State Banking Department recently passed regulations to address predatory lending practices. The new regulations amend Part 41 of the Banking Board's General Regulations entitled "Restrictions and Limitations on High-Cost Home Loans."²⁰⁶ The Banking Department reviewed HOEPA and North Carolina's new bill²⁰⁷ to draft regulations in support of honest subprime mortgage lending. New Part 41 places the following limitations on high-cost home loans: 1) no balloon

¹⁹⁹Randy Kennedy, *Averting Civil Rights Lawsuit, Home Lender Settles in Inquiry*, N.Y. TIMES, June 23, 1999, at A21. Delta handles more than \$1 billion in loans in New York and twenty-one other states. *Id.*

²⁰⁰*Id.*

²⁰¹*Id.* See also Katherine Fraser, *N.Y. Settles with Delta on Predatory Lending Charges*, AMERICAN BANKER, Aug. 23, 1999, at 2.

²⁰²Stipulated Order on Consent, Index No. 99-Civ-4951.

²⁰³*Id.* The Equal Opportunity Credit Act (EOCA) requires notice to be given to prospective borrowers if the lender makes a counteroffer to a completed application. 15 U.S.C. §§ 1621 et seq. See *Newton*, 24 F. Supp. 2d at 457.

²⁰⁴Stipulated Order on Consent, Index No. 99-Civ-4951.

²⁰⁵Fraser, *supra* note 201, at 2. It was probably in Delta's best interests to reach the agreement rather than face the public relations nightmare of a court possibly finding the company the largest predatory lender in the state.

²⁰⁶3 N.Y.C.R.R. Part 41 (2000).

²⁰⁷Proposed New Part 41, New York Banking Regulations, Regulatory Impact Statement, ¶ 8 (proposed 12/29/99).

payment allowed on loans within the first seven years of the loan (or at all if the loan is shorter than seven years); 2) no negative amortization; 3) no increased interest rate in cases of default; 4) no oppressive mandatory arbitration clauses; 5) no advance payments; and 6) no deferral or modification fees.²⁰⁸ The regulations prohibit: 1) lending without a counseling disclosure; 2) lending without regard to the borrower's ability to repay; and 3) frequent refinancing of an existing high-cost home loan ("flipping").²⁰⁹ The regulations also prohibit unfair and deceptive acts such as high points and fees, mortgage brokers fees for unperformed services or fees for services that bear no reasonable relationship to those services performed, and the making or brokering of loans without due regard to the borrower's repayment ability.²¹⁰ "Flipping" and "packing" are expressly prohibited.²¹¹ The regulations also lower the percentage thresholds that trigger the regulations, making the levels lower than the federal standards under HOEPA.²¹²

The banking industry in New York does not believe the new Part 41 will work to help consumers. The industry asserts that the regulations will decrease the amount of subprime loans made, thereby punishing many for the bad actions of a few.²¹³ The industry fears that honest subprime lenders will no longer be able to make loans, and borrowers seeking alternative forms of loans will be shut out of the credit market.²¹⁴ The solution, according to the industry, is for the Banking Department to enforce regulations as they existed before enactment of the revised Part 41.²¹⁵ Arguably, as evinced by Delta, enforcement does work. But New York was able to pursue Delta only after the bad acts were committed. In the end, the Banking Department's old regulations served only as a type of preventative maintenance. Whereas the new regulations under New York law will prohibit bad acts from occurring rather than just making the Department enforce reactive measures.

In North Carolina the legislature passed a bill regulating high-cost loans and a separate bill limiting the practices of mortgage brokers is in the works. In New York, on the other hand, the Banking Department's decisions ultimately worked to regulate its own institutions. Self-regulation may be a good idea. When regulations come from the Department, or banks regulate themselves, scrupulous lenders profit. Lenders will be able to make and profit from loans that would have previously gone to unscrupulous lenders. Banks will benefit from investing in borrowers that have less of a chance of defaulting. The entire state will benefit from improved economic conditions that are a result of fewer foreclosures and bankruptcies.

²⁰⁸3 N.Y.C.R.R. Part 41, § 41.2(b)-(g) (2000).

²⁰⁹3 N.Y.C.R.R. Part 41, § 41.3(a), (b), (d) (2000).

²¹⁰3 N.Y.C.R.R. Part 41, § 41.5(b) (1)-(3) (2000).

²¹¹3 N.Y.C.R.R. Part 41, § 41.5(b) (4)-(5) (2000).

²¹²Proposed New Part 41, New York Banking Regulations, Regulatory Impact Statement, ¶ 3 (proposed 12/29/99) (noting that current federal standards are ineffective).

