

2004

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## Repository Citation

Dickerson, A. Mechele, "Bankruptcy and Mortgage Lending: The Homeowner Dilemma" (2004). *Faculty Publications*. 825.  
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# BANKRUPTCY AND MORTGAGE LENDING: THE HOMEOWNER DILEMMA

A. MECHELE DICKERSON\*

## I. INTRODUCTION

Homeownership: perhaps *the* symbol of the good life in America, undeniably the key to achieving the “American Dream,” and a large component of household wealth. While houses most commonly serve as shelter, they also serve as a forced savings device. Homeowners can, however, “withdraw” their savings and use the cash they built up in their homes if they need money to help them survive a financial crisis. Because financial crises often harm homeowners’ credit histories, they often find that they must borrow against the equity in their homes in the higher rate (and fee) subprime mortgage market.

That borrowers with blemished credit must pay higher rates and fees when they seek credit is reasonable, given the higher risks generally posed by this type of lending. Because, however, most subprime loans are home equity or refinance loans that decrease homeowner wealth while increasing their debts, and refinance loan proceeds increasingly are used to pay off credit card debts or to pay for non-housing goods and services, refinance borrowers essentially are putting their homes at risk to pay for the things inside their homes or in their driveways. The refinance market is, sadly, turning the American Dream into a nightmare for many cash-strapped households.

This Article argues that refinance loans presumptively should be treated differently than purchase money loans in bankruptcy. Part I of the Article discusses the American Dream of homeownership and chronicles recent efforts to increase homeownership rates, especially among minority and lower

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\* Professor of Law, William and Mary Law School. I am grateful to the research assistance provided by Megan Wortherspoon. I thank Professor Douglas Baird for suggestions he made at the 2004 Kratovil Conference in Real Estate Law held at the John Marshall Law School on May 21, 2004 and I thank Professor Celeste Hammond for inviting me to participate in that conference. I am grateful to the Virginia bankruptcy judges for discussing the ideas I present in this paper during the Spring 2004 EDVA and WDVA Judges’ Meeting held at William & Mary Law School on May 17, 2004. This Article was supported, in part, by a grant provided by the College of William & Mary.

income households. This Part then generally describes prime and subprime purchase money and home equity lending and notes the dramatic increase in subprime home equity lending. Part II explores how the American Dream has turned into the American Nightmare because of predatory practices involving some subprime lenders. This Part begins by discussing the types of loan products and lending practices that most often are characterized as predatory or abusive, and then describes legislative responses to predatory lending. This Part concludes by presenting lenders' objections to those consumer protection laws and their alternative proposals to curb predatory lending practices.

Part III contrasts the treatment of mortgage debt with other types of non-purchase money consumer debt in bankruptcy cases. Mortgage debt is favorably treated in bankruptcy cases because the Code (like other state and federal laws) encourages homeownership. To protect lenders who enable borrowers to buy homes, the Code requires mortgage debt to be paid before other claims and protects the mortgage holder's lien during the bankruptcy case. In contrast, unsecured consumer claims are dischargeable, absent allegations of fraud, and some non-purchase money secured claims can be avoided in bankruptcy and be treated instead like a general unsecured claim.

Part IV concludes by suggesting that refinance and home equity loans are functionally equivalent to non-purchase money, non-mortgage consumer finance loans since these loans do not help borrowers increase their wealth. Given this, all refinance and home equity loans should be treated as general unsecured debt in bankruptcy unless they are used for housing purposes or reduce the borrower's overall housing debt. In addition, the home equity or refinance lender should have its lien stripped in bankruptcy and be viewed as a creditor holding an unsecured claim.

## II. THE AMERICAN DREAM: HOMEOWNERSHIP

### A. *Benefits and Beneficiaries of the Dream*

Research indicates that homeowners feel better about themselves, maintain better and safer neighborhoods, and live in neighborhoods that have better schools.<sup>1</sup> In addition to these

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1. See Gary Orfield, *Metropolitan School Desegregation: Impacts on Metropolitan Society*, 80 MINN. L. REV. 825, 857 (1996) [hereinafter Orfield, *Metropolitan School Desegregation*] ("A good home in a good neighborhood and higher education are the primary dreams of American families . . ."); GEORGE S. MASNICK, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., HOMEOWNERSHIP TRENDS AND RACIAL INEQUALITY IN THE UNITED STATES IN THE 20TH CENTURY 9 (2001) (discussing studies); J. MICHAEL COLLINS ET AL., JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., TOWARDS A TARGETED HOMEOWNERSHIP TAX CREDIT 3-4 (1998) (discussing studies).

psychological and societal benefits, homeownership almost always is financially beneficial. Home equity is a significant component of household wealth and, for most lower-income and minority families, is the primary component of their net worth.<sup>2</sup> Moreover, owning a home can be a mitigating factor when a homeowner suffers economic misfortunes because owners can borrow against their home equity to pay living expenses (if their income declines or they incur unexpected expenses) or to payoff higher interest existing debt.<sup>3</sup> While 68% of total households participated in the American Dream of homeownership in 2002,<sup>4</sup> there is unfortunately a stubborn racial and economic disparity in homeownership rates.

Due to concerted efforts by the federal government to bolster low income and minority homeownership rates,<sup>5</sup> minorities constituted more than 40% of the net growth in homeownership

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2. JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., STATE OF THE NATION'S HOUSING 2003, at 6-7 [hereinafter STATE OF THE NATION'S HOUSING 2003]; TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS AMERICANS IN DEBT 233-34 (1999). See also *Subprime Lending: Defining the Market and Its Consumers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 3 (2004) (prepared statement of Anthony M. Yezer) (stating that medium income households owning homes hold 0% of their wealth in common stocks and "virtually all" in home equity and government-guaranteed assets); John Karl Scholz & Kara Levine, *U.S. Black-White Wealth Inequality: A Survey* at 42 (2002) (noting that homes constitute a larger portion of minority household wealth), available at [http://www.russellsage.org/programs/proj\\_reviews/si/revscholzlevine01.pdf](http://www.russellsage.org/programs/proj_reviews/si/revscholzlevine01.pdf).

3. Owners who need to radically reduce living expenses can always sell the home, use the equity to reduce existing debts, then rent less expensive housing. White homeowners are more secure financially than white renters and are less likely to file for bankruptcy than white renters. Elizabeth Warren, *The Economics of Race: When Making It to the Middle Is Not Enough*, 61 WASH. & LEE LAW REV. (forthcoming Feb. 2005) (manuscript at 17, on file with author). In contrast, blacks appear to *increase* their risk of filing for bankruptcy by being a homeowner because unlike white homeowners, black homeowners are more likely to file for bankruptcy than black renters. *Id.*

4. STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 15.

5. Raisa Bahchieva, Susan Wachter & Elizabeth Warren, *Mortgage Debt, Bankruptcy and the Sustainability of Homeownership, Credit Markets for the Poor* 11 (2005) (unpublished manuscript, on file with author) (discussing incentives the government provides to lenders to encourage them to loan to lower- and middle-income households). For example, Fannie Mae, Freddie Mac, and the FHA all adopted initiatives designed to increase homeownership generally and minority homeownership specifically. These initiatives included lowering down payment requirements, recognizing multiple income sources to qualify for a housing loan, providing loan documentation in Spanish, and conducting fair housing audits of lender practices to combat realtors and lenders' racially discriminatory marketing and lending practices. MASNICK, *supra* note 1, at 10. See generally Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1276-77 (2002) (discussing federal initiatives in the 1990s to increase lending to low and middle-income borrowers).

during the 1990s and the growth in loans to minorities increased at rates more than double the growth in loans to potential white home buyers.<sup>6</sup> However, while homeownership rates for whites in 2002 was almost 75%, the ownership rates for blacks was 49% — an increase for blacks of only 6% over the last decade.<sup>7</sup> The homeownership rates for other minority groups also lag the white homeownership rate, with Hispanics having a 47% rate, Asians having a 54% rate,<sup>8</sup> and Native Americans having rates of approximately 34%.<sup>9</sup> Indeed, while most white households have owned their homes since the end of World War II, the majority of black and Hispanic households still has not yet reached this level.<sup>10</sup>

Because 86% of high-income households own their own homes as opposed to only 45% of lower-income households and minority household income is lower than white household income, income no doubt contributes to the racial homeownership gap.<sup>11</sup> Median white household income in 2002 (\$47,000) is higher than the median household income for all races (\$43,000), is higher than median Hispanic household income (\$34,000), and is significantly higher than median black household income (\$30,000).<sup>12</sup> In addition, blacks are almost twice as likely to be lower-income (51%) than whites (28%), and twice the number of white workers (32%) earn over \$75,000 annually as black workers (16%).<sup>13</sup>

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6. See JOSEPHINE LOUIE ET AL., JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *THE HOUSING NEEDS OF LOWER-INCOME HOUSEHOLDS* 16 (1998) (reporting that minority home buyers contributed 42% of the growth in homeowners between 1994 and 1997 but were only 15% of all homeowners before that growth); MARK DUDA & ERIC S. BELSKY, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *THE ANATOMY OF THE LOW-INCOME HOMEOWNERSHIP BOOM IN THE 1990S* 1 (2001) (noting that minorities constituted 19.1% of first-time buyers in 1993 but 30% in 1999); *Id.* at 2 (reporting that growth in loans to white home buyers was 42% in contrast to 98% growth rate in loans to black buyers and 125% growth rate to Hispanic buyers); STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 15 (reporting that minorities constituted 32% of first-time buyers in 2001).

7. STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 105 tbl.A-5.

8. *Id.*

9. FANNIE MAE, AMERICAN DREAM COMMITMENT 2002 REPORT 10 (2003), available at <http://www.fanniemae.com/initiatives/pdf/adc/full2002.pdf>. See also Press Release, National American Indian Housing Council, Native American Homeownership: Far Below Other Americans; But Mortgage Default Data Shown As Less Risky (Nov. 13, 2002), available at <http://naihc.indian.com/pr/mortgage-data-11-02.html>.

10. See Menna Demessie, *National Urban League Reports Racial Disparities Continue*, at <http://www.civilrights.org/issues/housing/details.cfm?id=9727> (July 30, 2002).

11. COLLINS ET AL., *supra* note 1, at 4.

12. CARMEN DENAVAS-WALT ET AL., UNITED STATES CENSUS BUREAU, CURRENT POPULATION REPORTS, PUB. NO. P60-221, INCOME IN THE UNITED STATES: 2002, at 3 (2003).

13. *Id.*

Whether the racial homeownership gap is created by income disparities, the lingering effects of earlier discriminatory housing policies, or other factors, it has not been closed despite recent efforts.<sup>14</sup> Indeed, even though the number of mortgage loans to low-income buyers in the 1990s grew by almost double the rate of loans to high-income buyers,<sup>15</sup> the racial home ownership gap has remained constant since the 1980s.<sup>16</sup> In fact, one study projected that, at the current rate, white-black homeownership rates would not achieve parity until the year 3666.<sup>17</sup>

### *B. Striving for and Struggling with the Dream*

People who want to purchase a home enter the mortgage market by taking out a purchase money loan (commonly referred to as a first mortgage) to buy their home. Existing homeowners who need additional cash and want to borrow against their home can take out a home equity loan (commonly referred to as a second mortgage) or a home equity credit line. Though home equity loans often are marketed as relatively inexpensive ways to borrow money for home repairs or improvements, borrowers can (and often do) borrow the entire amount of the equity in their homes (i.e., cash out) and use the proceeds to pay for non-housing services or products, or to repay consumer debt (often unsecured credit card debt).<sup>18</sup> It also has become a common practice for “second” mortgages to pay off the first mortgage and wrap the principal amount, fees, and costs associated with that loan into the new loan

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14. For a discussion of the factors that contribute to the racial homeownership gap, see A. Mechele Dickerson, *Race Matters in Bankruptcy*, 61 WASH. & LEE L. REV. (forthcoming Feb. 2005). See also Keith N. Hylton & Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and the Community Reinvestment Act*, 85 GEO. L.J. 237, 250–51, 268–75 (1986) (discussing the extent of racial discrimination in mortgage lending practices).

15. DUDA & BELSKY, *supra* note 6, at 1 (reporting that loans to high-income buyers grew by 52% while loans to low-income home buyers grew by 94%).

16. UNITED STATES CENSUS BUREAU, HISTORICAL CENSUS OF HOUSING TABLES OWNERSHIP RATES (2002), at <http://www.census.gov/hhes/www/housing/census/historic/ownrate.html> (last updated July 8, 2004). See also MASNICK, *supra* note 1, at 2; JOINT CTR. FOR POLITICAL AND ECON. STUDIES, HOMEOWNERSHIP: PERCENT OF HOUSEHOLDERS WHO OWN THEIR OWN HOMES: 1983–1997, available at <http://www.jointcenter.org/DB/printer/homeown.htm> (last visited Sept. 10, 2004); STATE OF THE NATION’S HOUSING 2003, *supra* note 2, at 16.

17. STATE OF THE NATION’S HOUSING 2003, *supra* note 2, at 14. See also SULLIVAN ET AL., *supra* note 2, at 231 (indicating that minorities show “no sign of making up the [homeownership] gap”).

18. *Subprime Lending: Defining the Market and Its Customers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 7 (2004) [hereinafter *Stein Statement*] (prepared statement of Eric Stein).

thus giving the new lender first-lien status.<sup>19</sup> When interest rates fall, homeowners often seek to refinance their mortgage loans to obtain a loan with a lower interest rate. In contrast to cash out refinance loans (which give borrowers cash, but increase their overall mortgage debt), refinance loans that have lower interest rates than the existing mortgage (or that allow borrowers to change from or to a fixed or adjustable interest rate) are designed to reduce homeowners' monthly payments and total overall debt.