²¹³Glenn Kalinoski, *Proposed NY law creates a call for enforcement, not New Regs*, ORIGINNEWS, Nov. 1, 1999, at 43.

²¹⁴*Id.*

²¹⁵*Id.*

The North Carolina bill and New York regulations are similar. New York looked to North Carolina when drafting the proposed regulations²¹⁶ and, for the most part, improved upon North Carolina's bill. Like North Carolina, the New York regulations exempt reverse mortgages from regulation. New York, however, includes open-ended loans, which North Carolina exempts. The New York regulations limit advertising that claims that a high-cost mortgage loan will reduce a borrower's monthly debt payments without also disclosing that the loan will increase the number of payments and total amount paid.²¹⁷ The proposal also prohibits unconscionable arbitration clauses.²¹⁸ The only section the New York regulations are lacking is a provision for loan counseling. The North Carolina bill *requires* that all high-cost loan borrowers receive loan counseling.²¹⁹ The New York proposal only requires that lenders and brokers recommend loan counseling.²²⁰ North Carolina's comprehensive Act can serve as a role model statute, and advocates and legislators can improve on the Act to suit the needs of their individual states.

C. *Creative Litigation Techniques and Remedies in Other States*

New York and North Carolina are two examples of states at the forefront in protecting consumers against predatory mortgage lending. Nationwide, consumer advocates hope that their states will look to those leaders and propose legislation to protect unsophisticated borrowers. Illinois, Georgia, and Massachusetts are in the process of drafting or enacting legislation that specifically regulates high-cost loans. Advocates in states that do not have explicit regulations have found other state statutes that allow for some protection. In the context of protecting indigent consumers, most legal advocates are looking for defenses to default actions. The most common scenario occurs when a prospective client comes in looking for legal assistance with a foreclosure or bankruptcy. The challenge is to find a means to stave off a foreclosure or help a client reclaim money.²²¹

Many states have statutes that allow for recovery when federal laws fail. In Connecticut, an appellate court allowed for a claim based on the Connecticut Unfair Trade Practices Act.²²² The court held loans unconscionable when the terms of the mortgage were unfavorable to the borrower, the borrower could not reasonably be

²¹⁶Proposed New Part 41, New York Banking Regulations, Regulatory Impact Statement, ¶ 8 (proposed 12/29/99).

²¹⁷3 N.Y.C.R.R. Part 41, § 41.5(b)(7) (2000).

²¹⁸3 N.Y.C.R.R. Part 41, § 41.2(e) (2000).

²¹⁹H.R. 1149 at § 24-1.1E(c)(1).

²²⁰3 N.Y.C.R.R. Part 41, § 41.4(a) (2000).

²²¹Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland (Jan. 13, 2000). For-profit attorneys often will not take poor clients on contingency who are victims of predatory lending practices and need defenses to a foreclosure action or bankruptcy because there are often no damage awards available.

²²²Family Financial Services, Inc. v. Spencer, 677 A.2d 479, 482 (Conn. 1996).

expected to make the required balloon payment, or the borrower did not understand the terms of the loan contract.²²³

In Alabama, the Consumer Credit Act (Mini-Code), covers real estate transactions and requires full disclosure of all finance charges.²²⁴ The Mini-Code does not cap interest rates but requires a full disclosure of all fees, direct and indirect, that are charged on a loan.²²⁵ Indirect fees may include yield-spread premiums, other fees paid to the broker, or insurance. Mortgage loan origination fees are capped at 5%, including any indirect fees.²²⁶

In Massachusetts, the Massachusetts Consumer Credit Cost Disclosure Act (CCDDA) allows four years to rescind or bring an action for damages.²²⁷ The Attorney General has also promulgated regulations governing mortgage lenders and brokers that state that it is illegal for a broker or lender to practice unconscionable acts in relation to the rates and terms of a loan and calls for the disclosure of all fees and points.²²⁸

In Ohio, as previously mentioned, neither state nor federal law is sufficient in providing adequate relief. Searching for causes of action can be difficult.²²⁹ In *Williams*, the borrower charged that the mortgage broker and lender engaged in civil conspiracy.²³⁰ Because this charge was successful, the jury awarded \$1.5 million in punitive damages.²³¹ Civil conspiracy is defined as “a malicious combination of two or more persons to injure another in person or property, in a way not competent for one alone, resulting in actual damages.”²³² An underlying unlawful act, in this case fraud, is required before a party can bring a successful conspiracy claim.²³³ The Ohio Supreme Court upheld both the cause of action and the punitive damage amount, which suggests that civil conspiracy may be a viable basis for challenging predatory lending practices.