Purchase money and home equity loans can be prime or subprime.<sup>20</sup> Prime (or conventional rate) loans are made to borrowers with solid, essentially unblemished credit who meet the lender's underwriting standards and are viewed as less risky and more deserving of the lowest available rates. In contrast, subprime lending generally is defined as lending that involves an elevated credit risk.<sup>21</sup> Riskier homeowners (including those who are self-employed, have difficulty verifying their income, lack the funds to make the required down payment, have impaired or limited credit histories, or have relatively higher debt to income ratios) must pay higher rates and fees in the subprime loan market to compensate lenders for the increased risk of default.<sup>22</sup>

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19. Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 524 (2000). Lenders likely demand first lien status to take advantage of the protections given those liens under federal law. See Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980) [hereinafter DIDMCA] (preempting state usury laws that regulate the interest rate that can be charged for loans secured by a first lien on residential property).

20. Subprime loans also are characterized as "non-prime" by members of the subprime industry.

21. Federal Reserve Governor Edward M. Gramlich, *Subprime Mortgage Lending: Benefits, Costs, and Challenges* (2004) (memorializing the Governor's remarks at the Financial Services Roundtable Annual Housing Policy Meeting on May 21, 2004), available at <http://www.federalreserve.gov/boarddocs/speeches/2004/20040521/> (last updated May 21, 2004).

22. See U.S. DEPT OF TREASURY & U.S. DEPT OF HOUS. & URBAN DEV., CURBING PREDATORY HOME MORTGAGE LENDING 28 (2000) [hereinafter TREASURY/HUD REPORT] (noting that borrowers who present less risk are offered lower interest rates), available at <http://www.huduser.org/publications/pdf/treasrpt.pdf>; Engel & McCoy, *supra* note 5, at 1265-66 (discussing increased costs associated with subprime lending). Lenders charge different rates, points, and fees for subprime loans and typically do not publicly disclose pricing information. Because of this, it is difficult to predict with precision when a borrower will be deemed ineligible for a conventional loan or which terms a subprime lender will include in the subprime product. See Mansfield, *supra* note 19, at 533-35. See generally TREASURY/HUD REPORT, *supra*, at 27-28 (listing factors lenders consider when determining whether borrower is eligible for prime rates); BD. OF GOVERNORS OF THE FED. RESERVE SYS., FED. DEPOSIT INS. CORP., OFFICE OF THE COMPTROLLER OF THE CURRENCY, & OFFICE OF THRIFT SUPERVISION, INTERAGENCY GUIDELINES ON SUBPRIME LENDING (1999) (discussing guidelines federal banking regulators use to define subprime portfolio).

Subprime borrowers, like debtors in bankruptcy, also are more likely: to have had a household member suffer a major illness; to have large medical expenses, to have income interruptions caused by unemployment; to be recently divorced; and to borrow more heavily against their houses than mortgage borrowers overall.<sup>23</sup> Finally, most subprime loans (whether offered by traditional lenders or finance companies)<sup>24</sup> are non-purchase money refinance loans<sup>25</sup> and most home equity loans, home equity lines of credit, and refinance loans are used to purchase or pay for non-housing consumer goods or services.<sup>26</sup>

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23. *Subprime Lending: Defining the Market and Its Consumers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 8 (2004) [hereinafter *Staten Statement*] (prepared statement of Michael E. Staten, Credit Research Center); ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE* 83 (2003); DEBORAH GOLDSTEIN, *JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., UNDERSTANDING PREDATORY LENDING: MOVING TOWARDS A COMMON DEFINITION AND WORKABLE SOLUTIONS* 31 (1999). Recent research also indicates that borrowers with higher loan-to-value ("LTV") ratios are more likely to lose their homes and that debtors in bankruptcy tend to have higher LTV ratios than non-debtors. See Bachieva, Wachter & Warren, *supra* note 5, at 15–17.

24. Until the early 1980s, traditional lenders offered most home-mortgage loans, typically to customers with prime credit ratings. Finance companies and non-bank lenders, which now dominate the subprime lending market, wrote few loans principally because of liquidity constraints (which largely have been removed because of the widespread securitization of mortgage loans). See Engel & McCoy, *supra* note 5, at 1272, 1279 (describing changes to home mortgage lending market). Currently, traditional lenders often avoid subprime lending because of the risks associated with that lending, the likelihood that they will be required to foreclose on property, and because of their concern that loan rejection rates that appear to correlate with race will subject them to discrimination law suits. *Id.* See also *State of the Banking Industry: Before the Senate Comm. on Banking, Housing and Urban Affairs*, 108th Cong. 4 (2004) (statement of James E. Gilleran, Director, Office of Thrift Supervision) (commenting that subprime lending is not fully served by conventional lenders); Serv. Corp. of Retired Executives, *Borrowing Money*, at <http://www.scoreknox.org/library/borrowing.htm> (last visited Sept. 13, 2004).

25. See *Subprime Lending: Defining the Market and Its Customers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 9, 10 (2004) [hereinafter *CFAL Statement*] (prepared statement of the Coalition for Fair and Affordable Lending ("CFAL") and New Century Financial Corporation); Harold L. Bunce et al., *Subprime Foreclosures: The Smoking Gun of Predatory Lending?*, in *HOUSING POLICY IN THE NEW MILLENIUM* 257, 260 n.4 (2003) (suggesting that 80% of subprime loans are refinance loans); *Staten Statement*, *supra* note 18, at 7.

26. See, e.g., Marianne A. Hilgert & Jeanne M. Hogarth, *Household Financial Management: The Connection Between Knowledge and Behavior*, 89 *FED. RES. BULL.* NO. 7 309, 310 (July 2003) (indicating that only 35% of respondents in the survey reported refinancing a mortgage or loan for home improvement); *Staten Statement*, *supra* note 18, at 7 (citing research that indicates that most subprime loans are refinance loans used to pay for non-



The refinance market, especially subprime refinance loans, has grown tremendously over the last decade.<sup>27</sup> For example, while the total mortgage volume (including purchase and refinance loans) in 1990 was \$458 billion, the volume for refinance loans in 2003 was \$2.2 trillion.<sup>28</sup> In addition, the number of subprime mortgage originations in 1994 was \$35 billion but increased to \$160 billion in 1999, \$213 billion in 2002, and \$325 billion in 2003.<sup>29</sup> Similarly, subprime originations doubled their share of the overall mortgage origination market from 5% in 1994 to 10.5% in 2003.<sup>30</sup> Moreover, the overall number of subprime loans increased from approximately 100,000 in 1993, to over 1.36 million less than ten years later, in 2002.<sup>31</sup>

Home equity lending generally, and subprime lending in particular, increased in volume and became much more popular for a number of reasons. First, due to technological changes, it became easier for lenders to assess, or “score”, a borrower’s credit history.<sup>32</sup> In addition, most mortgage loans, and virtually all subprime loans, are now securitized or sold in the secondary market to private investors.<sup>33</sup> Indeed, the subprime securitization market increased by over \$70 billion from 1994 to 1999 and this increase appears to have contributed to the increase in subprime originations.<sup>34</sup>

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housing debt).

27. See Press Release, U.S. Department of Housing and Urban Development, Subprime Lending Report, Unequal Burden: Income and Racial Disparities in Subprime Lending in America (Apr. 12, 2000) [hereinafter *Unequal Burden*] (reporting that the number of subprime refinance loans increased ten-fold between 1993 and 1998), available at <http://www.hud.gov/library/bookshelf18/pressrel/subprime.html>.

28. Holden Lewis, *Reasons Remain to Refinance*, at <http://www.bankrate.com/brm/news/refinance/20040115a1.asp?prodtype=mtg&thisponsor=refi> (last visited Jan. 15, 2004).

29. ROBERTO G. QUERCIA ET AL., UNIV. OF N. CAROLINA AT CHAPEL HILL, THE IMPACT OF NORTH CAROLINA’S ANTI-PREDATORY LENDING LAW: A DESCRIPTIVE ASSESSMENT 2 (2003); *CFAL Statement*, *supra* note 25, at 3; Bunce et al., *supra* note 25, at 257.

30. *CFAL Statement*, *supra* note 25, at 3; Bunce et al., *supra* note 25, at 257.

31. ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW (“ACORN”), SEPARATE AND UNEQUAL 2004: PREDATORY LENDING IN AMERICA 6 (2004), [hereinafter ACORN, SEPARATE AND UNEQUAL 2004], available at <http://www.acorn.org/index.php?id=108>.

32. See Dennis Hevesi, *A Wider Loan Pool Draws More Sharks*, N.Y. TIMES, Mar. 24, 2002, § 11, at 1 (discussing increased use of computerized credit scoring); *The Condition of the Banking Industry: Hearing Before the Senate Comm. on Banking, Hous. and Urban Affairs*, 108th Cong. 4 (2004) (statement of Donald E. Powell, Chairman, FDIC) (suggesting that household indebtedness increased because of market and technological changes).

33. See Mansfield, *supra* note 19, at 531-32 (describing increase use of securitization of subprime loans).

34. See generally *Subprime Lending: Defining the Market and Its*

Changes in federal tax laws also helped fuel the growth in non-purchase money lending. Owners who itemize their deductions on their federal income tax forms now have an incentive to borrow against their homes because the Tax Reform Act of 1986 ("TRA") eliminated the deduction of interest for all consumer debt except home equity loans.<sup>35</sup> This change encouraged itemizers to borrow against their homes to pay off existing debt or to pay for non-housing goods and services rather than incur additional (or continue to maintain existing) unsecured credit card debt. In addition, increased government directives that lenders provide more loans to lower-income households encouraged home equity lenders to aggressively advertise and promote home equity and refinance loans, initially to prime borrowers (as second mortgages) and ultimately to subprime borrowers.<sup>36</sup>

Efforts to increase homeownership rates among lower-income and minority households caused many lenders to drop the required average down payment for first-time home buyers from 10% to 3–5% and some even offer mortgages with zero-down.<sup>37</sup> Lenders also

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*Consumers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 3 (2004) [hereinafter *Samuels Statement*] (prepared statement of Sandy Samuels, Senior Managing Director and Chief Legal Officer, Countrywide Financial Corporation—one of the nation's largest home mortgages lenders—and on behalf of the Housing Policy Council of the Financial Services Roundtable) (discussing practice of selling or securitizing loans in its portfolio to Fannie Mae, Freddie Mac and other secondary purchasers). QUERCIA ET AL., *supra* note 29, at 2 (discussing an increase in the subprime securitization market from \$11 billion to \$83 billion). Most originating lenders sell their loans to secondary purchasers (including private investors and private investors like Fannie Mae, Freddie Mac, and, Ginnie Mac) then use the sale proceeds to originate more loans. The secondary purchasers either hold the loans or pool them into mortgage-backed securities which they then sell to other (typically large institutional) investors. See Engel & McCoy, *supra* note 5, at 1273–74 (describing securitization and the effect it had on subprime lending); *Subprime Lending: Defining the Market and Its Consumers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 4 (2004) [hereinafter *Bryce Statement*] (prepared statement of Teresa A. Bryce).

35. Tax Reform Act of 1986, Pub. L. No. 99-514, § 511(b), 100 Stat. 2245, 2246–49. Congress capped the amount of the home equity interest deduction at \$100,000 in 1987. Revenue Act of 1987, Pub. L. No. 100-203, § 10102, 101 Stat. 1330–84 to 1330–87 (codified at I.R.C. 163(h)(3) (1993)).

36. See generally Mansfield, *supra* note 19, at 522–25 (discussing likely causes for the increase in consumer home equity borrowing).

37. Ruth Simon & Michelle Higgins, *Stretched Buyers Push Mortgage Levels to a New High*, WALL ST. J., June 12, 2002, at D1; STUART S. ROSENTHAL, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., ELIMINATING CREDIT BARRIERS TO INCREASE HOMEOWNERSHIP: HOW FAR CAN WE GO? 1, 7 (2001); Farnoosh Torabi, *Home Loans First-Timers*, MONEY, Nov. 2003, at 35 (discussing Fannie Mae's Flex mortgage and Wells Fargo's No Money Down

made it easier for cash-strapped buyers to purchase homes that would have been beyond their reach fifteen years earlier by encouraging them to apply for both first and second mortgages when they purchased the home.<sup>38</sup> Though lower- and middle-income potential and existing homeowners may have greater access to credit due to this democratization of credit, many of those homeowners are paying far too much for their housing expenses. That is, decreasing barriers to homeownership has now increased the number of homeowners (especially low-income homeowners) who spend 50% of their monthly income on housing expenses — a significant increase from the 30% figure historically recommended by private and public lenders.<sup>39</sup>

Research indicates that 80% of extremely low income homeowners<sup>40</sup> spend more than 30% of their income on housing expenses (mortgage, property taxes, and insurance) and that 60% of these homeowners spend more than half their income on housing expenses.<sup>41</sup> Given the increase in job instability,<sup>42</sup> the decreased availability of comprehensive health insurance,<sup>43</sup> and

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Plus 3% or no-money-down loan programs).

38. Doing so allowed them to avoid paying the private mortgage insurance typically charged when borrowers put down less than 20% of the home price. Simon & Higgins, *supra* note 37. See Exec. Order No. 418 Housing Certification, Commonwealth of Mass., Dep't of Hous. and Comm. Dev. (2003) (discussing "soft second mortgages" which allow the borrower to avoid paying private mortgage insurance), available at [www2.massdhcd.com/e418portal/FY03/CommReport02.asp?MNO=163&FY=2003](http://www2.massdhcd.com/e418portal/FY03/CommReport02.asp?MNO=163&FY=2003).

39. LOUIE ET AL., *supra* note 6, at 3; STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 3, 4. See also Judy Ellen & Feldman McGirt, *Am I Ready to Buy a Home?*, MONEY, Mar. 2004, at 30 (suggesting that lenders prefer that housing expenses—mortgage, insurance, taxes and maintenance—not exceed 28% of gross income and that total debt payments not exceed 36%). While the mortgage debt burden has declined for high-income homeowners, the proportion of total family income low-income homeowners devote to paying their mortgage debt increased. See Bahchieva, Wachter & Warren, *supra* note 5, at 11.

40. LOUIE ET AL., *supra* note 6, at 4 (defining extremely low income homeowners as homeowners with incomes less than 30 % of area median).