²²³*Id.* The court found important the fact that the borrower had a limited knowledge of English. *Id.* at 485.

²²⁴Alabama Consumer Credit Act, §§ 5-19-1, 5-19-1(1), 5-19-4(g) (1975).

²²⁵Alabama Consumer Credit Act, §§ 5-19-1(1).

²²⁶Alabama Consumer Credit Act, §§ 5-19-4. See *Smith v. First Family Financial Services, Inc.*, 626 So.2d 1266 (Ala. 1993).

²²⁷MASS. GEN. LAWS. ANN. ch. 140D, §§10, 32 (2000). See *Whitley v. Rhodes Financial Services, Inc.*, 177 B.R. 142 (Bankr. D Mass. 1995).

²²⁸940 C.M.R. 8.06(6) and 1994 Mass. Acts. c.245. See *United Companies Lending Corp. v. Sargeant*, 20 F. Supp. 2d 192 (D. Mass 1998).

²²⁹An added burden in Ohio is that many programs that offer legal representation to the poor no longer receive funding to bring, or are prohibited from bringing, class action lawsuits. Since the plaintiff in a lawsuit often has to meet “pattern and practice” requirements, less likelihood exists that it is beneficial to bring suit. Class actions are valuable because they may increase the chance of press coverage; thereby enabling consumer education about predatory lending practices as well as fair subprime lending.

²³⁰700 N.E.2d at 869.

²³¹*Id.* at 870.

²³²*Id.* at 868.

²³³*Id.*

VI. TOWARD A NEW THEORY OF PROTECTION AGAINST PREDATORY
MORTGAGE LENDING IN OHIO

*“They did what a man with a gun in a dark alley couldn’t do. They stole my house.”*²³⁴

Delta Mortgage Company has the highest default rate of all loans made in Cleveland: 10.06%.²³⁵ Delta also has been criticized for targeting Cleveland’s minority areas.²³⁶ Predatory mortgage lending practices exist in Ohio, as they do throughout the country. Consumer advocates and attorneys from around the state have expressed concern about the rise of equity-based lending.²³⁷

Increased regulations may create a tenuous situation because they may limit desirable and available credit. Action taken in North Carolina and New York is too recent to see what effect the new regulations will have on lending. Ohio does not want to further limit loan choices to borrowers who are already disproportionately turned down for loans or who do not have the same array of lending options as prime-rate borrowers. Mortgage lenders loathe regulation. Lenders believe they can regulate themselves without increased government intervention. But at least one court argues that “mortgage scams and predatory lending are most common in those states that lack legal and regulatory structure.”²³⁸ The most effective mechanism for regulating the market is informed borrower choice, but “this self-correcting mechanism is impaired where the behavior of the seller unreasonably creates or takes advantage of the barriers to the free exercise of consumer choice.”²³⁹ Because borrowers are being taken advantage of, even if it is just by a small sector of the subprime industry, those who make and broker high-cost loans should be regulated.

What has become evident to fair housing and consumer advocates in the state is that existing state and federal remedies do not go far enough to protect vulnerable borrowers. Two main areas of change are necessary: increased regulation of mortgage brokers and the regulation of high-cost loans.

In Ohio, mortgage brokers are no longer covered under the MLA. Brokers are required to be licensed under section 1322 of the Ohio Revised Code. The requirements are limited to registration and maintenance of an office in Ohio.²⁴⁰ Under the section, mortgage brokers are prohibited from making false promises and engaging in improper, fraudulent, or dishonest dealings.²⁴¹ Improper, fraudulent, and

²³⁴*The Case Against Predatory Lending*, *supra* note 103 (quote is from a victim of predatory lending testifying in front of the United States Senate in 1998).

²³⁵Sabrina Eaton, *Housing Advocates Call for Changes in FHA Loan Terms*, PLAIN DEALER, Oct. 29, 1997, at 5B.

²³⁶Information obtained from Metropolitan Strategy Group, Cleveland, Ohio.

²³⁷Ohio legal services associations and fair housing groups around the state hold seminars and workshops for advocates and attorneys on predatory lending issues. The friend that offered me the idea for this Note, Attorney Steven McKenzie, suggested the topic in order to assist state legal aid societies with litigating predatory mortgage lending cases.

²³⁸*United Companies Lending v. Sargeant*, 20 F. Supp. 2d 192, 203 (D. Mass. 1998).