41. *Id.* at 3. A household that pays between 30% and 50% of income for housing (including mortgage, insurance, real estate taxes and utilities) is moderately cost-burdened while a household that pays more than half its income for housing is severely cost-burdened. See STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 25–26 (suggesting that 30% of all U.S. households have housing affordability problems, that 1 in 7 spend more than half their income on housing, and that homeowners now outnumber renters). The total number of Asian, Black, and Hispanic lower-income households who are severely cost-burdened is more than twice the number of households who either are moderately burdened or not burdened (pay 30% or less of monthly income for housing). See *id.* at 105 tbl.A-9.

42. WARREN & TYAGI, *supra* note 23, at 83 (documenting the increased likelihood that an earner will lose a job).

43. Increasingly, employers are providing reduced (or no) health insurance even though medical care expenses have soared. See JOEL E. MILLER, NAT'L

increased rates of divorce,<sup>44</sup> lower-income households increasingly are unable to pay for basic home maintenance or more extensive renovations.<sup>45</sup> Because these homeowners can barely pay their mortgage debt, they face the prospect of either remaining in a deteriorating home or going even deeper in debt by taking out a home equity loan to make any needed repairs to their home.<sup>46</sup>

Little data address the extent to which the increased availability of credit has helped borrowers buy and retain their homes. Some studies suggest that there has been a dramatic growth in the number of foreclosures by subprime lenders (especially relative to the number of foreclosures by other lenders), that the foreclosure rate for subprime mortgages is thirteen times higher than the rate for prime loans, and that subprime lenders tend to foreclose on loans at a much quicker rate than prime or conventional loans.<sup>47</sup> That lenders foreclose on subprime loans soon after they are originated suggests the unaffordability of those loans when they were originated.<sup>48</sup>

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COALITION ON HEALTH CARE, *A PERFECT STORM: THE CONFLUENCE OF FORCES AFFECTING HEALTH CARE COVERAGE* 9 (2001), available at <http://www.nchc.org/materials/studies/index.shtml>; Stephanie Strom, *For Middle Class, Health Insurance Becomes a Luxury*, N.Y. TIMES, Nov. 16, 2003, § 1, at 33 (noting the increase in the number of American workers who lack health insurance due to “ever soaring costs and job losses”).

44. Roughly 50% of all marriages will end in divorce and a recent book suggests that middle-class couples have a higher divorce rate than other groups. WARREN & TYAGI, *supra* note 23, at 85–86.

45. LOUIE ET AL., *supra* note 6, at 3.

46. *Id.* Homeowners who lack funds to make home repairs place their health at risk by continuing to live in homes with lead paint, mold, or broken (or hazardous) cooling or heating systems. *Id.* at 12–16, 22. Though the federal government made concerted efforts in the 1990s to increase homeownership rates for minority and lower-income households, it has never provided funds or tax subsidies to help these owners pay for home repairs or improvements. These households must rely either on private charitable organizations (to make the repairs) or private lenders (to loan funds to pay for their repairs). *Id.* at 11.

47. See Bunce et al., *supra* note 25, at 263–64. See generally ACORN, SEPARATE AND UNEQUAL 2004, *supra* note 31, at 9; Dan Immergluck & Geoff Smith, *Risky Business - An Econometric Analysis of the Relationship Between Subprime Lending and Neighborhood Foreclosures* (2004), available at <http://woodstockinst.org/document/riskybusinesspr.pdf>.

48. The quick foreclosure rate in the subprime market also suggests that, at least for some subprime lenders, their ultimate goal was to strip borrowers of their home equity, foreclose on their homes, and sell the homes for a profit — a practice often referred to as a “loan to own” policy. See *Illinois Association of Mortgage Brokers Backs Important Consumer Protection Legislation*, PR NEWswire, Apr. 17, 2000 [hereinafter *Illinois Association of Mortgage Brokers*] (discussing bipartisan attack on “loan to own” practice), at <http://www.prnewswire.com>.

### III. THE AMERICAN NIGHTMARE: PREDATORY LENDING

#### A. Nature of the Abuse

The increase in home equity lending has, not surprisingly, lead to an increase in the incidence of abusive practices in the subprime home equity lending market. Though not all subprime loans are predatory, there is growing evidence of abusive practices in the subprime loan market.<sup>49</sup> While there is no generally agreed upon definition of “predatory,” most agree that predatory lending generally describes fraudulent practices involving loan originations and also loans with terms and practices that use inappropriate risk-based pricing.<sup>50</sup> Fraudulent or illegal predatory practices (all of which are illegal under existing laws) include forging loan documents, misrepresenting the borrower’s income, backdating documents, failing to disclose information required by federal or state laws, and inducing borrowers to apply for loans to pay for home improvements which either are never done or are improperly done.<sup>51</sup> Non-fraudulent predatory loans vary in type, but tend to share certain characteristics.

Predatory loans often have interest rates (including default interest rates) that are significantly higher than needed to ensure against the risk of borrower default.<sup>52</sup> Moreover, some lenders

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49. Subprime mortgage lenders and loan servicers recently have reached multi-million dollar settlements based on unscrupulous or illegal practices involving subprime loans. See Michael Hudson, *Banking on Misery*, S. EXPOSURE, Summer 2003, at 29 (discussing litigation and settlements involving subprime lenders including CitiFinancial and Associates); Daniela Deane, *Mortgage Servicer Must Pay Borrowers; Fairbanks Accused of Unscrupulous Practices*, WASH. POST, Nov. 13, 2003, at E1 (discussing a \$40 million settlement with Fairbanks Capital Corp., the nation’s largest servicer of subprime mortgages); Timothy L. O’Brien, *Fed Assesses Citigroup Unit \$70 Million in Loan Abuse*, N.Y. TIMES, May 28, 2004, at C1 (announcing penalty against Citigroup and its consumer finance company subsidiary). Because most predatory loans are subprime loans, prime loans rarely are deemed to be predatory and predatory lending almost always occurs in the subprime market. See TREASURY/HUD REPORT, *supra* note 22, at 2, 24–5; JOSEPH A. SMITH, JR., N.C. COMM’R OF BANKS, NORTH CAROLINA’S PREDATORY LENDING LAW: ITS ADOPTION AND IMPLEMENTATION 1 (2002).

50. See generally ACORN, *Predatory Lending Practices* (discussing practices viewed as being predatory), at <http://www.acorn.org/index.php?id=754> (last visited Sept. 17, 2004).

51. See generally GOLDSTEIN, *supra* note 23, at 11–12; ACORN, *Predatory Lending Practices*, *supra* note 50 (discussing home improvement scams). Another home improvement scam, known as property flipping, causes potential buyers to purchase a home that has serious (but masked) defects and an intentionally inflated appraisal. The scam involves the seller of the home with the hidden defects, an appraiser, and the subprime lender or broker. See ACORN, *Predatory Lending Practices*, *supra* note 50 (discussing property flipping); Hevesi, *supra* note 32, at 1 (discussing predatory lending practices among the poor).

52. See Hevesi, *supra* note 32, at 1 (characterizing default interest rates as

finance excessive fees (including single-premium credit life insurance<sup>53</sup>) into the loans and many borrowers appear to either be unaware that these fees have been added to the loan or they learn about these fees at closing.<sup>54</sup> Loans that have mandatory arbitration clauses<sup>55</sup> or balloon payments,<sup>56</sup> as well as negatively

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a “nail in the coffin” because borrowers who already have defaulted on loan payments will not be able to make higher payments caused by the higher default interest rate). Though disputed by the subprime market, some researchers have concluded that the interest rates of subprime loans are often higher than necessary to protect lenders from the higher costs associated with lending to riskier borrowers. See Bunce et al., *supra* note 25, at 258. But see *Staten Statement*, *supra* note 23, at 5 (arguing that risks justify higher rates); *Bryce Statement*, *supra* note 34, at 6 (discussing elevated operational costs associated with subprime lending).

53. Credit life insurance is designed to pay off a debt if the borrower dies before paying the loan. Single-premium credit life insurance requires the borrower to pay for the insurance in one lump sum (instead of over time) and typically is financed into subprime loans, thereby increasing the loan amount. This type of fee is especially pernicious since borrowers often pay for the insurance over the life of the loan (since it is included in the loan balance) even though the policy itself typically last no more than five years. ACORN, SEPARATE AND UNEQUAL 2002: PREDATORY LENDING IN AMERICA 42 [hereinafter ACORN, SEPARATE AND UNEQUAL 2002], at <http://www.acorn.org/index.php?id=108>.

54. See GOLDSTEIN, *supra* note 23, at 14, 31 (discussing manipulative pressure tactics designed to exploit borrowers’ cognitive biases and convince them to sign documents at closing that contain terms different from those initially presented to the borrower); Jean Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U. L. REV. 349, 366 (1998) (discussing behavioral tendencies that cause consumer to accept terms presented in form contract). See generally Ctr. For Responsible Lending, *Abusive Practices: 7 Signs of Predatory Lending* (discussing study that suggests high numbers of borrowers are unaware that their loan financed single premium credit insurance), at <http://www.responsiblelending.org/abuses/abusive.cfm> (last visited May 28, 2004). Credit insurance can especially be profitable to lenders who are associated with the insurance companies that provide the insurance. See Hudson, *supra* note 49, at 32 (discussing cross-selling and the profitability of credit insurance to one lender (Citigroup) because a sister company writes the insurance policy).

55. Mandating private arbitration forces borrowers to abandon certain judicial rights, including a jury trial, appeal options, and the right to rely on judicial precedent. Consumer advocates argue that mandatory arbitration protects lenders from large jury verdicts that would force them to reform their predatory practices. See Hudson, *supra* note 49, at 42–43. Lenders contend that arbitration helps consumers by allowing them to avoid the excessive costs and delays associated with the jury trial system. *Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Hous. and Urban Affairs*, 107th Cong. 6 (2001) [hereinafter *Zeltzer Statement*] (prepared statement of Jeffrey Zeltzer, National Home Equity Mortgage Association).

56. Balloon payments require borrowers to pay off a loan balance in one payment after making regular payments, typically for 5–7 years. A balloon loan often requires the borrower to pay off more than 75% of the principal balance of the loan in one payment. See generally FANNIE MAE, *TAKING THE MYSTERY OUT OF YOUR MORTGAGE* (2003), available at

amortized loans, can also be abusive, depending on the borrower's financial condition.<sup>57</sup>

Mandatory prepayment penalties, which charge borrowers who pay off (or refinance) loans early, also are cited as potentially abusive. Both consumer and lender advocates agree that a loan that fails to disclose the penalty or that contains penalties that are "unduly long" is abusive.<sup>58</sup> Consumer advocates argue that, even if disclosed, these penalties can still strip owner wealth because they often charge up to six months' interest if borrowers prepay the loan in the first five years.<sup>59</sup> Consumer advocates also contend that the prevalence of prepayment penalties in subprime loans and their virtual absence in prime loans suggests that lenders are unfairly targeting subprime borrowers.<sup>60</sup> Subprime lenders respond that prepayment penalties often help borrowers because lenders can offer them lower interest rate loans because these

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<http://www.efanniemae.com/singlefamily/pdf/takingthemysteryout.pdf> (last visited June 14, 2004).

57. Negative amortization occurs when the borrower makes regular monthly payments, but the principle loan balance increases because the payments do not pay off accrued interest or principal. While both balloons and negative amortization can be beneficial to some borrowers (especially those who need the low payments associated with negatively amortized loans or who intend to sell their homes before the balloon payment is due), lower-income borrowers rarely benefit from these loans — especially if they are forced to refinance the loan and incur additional points and fees. See generally ACORN, *Predatory Lending Practices*, *supra* note 50 (describing negative amortization).

58. See, e.g., *CFAL Statement*, *supra* note 25, at 18.

59. Thus, for a \$100,000 loan with 11% interest, the prepayment penalty would exceed \$5,000. See *Seven Signs of Predatory Lending*, S. EXPOSURE, Summer 2003, at 70. A consumer advocate notes that the \$7,500 fee that would be assessed against a homeowner who sought to prepay a \$150,000 loan (with an interest rate of 12%) constitutes approximately 40% of the total net worth of the median black family in 2001. *Stein Statement*, *supra* note 18, at 8. Fannie Mae discourages lenders from including mandatory prepayment penalties in the loan document unless the penalty is disclosed and gives the borrower some benefits. Fannie Mae, *FAQ: Predatory Lending Practices*, at <http://fanniemae.com/faq/231001q.jhtml?p=FAQ> (last visited Oct. 10, 2004). Two large subprime lenders (Household International and The Associates) settled complaints about involving prepayment penalties and Household agreed to limit all prepayment penalties to the first two years of the loan. Paul Beckett, *Household Settlement Boosts Stock*, WALL ST. J., Oct. 14, 2002, at A7.

60. *Stein Statement*, *supra* note 18, at 8–9; U.S. DEPT. OF THE TREASURY AND U.S. DEPT. OF HOUS. & URBAN DEV., 106TH CONG., JOINT REPORT ON CURBING PREDATORY HOME MORTGAGE LENDING 90 (2000) (suggesting that more than two-thirds of subprime loans, but only 2% of prime loans, contain prepayment penalties); DEBBIE GOLDSTEIN & STACY STROHAUER SON, WHY PREPAYMENT PENALTIES ARE ABUSIVE IN SUBPRIME HOME LOANS 6 (2003) (suggesting that 80% of subprime loans versus less than 2% of prime loans have prepayment penalties), available at [http://www.responsiblelending.org/pdf/PPP\\_Policy\\_Paper2.pdf](http://www.responsiblelending.org/pdf/PPP_Policy_Paper2.pdf).

loans are more valuable in the secondary market.<sup>61</sup> Moreover, lenders contend that they should be allowed to include reasonable prepayment penalties in subprime loans to protect themselves against the uncertainty and market instability associated with the frequent turnover of loans.<sup>62</sup>

Certain lender practices are also associated with predatory loans. One practice, known as loan flipping, involves repeated refinances of the same loan.<sup>63</sup> Another practice, often referred to as “asset-based” or in rem lending, involves loans that the borrower cannot afford to repay. Consumer advocates argue that lenders who engage in asset-based lending focus on the borrower’s equity in the home and have as their ultimate goal receiving the borrower’s house, not receiving timely loan payments.<sup>64</sup> Because mortgage brokers play a primary role in home loan originations and originate significantly more subprime loans than prime loans, flipping, in rem lending, and other unfair or fraudulent practices often involve brokers.<sup>65</sup> Indeed, because broker compensation depends largely on the total loan amount, brokers have an incentive both to place borrowers in high interest loans and to pack excessive fees into the loan.<sup>66</sup> Likewise, brokers and loan

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61. See *CFAL Statement*, *supra* note 25, at 18–19 (suggesting that a prepayment penalty can lower an interest rate by a full point and that subprime borrowers who do not intend to move or refinance in the near future would benefit). Indeed, the subprime industry maintains that forcing borrowers to bring additional cash to pay points (and, thus “buy down” the interest rate) at closing is the functional equivalent of an upfront prepayment penalty. *Id.* at 20.

62. *Samuels Statement*, *supra* note 34, at 11.

63. See, e.g., *Seven Signs of Predatory Lending*, *supra* note 59, at 71. Some lenders (or their brokers) intentionally offer borrowers a high interest rate loan or one with unaffordable monthly payments to ensure that the borrower will need to refinance the loan. With each refinance, the loan amount increases because new fees are added (and the borrower often is forced to pay a prepayment penalty). Consumer advocates argue that these transactions give borrowers few tangible benefits and serve only to strip equity from the home. ACORN, *SEPARATE AND UNEQUAL* 2002, *supra* note 53, at 44. See generally ACORN, *Predatory Lending Practices*, *supra* note 50 (suggesting that lenders start borrowers with higher interest rate loan with goal of flipping loan to slightly lower rate that charges additional fees).

64. See, e.g., ACORN, *Predatory Lending Practices*, *supra* note 50 (discussing the broker’s goal of obtaining fees and the lender’s goal of foreclosing on the home then reselling it for a profit).

65. *CFAL Statement*, *supra* note 25, at 4; *Stein Statement*, *supra* note 18, at 10. See PR Newswire, *Illinois Association of Mortgage Brokers*, *supra* note 48 (suggesting that the majority of home loans are originated by brokers). Though borrowers may believe (and may have been told) that the broker’s job is to help them find the most favorable loan terms, mortgage brokers are unregulated in most states and generally owe no fiduciary duties to borrowers. *Stein Statement*, *supra* note 18, at 10.

66. Brokers also have an incentive to flip lower rate loans into higher rate loans or to pack fees into the loan because of the industry practice of compensating mortgage brokers with a “yield spread premium” that pays



officers have an incentive to make loans with a high loan-to-value ratio because most loans are sold or securitized in the secondary market. Brokers/lenders have no incentive to determine the borrower's creditworthiness or ability to repay the loan because their compensation is not based on whether the loan ultimately is repaid and, thus, they do not bear the risk of loss if the borrower defaults.<sup>67</sup>

Another lender practice that is unfair, abusive, and discouraged by public secondary purchasers, though likely legal, is the steering of borrowers whose income qualified them for lower-interest (or even prime) loans into higher-cost subprime loans.<sup>68</sup> Steering especially appears to be directed toward elderly and minority borrowers.<sup>69</sup> For example, while the number of subprime purchase loans to black borrowers increased by 686% from 1995-2001, the number of prime conventional purchase loans actually fell by almost 6%.<sup>70</sup> Subprime loans constitute more than half (51%) of all refinance loans in black communities, but just 9% of

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brokers a bonus if they steer borrowers into higher interest loans. Though industry reports suggest that this premium can benefit customers who are unable to (or choose not to) pay the "upfront compensation" brokers require for any particular loan, there is no evidence that borrowers who pay a yield spread premium (and, necessarily, pay higher interest) are offered loans that have more favorable overall terms than the loans offered to borrowers whose brokers did not receive a yield spread premium. Compare *CFAL Statement*, *supra* note 25, at 17 (advocating benefits to consumer of the yield spread premium) with *ACORN, SEPARATE AND UNEQUAL 2002*, *supra* note 53, at 41 (explaining that yield spread premiums harm borrowers, while the borrowers think that are securing the best possible loan).

67. Loans that exceed the value of the borrower's home leave the borrower "upside down", i.e., the borrower owes more than the home is worth. These loans harm borrowers if the lender forecloses on the home or the borrower deeds the home to the lender to avoid a formal foreclosure proceeding because the borrower would still owe the lender money.

68. Fannie Mae has stated that lenders who deliver loans to Fannie Mae for purchase must ensure that "consumers who seek financing through a . . . higher priced subprime lending channel should be offered (or directed toward) the . . . standard mortgage product line if they are able to qualify for one of the standard products." Fannie Mae, *FAQ: Predatory Lending Practices*, *supra* note 59.

69. See generally Bunce et al., *supra* note 25, at 260; *ACORN, SEPARATE AND UNEQUAL 2002*, *supra* note 53, at 2; Michael Hudson, *Banking on Misery*, S. EXPOSURE, Summer 2003, at 37 (reporting a claim by the former manager of a subprime lender that admitted to packing the loans of borrowers who appeared uneducated or inarticulate, was a minority, or was particularly young or old). Elderly homeowners, especially, are vulnerable to subprime home improvement scams since they are less likely to be able to make home repairs themselves but are more likely to need home renovations to accommodate their physical impairments. TREASURY/HUD REPORT, *supra* note 22, at 39, 72; LOUIE ET AL., *supra* note 6, at 12-13.

70. *ACORN, SEPARATE AND UNEQUAL 2002*, *supra* note 53, at 24 (describing the growth of subprime purchase loans)

refinance loans in white neighborhoods.<sup>71</sup> In addition, minorities constitute a larger overall percentage of the borrowers of subprime refinance and purchase loans than their representation among borrowers of prime refinance and purchase loans.<sup>72</sup>

For example, in 2000, black borrowers received 13% of all subprime refinance loans (compared to their 5% share of prime refinance loans) and received 13% of all subprime purchase loans (compared to their 4% share of prime purchase loans).<sup>73</sup> In contrast, white borrowers in 2000 received 70% of prime refinance loans, but only 44% of all subprime refinance loans, and received 73% of all prime purchase loans, but only 51% of subprime purchase loans.<sup>74</sup> In addition, homeowners in high-income black neighborhoods are twice as likely as homeowners in low-income white neighborhoods to have subprime loans.<sup>75</sup> Indeed, both Fannie Mae and Freddie Mac concluded that potentially 35–50% of minority borrowers of subprime loans could have qualified for a lower-cost or conventional mortgage loan product.<sup>76</sup> In response,

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71. ACORN, SEPARATE AND UNEQUAL 2004, *supra* note 31.

72. *Staten Statement*, *supra* note 23, at 2; Bunce et al., *supra* note 25, at 258. See also ACORN, PREDATORY LENDING REPORTS 1 (2001) (reporting that in 2000, 49.9% of all refinance loans received by black homeowners and 26.2% of refinance loans received by Hispanic homeowners were from subprime lenders whereas only 18% of the refinance loans received by white homeowners were from subprime lenders), at <http://www.acorn.org/acorn10/predatorylending/plreports/summary.htm>. It is difficult to discern the precise racial disparity in subprime refinance lending because lenders often failed to report the borrower's race and this failure may mask the actual concentration of subprime lending in minority communities. See ACORN, SEPARATE AND UNEQUAL 2002, *supra* note 53, at 22. The Federal Reserve now requires lenders to inquire about the race of all telephone applicants. See Press Release, Federal Reserve, Federal Reserve Release 20 (June 21, 2002), at <http://www.federalreserve.gov/boarddocs/press/bcreg/2002/20020621>.

73. ACORN, PREDATORY LENDING REPORTS, *supra* note 72, at 2. A recent report indicates that 28% of all purchase money loans blacks received and 19.6% of purchase loans Hispanics received were from subprime lenders in 2002 while whites received only 7.8% of subprime purchase money loans. Likewise, blacks are 4.1 times more likely to receive a subprime refinance loan and Hispanics 2.5 times more likely to receive a subprime loan than whites. ACORN, SEPARATE AND UNEQUAL 2004, *supra* note 31, at 19, 35.

74. ACORN, PREDATORY LENDING REPORTS, *supra* note 72, at 2.

75. Unequal Burden, *supra* note 27, at 2 (reporting that while 6% of homeowners in upper-income white neighborhoods have subprime loans and 18% of homeowners in lower-income white neighborhoods have subprime loans, 39% of homeowners in upper-income black neighborhoods have subprime loans and 51% of all home loans in black neighborhoods were subprime loans (compared to 9% of all loans in white neighborhoods)); ACORN, SEPARATE AND UNEQUAL 2004, *supra* note 31, at 25 (reporting that 19.6% of upper-income black homeowners, 13.4% of Hispanic homeowners, but only 11.2% of lower-income whites receive subprime loans).

76. James H. Carr & Lopa Kolluri, *Predatory Lending: An Overview*, in FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 31, 36–39 (2001) [hereinafter DISTRESSED COMMUNITIES]; FREDDIE MAC,

subprime lenders stress that even higher-income subprime borrowers likely would not qualify for prime loans because of their credit history and debt-to-income ratios, and maintain that they ensure that qualified borrowers are offered all available lending products.<sup>77</sup>

Finally, in addition to being steered to the subprime market, minorities—regardless of their credit profiles—appear to rely disproportionately on subprime lending because prime lenders have significantly reduced the number of banking locations in minority neighborhoods. The absence of traditional lenders in minority neighborhoods may lead minorities to conclude that they would not qualify for a prime mortgage product. Moreover, the remaining vestiges of discriminatory lending practices may prevent minorities from receiving prime loans, thereby forcing them into the higher cost subprime market.<sup>78</sup>

## B. Regulatory Responses to the Abuse

### 1. State and Federal Legislation

Most federal and state legislation that regulates predatory lending practices essentially is a form of price control laws. The oldest federal legislation, the Homeownership and Equity Protection Act of 1994 (“HOEPA”), applies to home equity (not purchase money) loans and mandates additional restrictions and disclosures for home equity or refinance loans that have interest

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AUTOMATED UNDERWRITING: MAKING MORTGAGE LENDING SIMPLER AND FAIRER FOR AMERICA’S FAMILIES 2 (1996).

77. ACORN, *Predatory Lending Practices*, *supra* note 50. Consumer advocates dispute the claim that minority, low-income, and elderly borrowers appropriately are steered to the subprime market by citing research that indicates that loans to lower-income customers perform at levels similar to loans to upper-income customers (especially when prepayment risk is taken into account). See Robert Van Order & Peter Zorn, *Performance of Low-Income and Minority Mortgages*, in *LOW-INCOME HOMEOWNERSHIP: EXAMINING THE UNEXAMINED GOAL* 324 (Nicolas Retsinas & Eric Belsky eds., 2002).

78. See Bunce et al., *supra* note 25, at 258; James H. Carr & Jenny Schuetz, *Financial Services in Distressed Communities: Framing the Issues, Finding Solutions*, in *FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS* 5, 7 (2001) (arguing that racial and economic disparities in subprime lending cannot be justified by borrower creditworthiness alone); ACORN, *SEPARATE AND UNEQUAL* 2002, *supra* note 53, at 34 (discussing racially discriminatory lending practices and lender abandonment of low-income and minority neighborhoods); Ross D. Petty et al., *Regulating Target Marketing and Other Race-Based Advertising Practices*, 8 MICH. J. RACE & L. 335, 354 (2003) (suggesting that the banking industry’s failure to advertise or otherwise market to minorities may depress minority homeownership rates). See generally JOHN P. CASKEY, *FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR* 81–84 (1994).

rates or fees that exceed a certain statutorily defined threshold.<sup>79</sup> HOEPA imposes limitations on prepayment penalties, default interest rates, balloon payments, loan flipping, asset-based lending, and negative amortizations.<sup>80</sup> Many lenders appear to avoid making loans covered by HOEPA because of both the stigma associated with making high-cost loans and the decreased value of those loans in the secondary market.<sup>81</sup>

In response to reported cases of subprime lending abuses (notwithstanding HOEPA safeguards), North Carolina became the first state to adopt consumer protection legislation that regulates "high-cost" loans.<sup>82</sup> The law prevents high-cost loans from including balloon payments, higher post-default interest rates, negative amortization, certain prepayment and third-party fees, and prevents them from financing single-premium credit insurance or offering to a borrower whose debt-to-income ratio exceeds 50%.<sup>83</sup> This law also curtails lenders' ability to flip loans and mandates that borrowers who take out high-cost loans receive homeownership counseling.<sup>84</sup> Other states have also enacted anti-predatory lending legislation that either prohibits or severely regulates some (or all) loan terms viewed as predatory, including the financing of single-premium credit insurance (or debt cancellation, or debt suspension agreements), balloon payments, negative amortization, default interest rates, prepayment penalties, and asset-based lending.<sup>85</sup>

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79. HOEPA applies to first mortgage refinance loans if the annual percentage rate ("APR") is more than 8% of the rate for Treasury securities with a comparable maturity date. The APR interest rate trigger for second mortgages or home equity loans is 10%. If the points or fees the borrower pays exceed the greater of 8% of the loan amount or a flat fee (which is adjusted annually based on the Consumer Price Index), HOEPA also applies. Reg. Z, 12 C.F.R. § 226.32(a)(1)(i) (2004).

80. 15 U.S.C. § 1639(c)-(i) (2000); Reg. Z, 12 C.F.R. § 226.32.

81. See *Bryce Statement*, *supra* note 34, at 10 (noting that members of the Mortgage Brokers Association avoid making HOEPA-covered loans because they are viewed as predatory and because Fannie Mae and Freddie Mac refuse to purchase HOEPA-covered loans).