²³⁹*Id.*

²⁴⁰OHIO REV. CODE ANN. § 1322.02(A) (West 1994).

²⁴¹OHIO REV. CODE ANN. § 1322.07(B), (C) (West 1994).

dishonest dealing are not defined in the Code. The Code does not contain any disclosure requirements. Even if disclosure were required, some believe that does not go far enough. A broker can charge any kind of fees in whatever amount desired, even if the amount is unreasonable. A yield-spread premium in any amount may be charged and the broker is not required to disclose the amount on the loan papers. Borrowers without other options may not have, or know of, other choices and will accept the fees to secure the loan. Legislators should look to North Carolina's proposed regulations as a model for fair brokering throughout the state.

Another avenue for change is the expansion of the MLA and CSPA. The MLA could be revised to cover first-liens on property. This would give protection to borrowers who refinance existing loans into larger loans. The threat of federal preemption will remain, however, until federal law caps interest rates on high-cost loans. Broadening the CSPA to include financial institutions and real estate transactions would greatly increase consumer protection.²⁴²

Another option is to take steps similar to North Carolina and New York in the regulation of high-cost loans. Amending a current law, rather than passing brand new legislation, may seem an easier obstacle to overcome. To afford the borrower the best relief, however, may require new regulations. The MLA provides limited relief and insufficient deterrence. The CSPA does provide an array of relief but is not currently available to Ohio victims of predatory mortgage lending.

Loan counseling should be required of all borrowers to insure that they understand how a high-cost home loan works and that they are receiving a rate that meets their risk to the lender. Lenders should be required to look at a borrower's ability to repay rather than just the equity available in a home. Balloon payments, negative amortization, increased interest rates after default, advance payments, and deferral fees should be regulated or prohibited. The practices of "stripping," "flipping," and "packing" should be expressly outlawed. Any new legislation should cover open-end mortgage loans to prevent lenders from turning closed loans into exempted lines of credit.

Increasing the types and amounts of remedies available has two interconnected benefits. The first, and most obvious, is the protection of high-cost loan borrowers. This leads to a decrease in foreclosures and an increase in home ownership. If subprime lenders are not allowed to abuse, and the government keeps its current commitment to home-ownership in America, lenders will discover new and fair ways to profit. The second benefit is the increasing attractiveness of lawsuits. If attorneys are able to receive costs upon completion of a successful suit, or it becomes feasible to take cases on a contingency fee, attorneys will be able to afford to take on predatory mortgage lending cases. More litigation or increased settlements with predatory lenders equals increased press coverage and consumer education.²⁴³

VII. CONCLUSION

Homeownership is one of the great American dreams. Predatory lending practices serve not only to demean that dream but turn it into a nightmare as well. Although Ms. Williams was able to keep her home and recover monetary damages

²⁴²Interview with Sheila Tew, Attorney, Legal Aid Society of Cleveland (Jan. 13, 2000).

²⁴³A cursory search for newspaper and magazine articles in Ohio having to do with any type of predatory lending practice uncovered less than ten articles in the last four years.

despite being a victim of predatory mortgage lending, Ms. Thomas was not as fortunate. Ms. Thomas still deals with the daily reality that she may lose her home at the hands of the very lenders that promised to improve her situation.

As tragic as the impact of predatory mortgage lending can have upon individuals, its negative effects are felt beyond the isolated homeowner. Predatory mortgage lending practices can have a destabilizing effect on entire neighborhoods, creating a cycle that produces high profits for the unscrupulous and foreclosed homes for hardworking citizens.

The lending industry may argue that increased regulation will hurt the entire lending industry by increasing costs and decreasing the amount of loans available. However, this view is shortsighted. The increased costs to the industry will be offset by the improved economic conditions experienced by communities,²⁴⁴ allowing for better returns and reduced default rates on legitimate loans. As a result, loans can remain available and profitable, just not unethical or unjust.

The proposals set forth herein establish a more appropriate venue for lending credit and borrowing money secured by home equity. Current remedies available in Ohio are insufficient to protect consumers. The MLA and CSPA do little to effectively combat predatory lending practices. Ohio should seek to be among the national leaders of effective, substantive reform. The result may create a model environment of fair lending. Future reform on a national and state level is likely, as the momentum for change in this area increases and predatory lending becomes a national concern. By embracing and adapting the progressive measures piloted in North Carolina and New York, Ohio may emerge at the forefront of providing new avenues for consumer relief.

ANNA BETH FERGUSON

²⁴⁴Proposed New Part 41, New York Banking Regulations, Regulatory Impact Statement, ¶ 4 (proposed 12/29/99).