82. High cost loans generally are defined as those that charge either interest that exceeds Treasury bill rates by specified percentages or loans whose points and fees exceed a certain percentage of the loan amount (excluding certain legitimate fees, such as appraisal or title insurance). CONFERENCE OF STATE BANK SUPERVISORS, STATE INITIATIVES TO BATTL PREDATORY LENDING 10 (2002), available at [http://www.csbs.org/government/regulatory/pred\\_lending/pl\\_initiatives.pdf](http://www.csbs.org/government/regulatory/pred_lending/pl_initiatives.pdf).

83. N.C. GEN. STAT. § 24-1.1E (1999).

84. QUERCIA ET AL., *supra* note 29, at 7, 25.

85. See, e.g., CAL. FIN. CODE §§ 4970-4979.8 (West 2002); District of Columbia Home Loan Protection Act of 2002, D.C. CODE ANN. §§ 26-1151.01-26-1155.01 (2002); Colorado Equity Protection Act, COLO. REV. STAT. §§ 5-3.5-101-5.3.5-303 (2002); MASS REGS. CODE tit. 209 § 32.32 (2002); High Cost Loan Regulation, N.Y. COMP. CODES R. & REGS. tit. 3, §§ 41.1-41.11 (2001); New Jersey Homeownership Security Act of 2002, N.J. STAT. ANN. §§ 46:10b-

After the North Carolina legislation was enacted, the number of subprime refinance loans made in that state decreased, causing some to argue that the law reduced the supply of credit available for lower and middle-income home buyers and has increased the cost of the available credit.<sup>86</sup> In contrast, consumer advocates maintain that the decrease can be attributed to a decline in “bad” refinance loans, i.e., those that contain balloon payments or prepayment penalties exceeding three years, and loans with loan-to-value ratios exceeding 110%. In addition, consumer advocates note that while there was a decrease in subprime loans to customers whose credit scores suggest that they could qualify for prime loans and an overall decrease in refinance loans, there was an overall increase in prime loans to those customers and an increase in purchase money loan originations.<sup>87</sup> In essence, consumer advocates argue, the decrease in subprime refinance loans proves that the law was achieving its intended effect of preventing lenders from engaging in predatory lending practices.<sup>88</sup>

## 2. Critiques of Legislation

### a. Preemption

The Office of the Comptroller of the Currency (“OCC”), the federal agency principally responsible for regulating and supervising federally chartered banks,<sup>89</sup> recently considered whether banks with federal charters can be regulated by state predatory lending laws. The OCC ruled that federal law preempts state consumer protection laws because of its view that those laws encroach on the federal government’s authority to regulate the lending terms of federally chartered (or insured) banking

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22–46:10B-35 (West 2004); Illinois High Risk Home Loan Act, 815 ILL. COMP. STAT. 137/1–137/900 (2004); FLA. STAT. ch. 494.0079(g) (2001); New Mexico Home Loan Protection Act, N.M. STAT. ANN. § 58-21A-14 (Michie 2004); Georgia Fair Lending Act, GA. CODE ANN. §§ 7-6a-1–7-6a-13 (2003).

86. See GREGORY ELLIEHAUSEN & MICHAEL E. STATEN, REGULATION OF SUBPRIME MORTGAGE PRODUCTS: AN ANALYSIS OF NORTH CAROLINA’S PREDATORY LENDING LAW 1 (2002); GREGORY ELLIEHAUSEN & MICHAEL E. STATEN, AN UPDATE ON NORTH CAROLINA’S HIGH-COST MORTGAGE LAW (2003) [hereinafter ELLIEHAUSEN & STATEN, UPDATE ON NORTH CAROLINA].

87. QUERCIA ET AL., *supra* note 29, at 12–18.

88. *Subprime Lending: Defining the Market and Its Customers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 8 (2004) [hereinafter *Butts Statement*] (prepared statement of George Butts, ACORN Housing Corporation); QUERCIA ET AL., *supra* note 29, at 19–21.

89. Other federal agencies with oversight are the Federal Deposit Insurance Corporation, the Federal Reserve System and the Office of Thrift Supervision.

institutions.<sup>90</sup> The OCC also maintains that state laws are unnecessary because existing OCC anti-predatory lending laws adequately protect consumers.<sup>91</sup> Not surprisingly, the subprime lending industry supports the OCC ruling, contending that the overly restrictive patchwork of state laws creates confusion and leads to a balkanized environment which generally disrupts the national mortgage system and erodes investor confidence in (and thus the value of) securitized or pooled subprime loans in the secondary mortgage market.<sup>92</sup> Moreover, lenders maintain that this balkanization of credit will increase the cost of, and decrease the availability of, credit for borrowers with less than prime credit profiles, thus harming the people who should be helped by the legislation.<sup>93</sup> Moreover, lenders contend that the state and local laws are “stealth usury laws” designed to ban certain loans by increasing the costs of certain loan procedures and also increasing lender (and sometimes purchaser or assignee) liability for making those loans.<sup>94</sup>

Critics of the OCC ruling argue that it is ill-conceived because it effectively prevents states from using their laws to protect their citizens from predatory lending practices and because, in any event, only Congress (not a regulatory agency) should preempt state laws and regulations.<sup>95</sup> Critics also dispute lenders’ claims

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90. See *Oversight of Office of the Comptroller of the Currency: Hearing Before the House Comm. on Fin. Servs.*, 108th Cong. 18–19 (2004) [hereinafter *Hawke, Jr. Statement*] (prepared statement of John D. Hawke, Jr, Comptroller of the Currency) (discussing the preemption rule and longstanding precedent to operate under uniform federal standards).

91. See *id.* at 20–21; *OCC Takes on Abusive Loans in Texas In First Case to Allege “Unfair” Lending*, 72 U.S. L. WK. 18 (2003) (suggesting that OCC’s settlement with subprime lender for unfair (but not deceptive) practice indicates OCC’s ability to protect consumers).

92. See *Subprime Lending: Defining the Market and Its Customers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 5 (2004) [hereinafter *Calomiris Statement*] (prepared statement of Charles W. Calomiris); *Bryce Statement*, *supra* note 34, at 3.

93. *CFAL Statement*, *supra* note 25, at 26. See also ELLIEHAUSEN & STATEN, *UPDATE ON NORTH CAROLINA*, *supra* note 86.

94. *Calomiris Statement*, *supra* note 92, at 5; *Bryce Statement*, *supra* note 34, at 13.

95. The Office of Thrift Supervision also ruled that federal savings associations are exempt from state anti-predatory lending laws. Mark Fogarty, *Fed Charters Supercede State’s in Predatory Lending*, N.M. B. WKLY, Sept. 12, 2003, available at <http://www.bizjournals.com/albuquerque/stories/2003/09/15/story5.html>. See generally *Hearing on Oversight of Office of the Comptroller of the Currency: Hearing Before the House Comm. on Fin. Servs.*, 108th Cong. 1 (2004) (prepared statement of the Honorable Peter T. King) (questioning OCC authority to preempt state laws); *Hearing on Oversight of Office of the Comptroller of the Currency: Hearing Before the House Comm. on Fin. Servs.*, 108th Cong. 1 (2004) (prepared statement of the Honorable Rahm Emanuel) (same).

that complying with state consumer protection laws will necessarily increase the cost of credit. Because most subprime mortgages are originated by state-licensed mortgage companies, costs should not significantly increase since state entities should be expected to know their own state laws and generally would not need to understand the laws of other states.<sup>96</sup> Moreover, because states can more quickly respond to abusive real estate lending practices involving their citizens, critics maintain that in the long run federal preemption will harm consumers.<sup>97</sup>

b. Controversy over Scope of "Predatory"

Critics also contend that state predatory lending laws are vague and overbroad, citing the sharp disagreement over which loan features or lender practices should be deemed abusive or "predatory." Both consumer advocates and lenders agree that illegal or fraudulent practices (including forging documents or misrepresenting the features included in a loan) constitute predatory lending practices. Moreover, most now appear to agree that single-premium credit insurance, high-interest default interest rates, asset-based lending, and loan flipping generally are abusive.<sup>98</sup> However, lenders refute suggestions that balloon payments and prepayment penalties are per se abusive because of their view that these loan terms can help borrowers who want low initial payments (which balloons provide) or lower interest rates (which prepayment penalties give to borrowers who do not repay their loans early).<sup>99</sup> Likewise, lending industry spokespersons

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96. See, e.g., *CFAL Statement*, *supra* note 25, at 4 (characterizing the subprime market as primarily local); *Subprime Lending: Defining the Market and Its Customers: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 9 (2004) (prepared statement of William M. Dana, American Bankers Association) (recognizing that "real estate lending is in many ways a local issue").

97. See *Protecting Homeowners: Preventing Abusive Mortgage Lending While Preserving Access to Credit: Joint Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit and the Subcomm. on Hous. and Cmty. Opportunity, Before the House Comm. on Fin. Servs.*, 108th Cong. 7, 14–15 (2003) [hereinafter *Brown Statement*] (prepared statement of George Brown) (detailing superiority of state regulators to protect consumers against predatory lending).

98. *CFAL Statement*, *supra* note 25, at 22; SMITH, *supra* note 49, at 1. Of course, some lenders may now agree that asset-backed lending is improper because of a Federal Trade Commission ruling that concluded that making a loan to a borrower who cannot afford the monthly payments constitutes an unfair and deceptive act and practice. *Predatory Lending Practices in the Home-Equity Lending Market*: Hearing Before the Cal. State Assembly Comm. on Banking and Fin., [NEED CA SESSION NUMBER] (2001) (prepared statement of the FTC), available at <http://www.ftc.gov/os/2001/02/predlendstate.htm>;

99. *Zeltzer Statement*, *supra* note 55, at 4.

vehemently deny that minorities, the poor, or the elderly are inappropriately steered to subprime products, citing their own data that suggest that sub-prime borrowers are demographically similar to the general population and to prime borrowers.<sup>100</sup> Moreover, even if minorities, the poor, and the elderly disproportionately receive subprime loans, lenders argue that they appropriately pay more for credit because they are more likely to have lower income and credit scores and relatively higher delinquency and foreclosure rates.<sup>101</sup>

### C. Non-Regulatory Tools to Combat the Abuse

#### 1. Consumer Counseling and Education

The subprime lending industry contends that the best way to combat abusive predatory lending practices is through the use of consumer financial education and counseling programs.<sup>102</sup> Indeed, credit counseling and financial literacy programs increasingly are touted as the most effective way to help consumers avoid unwise spending decisions.<sup>103</sup> Consumer advocates are more skeptical of the benefits of mandated consumer education for adults<sup>104</sup> and

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100. See *CFAL Statement*, *supra* note 25, at 8–9 (suggesting that subprime borrowers are racially diverse, and are approximately the same age as and have comparable annual incomes to the general population); *Zeltzer Statement*, *supra* note 55, at 3–4 (disputing a stereotype that subprime borrowers are minority, elderly and very poor); *Samuels Statement*, *supra* note 34, at 9 (suggesting that prime and nonprime customers have substantially similar demographic features).

101. ABDIGHANI HIRAD & PETER M. ZORN, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., A LITTLE KNOWLEDGE IS A GOOD THING: EMPIRICAL EVIDENCE OF THE EFFECTIVENESS OF PRE-PURCHASE HOMEOWNERSHIP COUNSELING 13 (Low-Income Homeownership Working Paper Series No. 01.4, 2001); *Staten Statement*, *supra* note 23, at 14–15. Elderly homeowners appear to be targeted by predatory lenders because they tend to have relatively high home equity, but low income, and often have medical or home repair needs and often need funds to support a family member. GOLDSTEIN, *supra* note 23, at 15–17; LOUIE ET AL., *supra* note 6, at 37.

102. *CFAL Statement*, *supra* note 25, at 11; *Samuels Statement*, *supra* note 34, at 14 (noting support by Housing Policy Council, which funds more than 60% of prime and subprime mortgages, for stronger financial literacy programs and greater availability of credit counseling); *Bryce Statement*, *supra* note 34, at 14–15 (noting support of Mortgage Bankers Association, the national association that represents the real estate finance industry, of consumer education); *Zeltzer Statement*, *supra* note 55, at 7 (stating support by trade association for home equity lenders for consumer education).

103. For example, the bankruptcy reform legislation that has stalled in Congress for almost a decade would force debtors to receive limited counseling as a prerequisite to filing for bankruptcy and then would condition the right to a discharge on the consumers completion of a personal financial management course. See, e.g., Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975, 108th Cong. § 106 (2003).

104. Though consumer advocates may be leery of mandated consumer



maintain that counseling and education (without regulating predatory lending practices) inadequately responds to predatory lending just as crime prevention and safety education (without prosecuting the criminal) is an inadequate response to a crime wave.<sup>105</sup>

There is limited empirical evidence about the effectiveness of debtor education or financial literacy and education programs.<sup>106</sup> The programs that appear to be the most effective in helping consumers avoid unwise financial decisions are individualized pre-purchase counseling courses that are taught in a classroom or a one-on-one setting with the borrower.<sup>107</sup> Unfortunately, most credit counseling programs rely heavily on telephone or home study counseling or steer clients to internet sites for financial information.<sup>108</sup> Given this, it is unclear how well these programs

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education for adults, consumer advocates, industry spokespersons, bankruptcy judges, and government officials universally support mandated personal finance courses to K-12 students. See, e.g., Marc Perrusquia, *Bankruptcy Didn't Solve Couple's Financial Problems. They Seek Help to Trim Uncontrolled Spending*, THE COM. APPEAL (Memphis, Tenn.), Dec. 9, 2003, at A8 (reporting support for K-12 financial literacy program by the Federal Reserve Chairman, a nonprofit debt counseling organization, and a bank foundation); *Bankruptcy Judges Launch Debtor Education Program*, CONSUMER BANKR. NEWS, Mar. 19, 2004 (discussing the Credit Abuse Resistance Education Program for middle, high school and college students); John C. Ninfo, II, *Credit Education for Young People Works*, 23-5 AM. BANKR. INST. J. 32 (June 2004) (discussing Credit Abuse Resistance Education Program that provides education to middle, high school and college students and is sponsored by bankruptcy judges and the local bar association).

105. Butts Statement, *supra* note 88, at 9.

106. HIRAD & ZORN, *supra* note 101, at 13. Cf. MARK WIRANOWSKI, JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., SUSTAINING HOMEOWNERSHIP THROUGH EDUCATION AND COUNSELING 5 (2003) (noting that "evidence of the potential benefits of postpurchase education and counseling is almost entirely anecdotal; very little empirical evidence corroborates their effectiveness").

107. *Financial Literacy Education: What Do Students Need to Know to Plan for the Future: Hearing Before the Subcomm. on Educ. Reform, House Comm. on Educ. and the Workforce*, 108th Cong. 4 (2003) (statement of Dr. Angela Lyons, Assistant Professor and Extension Specialist, Department of Agriculture and Consumer Economics) (suggesting financial education reduces the likelihood of being financially at-risk but that effective programs and services must be tailored to the client's needs). Credit counseling agencies may provide less face-to-face counseling because of concerns that borrowers would prefer the anonymity of online education or because borrowers may have difficulties leaving work to attend classes during regular business hours. See *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Sen. Governmental Affairs*, 108th Cong. 2 (2004) [hereinafter *Dancel Statement*] (prepared statement of Bernaldo Dancel, Chief Executive, Amerix Corporation).

108. CONSUMER FED'N OF AM. & NAT'L CONSUMER L. CTR, CREDIT COUNSELING IN CRISIS: THE IMPACT ON CONSUMERS OF FUNDING CUTS, HIGHER FEES AND AGGRESSIVE NEW MARKET ENTRANTS 8, 19 (2003) [hereinafter CREDIT COUNSELING IN CRISIS]; *Profiteering in a Non-Profit*

would educate consumers about the risks of predatory lending practices since education requires more than just providing information.<sup>109</sup>

Advocates for greater regulation of the subprime lending market can now point to recent controversies involving the credit counseling industry to support their view that legislators should use caution before mandating credit counseling instead of regulating lenders. Consumers, their advocates, and some governmental entities have charged existing counseling agencies with engaging in deceptive practices, giving improper advice, and charging exorbitant fees notwithstanding their tax-exempt status.<sup>110</sup> Indeed, some counselors appear to give no budgeting, saving, or planning advice and, instead, encourage consumers to participate into debt management plans (“DMPs”) that require

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*Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Sen. Governmental Affairs*, 108th Cong. 6 (2004) (statement of Cuba Craig, CEO, American Financial Solutions—a nonprofit consumer credit counseling agency) (reporting that counseling and educational services largely consist of interactive online class, telephone sessions, and newsletters). Until 1993, most counseling was supplied in a classroom or by individual in-person meetings. Once Fannie Mae and Freddie Mac required counseling for some of its borrowers, the demand for counseling increased, which may have caused more agencies to start providing home study and telephone counseling. See, e.g., HIRAD & ZORN, *supra* note 101, at 5.

109. See generally Hilgert & Hogarth, *supra* note 26, at 321 (suggesting that education requires a “combination of information, skill-building, and motivation to make the desired changes in behavior”).

110. CREDIT COUNSELING IN CRISIS, *supra* note 108, at 8–9; MAJORITY & MINORITY STAFF OF THE PERMANENT SENATE SUBCOMM. ON INVESTIGATIONS, 108TH CONG., PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING 11, 12 (2004) [hereinafter ABUSIVE PRACTICES IN CREDIT COUNSELING]. Because credit card companies and many state laws require credit counseling programs to have non-profit status, most credit counseling agencies are tax-exempt organizations who are now finding it increasingly difficult to fund credit counseling. CREDIT COUNSELING IN CRISIS, *supra* note 108, at 26–27. The IRS has performed audits of several large consumer counseling agencies in response to allegations of abuse. See *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Governmental Affairs*, 108th Cong. 1 (2004) (statement of the Honorable Mark W. Everson); ABUSIVE PRACTICES IN CREDIT COUNSELING, *supra*, at 31–32 (discussing audits). One of these agencies (AmeriDebt) recently filed for bankruptcy partly because of litigation involving its counseling practices. See also *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Sen. Governmental Affairs*, 108th Cong. 4 (2004) [hereinafter *Puccio Statement*] (prepared statement of John Puccio, President and CEO of Cambridge Credit Counseling Corporation) (deflecting criticisms of tax-exempt not-for-profit status of credit counseling agencies by noting that they are forced to have that organizational structure); Caroline E. Mayer, *AmeriDebt Bankruptcy Threatens Settlement*, WASH. POST, June 8, 2004, at E02.

them to repay virtually all their unsecured credit card debts.<sup>111</sup> There is a fairly high failure rate in DMPs, which is not surprising since employees of some credit counseling agencies often fail to determine whether the consumer has the means to repay the debts, rarely recommend that the consumer would benefit by filing for bankruptcy, and often spend as little as ten minutes “counseling” clients before placing them in a DMP.<sup>112</sup>

Even a well designed consumer education or counseling program may fail if consumers possess certain cognitive biases. Behavioral studies indicate that people tend to underestimate low-probability but high-loss events because the “availability” heuristic

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111. ABUSIVE PRACTICES IN CREDIT COUNSELING, *supra* note 110, at 2–3. Much of the recent controversy surrounding debt counseling agencies involve DMPs. Some agencies now charge consumers monthly service fees (though some deceptively suggest that those fees are “voluntary charitable contributions”) and often charge consumers a one-time initial fee (in an amount equal to one month’s regular debt payment) to “customize” the DMP. CREDIT COUNSELING IN CRISIS, *supra* note 108, at 17, 27; Puccio Statement, *supra* note 110, at 12–13; Jennifer Bayot, *U.S. Suit Accuses Credit Counselor of Deception*, N.Y. TIMES, Nov. 20, 2003, at C17 (discussing a lawsuit filed by the FTC against a large nonprofit credit counselor that alleged the agency charged customers 3% of outstanding debts upon enrollment plus a \$20 monthly fee). Critics note that many DMPs include only the debts of creditors who return a percentage of the funds they receive from the counseling agency back to the agency (an arrangement known as Fair Share). See CREDIT COUNSELING IN CRISIS, *supra* note 108, at 9–11. This often leaves consumers faced with making one payment to the credit counseling agency then multiple payments to secured creditors and to unsecured creditors whose debts are not included in the DMP. See *id.* at 24–25.

112. See *Profiteering in a Non-profit Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the Sen. Comm. on Governmental Affairs*, 108th Cong. 1 (2004) (statement of Jon Pohlman) (former employee of a major credit counseling agency reported that the agency pressured consumers into DMPs and discouraged counselors from scrutinizing consumer’s total financial profile); *Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the Sen. Comm. on Governmental Affairs*, 108th Cong. 1 (2004) (statement of John Paul Allen) (former employer of counseling agency reporting reprimands for spending too much time counseling clients and disclosing too much information to clients). Credit counseling programs suggest that they have been forced to abandon in-depth consumer education programs in favor of DMPs because the credit card industry has substantially decreased its Fair Share Contributions and many essentially refuse to fund credit counseling services other than DMPs. *Profiteering in a Non-profit Industry: Abusive Practices in Credit Counseling: Hearing Before the Permanent Subcomm. on Investigations of the Sen. Comm. on Governmental Affairs*, 108th Cong. 12, 14 (2004) [hereinafter *Malesardi Statement*] (prepared statement of Michael Malesardi). This also likely explains why credit counseling agencies resist advising consumers to file for bankruptcy. CREDIT COUNSELING IN CRISIS, *supra* note 108, at 25. Notwithstanding the high failure rates associated with DMPs, credit counseling agencies contend that DMPs themselves can educate consumers by giving them a framework both to exercise financial discipline and to learn how to devise and follow a budget. See *Dancel Statement*, *supra* note 107, at 4.

causes people to view an event (like losing your home to a foreclosure) as improbable unless the person has recently seen it or heard about it.<sup>113</sup> Likewise, once people form certain beliefs or make decisions based on those beliefs, they become overly committed to those beliefs and are inattentive to, or simply ignore, new information (assuming it is provided) that contradicts their beliefs.<sup>114</sup> If “anchoring” causes their present decisions and choices to be constrained by prior decisions, they will attempt to justify prior decisions even if others suggest that those decisions are not sound.<sup>115</sup>

A cognitively-impaired consumer who has formed a certain belief (e.g. I am a hard worker who deserves the American Dream), will be inattentive to any new information (low or no down payments or cash-out refinance loans may cause high debt-to-income ratios that increase the risk of default and foreclosure) that contradicts her beliefs whether she learns about this information from friends or family, the media, or in a consumer literacy course. Moreover, unless the information is presented to her at a “teachable moment,” she may be unwilling to pursue consumer education or unwilling to change her behavior based on what is being taught in the course.<sup>116</sup>

Even if a current or potential homeowner participates in a consumer education course, she may be over-committed to certain decisions and search for ways to justify those decisions (homeownership provides valuable tax benefits; cash-out refinance loans can help reduce unsecured credit card debt) rather than

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113. See Goldstein & Strohauer, *supra* note 60, at 7 (suggesting borrowers agree to prepayment penalties because of the highly asymmetric position of borrowers versus lenders in understanding the statistical likelihood that they will pay the penalty). See also Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 383–84 (1994) (arguing that homeowners likely discount the risk of losing home to a foreclosure).

114. Matthew Rabin, *Psychology and Economics*, 36 J. ECON. LITERATURE 11, 26 (1998). See generally Forrester, *supra* note 113, at 384–85 (noting how certain heuristics skew the homeowner decisionmaking process); DONALD C. LANGEVOORT, THE HUMAN NATURE OF CORPORATE BOARDS: LAW, NORMS, AND THE UNINTENDED CONSEQUENCES OF INDEPENDENCE AND ACCOUNTABILITY 811 (Georgetown Univ., Working Paper No. 241402, 2000); Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 27–28 (2002).

115. See Rabin, *supra* note 114, at 26 (noting that “‘fresh’ thinkers may be better at seeing solutions to problems than people who have meditated at length on the problems, because the fresh thinkers are not overwhelmed by the ‘interference’ of old hypotheses”).

116. See Hilgert & Hogarth, *supra* note 26, at 320 (discussing the challenge of teaching consumers about financial management topics using an effective method (like one-on-one counseling) at a time when the consumer is most likely to “recogniz[e] the value of the information and [make] a behavioral change”).

accept information that suggests that she needs to change her financial behavior. Likewise, even if confronted with information concerning financially risky behaviors, consumers may interpret that information by incorporating the things that serve their personal interests or pre-conceived beliefs, but ignoring information that contradicts those interests or beliefs. Similarly, the “sunk cost trap” may hamper the effectiveness of consumer education programs by causing people to cling to their past decisions and then incrementally make overly optimistic but good faith decisions (like refinancing mortgages with prepayment penalties multiple times, or taking out a cash-out loan to repay credit card debt) which harms them once an unexpected event occurs (like unemployment, illness, or divorce).

## 2. Additional disclosures

The typical legislative response to abusive business practices is to require additional disclosures.<sup>117</sup> Consumers who are given these additional disclosures theoretically will be better able to make informed choices about the products or services being offered. Mandating additional disclosures to combat predatory lending practices is problematic for a number of reasons. First, even assuming homeowners read the disclosures, they are likely to discount any additional disclosures given the amount of paper they already receive during a mortgage loan closing. Since even a relatively sophisticated consumer likely does not comprehend these existing disclosures, the average consumer likely will not benefit from additional disclosures even if the information is clearly (and comprehensively) presented.<sup>118</sup> Moreover, given the number of Americans who are functionally illiterate, additional disclosures – even if clearly written – would not protect them from a potentially abusive loan.<sup>119</sup>

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117. See, e.g., 15 U.S.C. § 7262; CAL. CIV. CODE § 1748.13 (2003) (requiring credit card issuers to disclose the length of time it would take the borrower to repay the balance if only the minimum monthly payments are made).

118. The Truth in Lending Act (“TILA”) requires lenders to disclose the cost of credit (i.e., finance charges and the APR) to potential borrowers and the Real Estate Settlement Procedures Act (“RESPA”) requires lenders to give potential borrowers a standard statement of settlement costs. See, e.g., Truth in Lending Act, 15 U.S.C. § 1601; Real Estate Settlement Procedures Act, 12 U.S.C. § 2601. Cf. Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1179 (1983) (stating general agreement among scholars that an “adhering party is in practice unlikely to have read the standard terms before signing the document and is unlikely to have understood them if he has read them”).

119. OFFICE OF EDUC. RESEARCH AND IMPROVEMENT, U.S. DEP’T OF EDUC., PUB. NO. 1993-275, ADULT LITERACY IN AMERICA 16 (2002) (reporting that the percentage of functionally illiterate adults in America is near 21%); IRWIN S. KIRSCH ET AL., NAT’L CTR. FOR EDUC. STATISTICS, ADULT LITERACY IN AMERICA 17 (1993) (finding 21–23% of adults are functionally literate). See

In addition, given the cognitive biases previously discussed, even borrowers who comprehend the disclosures may underestimate the likelihood that they will either default on their loan payments or be forced to pay prepayment penalties. Likewise, because lenders are not required to disclose credit and pricing information until closing, few homeowners will delay a closing to try to compare price information (assuming, of course, the potential borrower had the ability to obtain useful pricing information from other subprime lenders).<sup>120</sup> Finally, because research suggests that the most effective form of consumer education is an individualized, in-class format, even if disclosures are clear and understandable, the average borrower will not understand (or change their behavior based on) the information provided in the disclosure or the risks associated with the disclosed term or transaction.

### 3. *Voluntary Compliance or "Best Practices"*

Many subprime lenders appear willing to adhere to voluntary industry codes or "best practices" and they contend that compliance with these guidelines would eliminate much of the perceived or actual abuses in the subprime market.<sup>121</sup> Developing, and offering to comply with, best practices or standards is often proposed by industries or groups who face potentially more stringent regulations.<sup>122</sup> Thus, some subprime lenders have agreed: not to "purchase or offer loans with balloon payments,

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Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POLY REV. 233, 262 (2002) (discussing futility of disclosures for illiterate consumers). Making the disclosures clear and meaningful likely would be cost-prohibitive and still may be too complex for the average consumer. See, e.g., Jean Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U. L. REV. 349, 359–361 (discussing whether even meaningful disclosures would alter consumer behavior).

120. See Mansfield, *supra* note 19, at 544–45 (discussing information asymmetry between lenders and borrowers and general unavailability of pricing information in the subprime market). See generally Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 626 (2000) (discussing inequality of bargaining power and information asymmetry between consumers and the fringe banking industry, including title pawn shops and finance companies).

121. *Zeltzer Statement*, *supra* note 55, at 5 (stating support by the trade association for home equity lenders for the voluntary Code of Ethics and Fair Lending and Best Practices Guidelines).

122. For example, credit counseling agencies now appear willing to comply with voluntary standards to avoid increased federal regulation of that industry. See *Dancel Statement*, *supra* note 107, at 4; *Malesardi Statement*, *supra* note 112, at 8–9. Members of this industry urge Congress to preempt state regulatory efforts, arguing that those regulations create a "confusing, inconsistent state patchwork of laws and creditor mandates." *Malesardi Statement*, *supra* note 112, at 15.

negative amortization, mandatory arbitration clauses,” or single premium credit insurance; not to approve loan applications until they “verify the borrower’s ability to repay the loan;” and “not to solicit their loan portfolios within [a year of] the origination of the loan” (which, theoretically, should prevent loan flipping).<sup>123</sup>

Voluntary codes, practices, or other forms of self-regulation are limited precisely because they are voluntary and do not require lenders to comply with the voluntary rules.<sup>124</sup> A member of the industry who determines that it is more profitable to engage in rogue behavior and ignore or violate the guidelines will do so even if most members of the industry comply with the rules. Since the rules are voluntary, there is no way to force the rogue member to agree to be bound by the voluntary rules. Moreover, even if a lender agrees to be bound by the guidelines, it is unclear who would have the authority to ensure compliance or how lenders who deviate from the guidelines after having agreed to comply with them would be punished.<sup>125</sup>

#### D. Damage to Homeowners Caused by the Abuse

Existing federal and state laws have not adequately protected consumers from either predatory lending practices or legitimate subprime lending that place their homes at risk. Homeowners with weaker credit histories, large household indebtedness, or adjustable rate mortgages are likely to be the most affected by a downturn in the economy or rising interest rates.<sup>126</sup> Homeowners’ higher mortgage debt burdens (whether or not the result of predatory practices) have triggered an increase in the number of lower and middle-income borrowers who are defaulting on

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123. *CFAL Statement*, *supra* note 25, at 22. Of course, the subprime lenders’ willingness to “voluntarily” remove mandatory arbitration clauses may have been prompted by Freddie Mac’s and Fannie Mae’s decision not to purchase prime or subprime mortgage loans that include mandatory arbitration clauses. *Freddie Mac Will Not Buy Subprime Loans that Contain Mandatory Arbitration Clauses*, 72 U.S. L. WK. 2342 (2003); *Fannie Mae Will Not Buy Home Mortgages with Mandatory Arbitration Clauses*, 72 U.S. L. WK. 2463 (2004).

124. Indeed, even a recently formed coalition of credit counseling agencies concedes that self-regulation without federal regulations will be ineffective. See MICHAEL BARNHART, COALITION FOR RESPONSIBLE CREDIT PRACTICES, BUILDING FULL FAITH IN CREDIT COUNSELING: AN AGENDA FOR INDUSTRY REFORM 8 (2004).

125. See Engel & McCoy, *supra* note 5, at 1338 (proposing legislation that requires mandatory participation by subprime mortgage lenders and brokers in self-regulatory organizations that would have the authority to discipline members who violate the rules of existing law). Cf. *ABUSIVE PRACTICES IN CREDIT COUNSELING*, *supra* note 110, at 23–24 (discussing limitations of self-regulation of consumer credit counseling industry).

126. *The Condition of the Banking Industry: Hearing Before the Sen. Comm. on Banking, Hous. and Urban Affairs*, 108th Cong. 6 (2004) (statement of Donald E. Powell, Chairman, FDIC).

mortgage loans and losing their homes either through foreclosures or informal proceedings.<sup>127</sup> Not surprisingly, the rate of foreclosures (especially by subprime lenders) increased when subprime lending increased.<sup>128</sup> While some private and public lenders now refuse to offer (or buy) loans that contain terms that are associated with predatory lending,<sup>129</sup> consumer advocates continue to demand increased regulation of home equity lending. Current legislative efforts focus on protecting homeowners from high cost-loans and eliminating predatory features of subprime lending.

Even if lenders stopped making loans with predatory features or if existing efforts that allow homeowners to refinance out of a predatory loan are successful, many low income, elderly, and minority homeowners will be harmed if they continue to use cash-out refinance or home equity loans to convert dischargeable unsecured card debt into non-dischargeable secured mortgage debt.<sup>130</sup> Recent research indicates that financially stressed homeowners with high loan-to-value ratios tend to have less

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127. See Bahchieva, Wachter & Warren, *supra* note 5, at 13 (stressing that homeowners who have defaulted on their mortgage loans increasingly lose their homes both through formal foreclosure proceedings and because they deed their homes to lenders in lieu of foreclosure).

128. See Bunce et al., *supra* note 25, at 263; Mansfield, *supra* note 19, at 554–56 (discussing studies that suggest increase in the foreclosure rate for subprime home equity loans). While some suggest that the high foreclosure rate for subprime loans is to be expected given the weaker credit histories of the borrowers, consumer advocates suggest that lenders create the high default rates by making loans borrowers cannot afford. See also Hevesi, *supra* note 32, at 1 (discussing increase in subprime mortgage industry predatory lending, and foreclosures). Compare STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 18–19 (suggesting that record level foreclosures are due to an increased share of loans extended to borrowers with weak credit histories), with Mansfield, *supra* note 19, at 541, 553 (arguing that lenders' extended loans to borrowers who could never afford to repay the loans).

129. For example, Fannie Mae has indicated that it will not purchase loans that finance prepaid single-premium credit life insurance premiums. Fannie Mae, *FAQ: Predatory Lending Practices*, *supra* note 59. Many subprime lenders no longer require or offer this type of insurance, most likely because Fannie Mae and Freddie Mac refuse to purchase loans on the secondary market if the loans finance this insurance and because several state consumer lending laws substantially restrict the use of this type of insurance. Similarly, Fannie Mae has indicated that it will not accept loans from lenders where the points and fees charged exceed 5% absent extraordinary circumstances (for example, if the larger fee was warranted because of the small size of the loan). Fannie Mae, *FAQ: Predatory Lending Practices*, *supra* note 59.

130. See Press Release, Mortgage Lender and Community Partners Join Fannie Mae to Introduce New Anti-Predatory Lending Refinance Initiatives to Help Borrowers (Oct. 15, 2001) (discussing a pilot initiative that would permit certain borrowers to refinance out of a high-cost loan into a fixed-rate loan); *Fannie Mae Announces Seven-Year, \$55 Billion 'HouseChicago' Investment Plan to Finance Affordable Housing for 500,000 Chicago Families*, BUS. WIRE, May 15, 2001 (discussing the same pilot initiative).



unsecured consumer debt, which suggests that they are substituting mortgage debt for consumer debt.<sup>131</sup> Given the high loan default rates for low-income and minority households, even if the non-purchase money loans are not fraudulent or abusive, many lower and middle-income homeowners who take out home equity or refinance loans increase the risk that they will place their homes at risk in order pay for non-housing goods and services.<sup>132</sup> Because purchase money mortgage loans help borrowers increase their wealth while non-purchase money refinance or home equity loans often do not, the rest of this Article considers whether bankruptcy laws should continue to provide the same favorable treatment to both types of mortgage debt.

#### IV. BANKRUPTCY TREATMENT OF CONSUMER DEBT

##### A. Mortgage Debt

Mortgage debt receives favored treatment in bankruptcy cases. Even though the debtor's personal obligation to repay this debt can be discharged, the mortgage holder's lien on the debtor's home survives the bankruptcy. Thus, even if the loan is a non-recourse loan or the debtor receives a discharge and is not personally obligated to repay the mortgage, the creditor can foreclose on the debtor's home after the debtor receives a discharge. Giving purchase money mortgage loans favored treatment easily can be justified.<sup>133</sup>

As an initial matter, protecting mortgage lenders from lien avoidance in bankruptcy is consistent with state and federal laws that encourage (and often subsidize) homeownership.<sup>134</sup> Protecting mortgage lenders should decrease lender risk, encourage them to keep lending to potential home owners, and, ostensibly give them a greater incentive to keep interest rates low. When the 1978 Bankruptcy Code was enacted, most mortgages were purchase money loans that had relatively low fixed interest

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131. Bahchieva et al., Wachter & Warren, *supra* note 5, at 17–18.

132. David Flaum, *High Default Rates Found on Memphis Home Loans; Number About Twice that of Nation's 6.4% Average*, THE COM. APPEAL (Memphis, Tenn.), May 21, 2002, at B7 (suggesting that high default rates in one city for Federal Housing Administration-backed purchase money loans were due to lenders giving out bad loans, loans that are too large for the borrower to repay, and abusive loans).

133. See *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220 (9th Cir. 2002); *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992).

134. See, e.g., I.R.C. § 163(h)(1), (h)(2) (date) (allowing a deduction for mortgage interest); I.R.C. § 164(a)(1) (date) (allowing deduction for real estate taxes); I.R.C. §§ 1034(a), 121(a)-(b) (date) (limiting the recognition of gains from home appreciation). The government also has promoted homeownership in the past by encouraging public housing units to be converted to private ownership. See Forrester, *supra* note 113, at 394, 394 n.105 (discussing laws).

rates and were heavily regulated by state usury laws.<sup>135</sup> Today, interest rates that can be charged in the mortgage market are essentially unregulated, lenders increasingly make adjustable rate, or negatively amortized loans, and federal law preempts state usury regulations of interest ceilings on mortgage loans secured by a first lien on the home for federally regulated loans.<sup>136</sup> Though prime purchase money loan interest rates still tend to be relatively low, the interest rates of some subprime loans can be almost double prime rates.<sup>137</sup>

The Code justifiably encourages purchase money lending by giving mortgage lenders protections that other consumer credit lenders (who typically charge much higher interest rates) do not receive.<sup>138</sup> The Code specifically favors mortgage lenders by preventing Chapter 7 debtors from reducing a mortgage holder's claim by bifurcating it into a secured (equal to the value of the home) and an unsecured claim then avoiding or "stripping" the unsecured (i.e., underwater) portion.<sup>139</sup> In addition, a Chapter 13 debtor cannot strip down the lien to the value of the home if the mortgage is partially secured. Some courts also prevent Chapter 13 debtors from discharging or modifying underwater mortgage liens.<sup>140</sup> Recently, however, an increasing number of courts have started to treat first mortgages more favorably than wholly unsecured junior mortgages. Specifically, a majority of federal courts now permit a Chapter 13 debtor to modify or partially avoid a wholly unsecured non-purchase money mortgage lien even though the Code generally prevents debtors from modifying liens on the debtor's principal residence.<sup>141</sup>

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135. See generally Engel & McCoy, *supra* note 5, at 1275 (discussing expansion of mortgage products as a result of federal deregulation of the home mortgage industry).

136. See Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1735f-7a (preempting state usury caps on first lien mortgages); *Id.* § 1735f-7a(1). Lew Sichelman, *Mortgage Discrimination Is Alive and Well*, REALTY TIMES, Oct. 4, 1999, available at [http://www.realtytimes.com/rtpages/19991004\\_discrimination.htm](http://www.realtytimes.com/rtpages/19991004_discrimination.htm).

137. ACORN, SEPARATE AND UNEQUAL 2004, *supra* note 31, at 5.

138. See generally Nobelman v. Am. Sav. Bank, 508 U.S. 324, 331–32 (1993) (Stevens, J., concurring). By making student loan debt presumptively non-dischargeable in both Chapter 7 and 13, the Code gives similar protections to student loan creditors who also tend to lend at below market interest rates. 8 COLLIER ON BANKRUPTCY 1322-05 (Henry J. Somer & Alan N. Resnick eds., 15th ed. Rev. 2004).

139. See *Dewsnup*, 502 U.S. at 412 (holding that a debtor cannot strip down a creditor's lien to the value of the collateral); *In re Pearson*, 214 B.R. 156, 158 (Bankr. D. Ohio 1997).

140. See *Nobleman*, 508 U.S. at 332 (refusing to permit a debtor from stripping down an under-secured lien to the fair market value of the home).

141. See, e.g., 11 U.S.C. § 1322(b)(2) (2004) (preventing debtors from impairing rights of mortgage lenders in Chapter 13 cases). See also *Wade v. Bradford*, 39 F.3d 1126, 1130 (10th Cir. 1994) (prohibiting a Chapter 13 debtor

### B. Other Consumer Debt

Consumer debt levels are staggering. Consumer debt has more than doubled in the last decade and total household debt was almost \$9 trillion in 2003. Consumers had \$6.8 trillion in mortgage debt in 2003 and non-housing debt exceeded \$2 trillion for the first time in 2004.<sup>142</sup> In 1990, the average household non-mortgage debt was approximately \$8,500 but increased to \$14,500 in 2000.<sup>143</sup> Total household debt is at a record high of 112% of disposable personal income.<sup>144</sup>

Credit card debt also has skyrocketed and exceeded \$750 billion at the end of 2002.<sup>145</sup> People with incomes below the poverty level doubled their credit card debt since the early 1990s and the poor now use credit cards more frequently than the wealthiest Americans.<sup>146</sup> Typical non-promotional credit card interest rates in 2004 range from 5.5% to 19.99%.<sup>147</sup> Because credit card lending is unsecured, lenders argue that they must charge relatively high interest rates for these loans to protect themselves against the risk of non-payment.<sup>148</sup> However, unlike non-purchase money home equity or refinance lenders, credit card issuers are not favored creditors in bankruptcy, even though borrowers often take out refinance or home equity loans to repay

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from modifying mortgage lender's rights); *Zimmer v. PAB Lending Corp.* (*In re Zimmer*), 313 F.3d 1220, 1225 (9th Cir. 2002) (permitting stripping of underwater lien); *Lane v. West. Interstate Bancorp.* (*In re Lane*), 280 F.3d 663, 664 (6th Cir. 2002); *Pond v. Farm Specialist Realty* (*In re Pond*), 252 F.3d 122, 124-25 (2d Cir. 2001); *Tanner v. FirstPlus Fin., Inc.* (*In re Tanner*), 217 F.3d 1357, 1358 (11th Cir. 2000); *Bartee v. Tara Colony Homeowners Ass'n* (*In re Bartee*), 212 F.3d 277, 280 (5th Cir. 2000); *McDonald v. Master Fin., Inc.* (*In re McDonald*), 205 F.3d 606, 607-08 (3d Cir. 2000).

142. Barbara Hagenbaugh, *Consumer Debt Loads at Record*, USA TODAY, Mar. 18, 2004, at 1B (citing Federal Reserve data); *Economy and Jobs Watch: Consumer Debt Increases, Savings Rate Down*, at <http://www.ombwatch.org/article/articleview/1938> (Dec. 2, 2003); *Markets; U.S. Import Prices Rise; Consumer Debt Slows*, L.A. TIMES, Apr. 8, 2004, Business at C4.

143. *Non-Profit Credit Counseling Organizations: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 108th Cong. 27 (2003) (statement of Michael Barnhart, Coalition for Responsible Credit Practices).

144. *The Condition of the Banking Industry: Hearing Before the Sen. Comm. of Banking, Hous. and Urban Affairs*, 108th Cong. 4 (2004) (statement of Donald E. Powell, Chairman, FDIC).

145. Eileen Alt Powell, *Consumer Debt More than Doubles in Decade*, AP, Jan. 5, 2004. Standard & Poor's puts the figure much lower, at \$412 billion. See Hagenbaugh, *supra* note 142; CardTrak, *Economic M.O.A.B.*, Mar. 2003, at <http://www.cardweb.com/cardtrak/pastissues/mar03.html>.

146. CREDIT COUNSELING IN CRISIS, *supra* note 108, at 4.

147. Cardweb, *Find a Card*, at <http://www.cardweb.com/perl/cardlocator/survey/lowrate?o=0> (last visited June 10, 2004).

148. Libby Wells, *High-Risk Borrowers Face Sky-High Rates, but Cards Can Be Used to Create Good Credit*, at <http://www.bankrate.com/brm/news/cc/19991220.asp> (last updated Aug. 14, 2002).

credit card debt.

Fortunately for debtors (since almost all consumer bankruptcy cases involve credit card debt),<sup>149</sup> credit card debt is presumptively dischargeable. Credit card issuers can rebut the presumption of dischargeability only if they prove that the debtor fraudulently incurred the debt.<sup>150</sup> Because of the amount of credit card debt that is discharged in bankruptcy, non-dischargeability complaints based on credit card debt are common and contentiously litigated disputes in consumer bankruptcy cases.<sup>151</sup> Though bankruptcy reform legislation that would make it harder to discharge credit card debt has been before Congress for almost a decade, the legislation has not passed and, thus, unsecured credit card debt remains presumptively dischargeable.<sup>152</sup>

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149. SULLIVAN ET AL., *supra* note 2, at 119-20 (2000); WARREN & TYAGI, *supra* note 23, at 77-78.

150. 11 U.S.C. § 523(a)(2). See, e.g., AT&T Universal Card Servs. v. Mercer (*In re Mercer*), 246 F.3d 391, 425 (5th Cir. 2001); Am. Express Travel Related Servs. Co. v. Hashemi (*In re Hashemi*), 104 F.3d 1122, 1126 (5th Cir. 1997).

151. See, e.g., Am. Express Travel Related Serv., Inc. v. Dorsey (*In re Dorsey*), 120 B.R. 592, 595 (Bankr. M.D. Fla. 1990). Some courts have held that debtors who cannot afford to repay credit card charges at the time they incur the debt defraud credit card issuers when they nonetheless use the credit card for purchases. *In re Cullen*, 63 B.R. 33, 35 (Bankr. D. Mo. 1986); J.C. Penney Co. v. Shanahan (*In re Shanahan*), 151 B.R. 44, 47 (Bankr. W.D. N.Y. 1993); Colonial Nat'l Bank USA v. Leventhal (*In re Leventhal*), 194 B.R. 26, 27 (Bankr. S.D. N.Y. 1996); First N. Am. Nat'l Bank v. Widner (*In re Widner*), 285 B.R. 913, 921 (Bankr. W.D. Va. 2002); Am. Express Travel Related Servs. v. Prieto (*In re Prieto*), 258 B.R. 518, 525 (Bankr. S.D. Fla. 2001). Increasingly, however, courts have ruled that credit card issuers cannot prevent debtors from discharging credit card debt that they could not afford to repay based on the court's finding that the credit card issuers failed to properly screen debtors to determine their creditworthiness before they issued the cards, then failed to properly monitor the debtor's credit card use after they issued the card. See, e.g., AT&T Universal Card Servs. v. Mercer (*In re Mercer*), 211 F.3d 214, 217 (5th Cir. 2000) (stating that "the credit card issuers' irresponsible lending practices... leads to more consumer bankruptcies"); AT&T Universal Card Servs. Corp. v. Feld (*In re Feld*), 203 B.R. 360, 372 (Bankr. E.D. Pa. 1996) (allowing discharge of credit card debt on grounds that the creditor did not sufficiently investigate the debtor's income prior to extending credit).

152. Once it became clear that most bankruptcy courts would discharge credit card debt even if the debtor was over-indebted when she used the credit card, the credit card industry lobbied Congress to revise the Code and make it harder to discharge debts. See Lou Dobbs, *In Hock to the Hilt*, U.S. NEWS & WORLD REP., July 21, 2003, at 36; Philip Shenon, *Hard Lobbying on Debtor Bill Pays Dividend*, N.Y. TIMES, Mar. 13, 2001, at A1 ("Sponsors of the bill acknowledge that lawyers and lobbyists for the banks and credit card companies were involved in drafting it."); Donald L. Barlett & James B. Steele, *Soaked By Congress*, TIME, May 15, 2000, at 64, (arguing that Congress aggressively pursued bankruptcy reform because of campaign contributions members received from various banks, credit card companies, debt consolidators, and other financial services businesses and because of the urging from the credit industry's politically influential lobbyists); Robert

In addition to giving unsecured consumer credit card lenders fewer protections in bankruptcy, the Code also gives non-purchase money, non-mortgage lenders fewer protections than mortgage lenders. Specifically, while purchase money and home equity mortgage liens survive bankruptcy, the Code allows debtors to avoid some non-purchase money secured liens on certain types of property.<sup>153</sup> Congress allows debtors to strip certain non-possessory, non-purchase money liens on household goods because they concluded that the liens were often coerced, were not needed to protect the lender's interest (often because the collateral/property had little more than sentimental value and virtually no resale value), and because the debtor's cost to replace the goods were higher than the amount the creditor would receive if the creditor repossessed the goods (which rarely happened).<sup>154</sup>

## V. PROPOSAL

Borrowers often use refinance/home equity loans to pay off other consumer debts or to purchase non-housing consumer goods or services. Given this, the lenders who provide these loans act no differently than other consumer lenders and the interest rates and fees associated with subprime loans (especially those with predatory features) are not substantially different from the rates associated with credit card lending.<sup>155</sup> Since credit card issuers and other non-purchase money consumer creditors have no favored treatment in bankruptcy, there is no theoretical justification for providing such treatment for mortgage lenders who effectively function as general consumer or credit card lenders. Therefore, while liens traditionally pass through bankruptcy, liens that arise because of a pre-petition<sup>156</sup> refinance or home equity loan presumptively should be voided in bankruptcy and the mortgage debt should be treated as a general, unsecured claim.<sup>157</sup> The loans

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Heady, *Consumers Take 1-2 Punch: House And Senate Legislation Would Make It Much Harder for Debtors to Declare Bankruptcy*, CHI. TRIB., Sept. 16, 1998, at C7.

153. 11 U.S.C. § 522.

154. H.R. REP. NO. 95-595 (1977); S. REP. NO. 95-989 (1978). Both reports appear reprinted in 11 U.S.C.S. § 522.

155. Holden Lewis, *Fed Tightens Rules on Subprime Lending*, Dec. 20, 2001, at <http://www.bankrate.com/brm/news/mtg/20011220a.asp?>.

156. Loans that a debtor enters into post-petition would not be affected by this proposal. Thus, the growing practice of using cash-out refinance loans to fund a Chapter 13 plan could continue, though the lender's lien would be affected by this proposal if the debtor files for bankruptcy again. *In re Sounakhene*, 249 B.R. 801, 804 (Bankr. S.D. Cal. 2000); *In re Evora*, 242 B.R. 560, 560-62 (Bankr. D. Mass. 1999).

157. There may be limited instances in which a loan that was designed to lower a borrower's overall debt failed to do so or the loan did not worsen the borrower's position in bankruptcy. In those instances, the creditor should be allowed to prove that the lien should not be stripped because the loan was

affected by this proposal would include non-purchase money loans that convert dischargeable non-housing consumer debt into non-dischargeable mortgage debt by, for example, repaying consumer debts or purchasing non-housing goods or services or loans that replace a lower interest rate mortgage loan.<sup>158</sup>

### A. *Benefits*

Consumers benefit in bankruptcy by having credit card or other unsecured non-purchase money debt rather than mortgage debt because, absent fraud, they can discharge the unsecured debt and the unsecured creditor has no bankruptcy or state law right to take the debtor's home after the bankruptcy. Distinguishing between purchase money and refinance/home equity debt in bankruptcy, instead of making a distinction between prime, subprime, and predatory lending, is consistent with the bankruptcy Code's more favorable treatment of purchase money debts. Moreover, treating purchase money debt more favorably than non-purchase money debt further reinforces the public policy that supports home acquisitions. Likewise, focusing on whether

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designed to lower the borrower's payments or that it made the borrower no worse off than the borrower would have been absent the loan. For example, if a borrower uses refinance loan proceeds to pay for college expenses, the creditor should be allowed to prevent the debtor from stripping the lien if the lender can prove that but for the home equity loan, the debtor would have incurred non-dischargeable student loan debt. Cf. Engel & McCoy, *supra* note 5, at 1343-44 (proposing a suitability test that evaluated whether terms in the subprime loan provided a "discernable benefit" to the borrower or were economically justified). When liens are avoided in bankruptcy, the value of the avoided transfer is preserved for the benefit of the estate. 11 U.S.C. § 551. To ensure that the debtor (and not his unsecured creditors, including the non-purchase money mortgage lender) reaps the benefit of avoiding the lien, the Code would also need to be amended to give debtors a right to exempt the value represented by any non-purchase money mortgage lien that is avoided.

158. Because lenders have "flipped" interest-free mortgages on Habitat for Humanity homes and convinced borrowers to exchange those interest-free mortgages for high interest ones, debtor homeowners should be allowed to discharge the refinanced debt and strip the lien of any lender who flips low-interest prime (or Habitat) loans into high-interest loans. See *Brown Statement*, *supra* note 97, at 7; Perrusquia, *supra* note 104 (discussing Habitat homeowners who almost lost their home to a predatory lender). See generally Engel & McCoy, *supra* note 5, at 1264, 1264 n.19 (discussing lenders who convince borrowers to refinance lower-interest rate loans with higher-rate loans). Loans that refinance higher-interest loans and result in an overall reduction of the loan debt would not be affected by this proposal. Moreover, if the lender and borrower intend for the refinance loan to lower overall debt (by, for example, going from a fixed rate to an adjustable rate during a period when interest rates are falling), but changes in market conditions cause the debt to increase (because, for example, interest rates increase dramatically after the loan is executed), the lender should be allowed to raise as an affirmative defense in a lien avoidance action that the loan was intended to benefit the borrower.

the loan is purchase money (rather than whether it is high-cost or predatory) also avoids the debate over the definition of predatory. Making a distinction between the purposes for the loan also should help prevent lenders from circumventing the law by creatively renaming their lending practices, as some lenders did to avoid HOEPA regulations.<sup>159</sup>

Unlike the price controls contained in most federal and state subprime lending laws, giving non-purchase money loans less favorable treatment in bankruptcy does not ban or otherwise regulate the substantive terms of the loan. Instead, it places the full risk of non-payment on lenders. The practice of asset-based lending indicates that some lenders consciously ignore the borrower's inability to repay the loan. Moreover, the high (and early) default and foreclosure rates associated with subprime lending, and the disproportionately higher amounts of refinance loan debt relative to purchase money loan debt held by debtors in bankruptcy, suggest that many borrowers cannot afford the refinance loans at origination.<sup>160</sup> Creating a rebuttable presumption that these loans are dischargeable will give lenders more of an incentive to carefully screen borrowers into "can pays." Giving lenders an incentive to better screen borrowers by making non-purchase money mortgage debt presumptively non-dischargeable also would bolster recent trends in the secondary market. That is, Fannie Mae has admonished lenders who want it to purchase loans to "determine[] the borrower's ability and willingness to repay the mortgage debt."<sup>161</sup> This policy suggests that Fannie Mae, at a minimum, specifically disapproves of asset-based lending and generally disapproves of any lending that is designed to force the borrower to default and, ultimately lose the home in a formal insolvency proceeding (or deed the home to the lender).<sup>162</sup> Fannie Mae's action also suggests it understands that

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159. To avoid HOEPA regulations, some lenders kept rates under the HOEPA caps but increased the loan by changing fees that are not required to be included when calculating whether the loan is covered by HOEPA. See ACORN, *Predatory Lending Practices*, *supra* note 50. Likewise, after states started to regulate single-premium credit insurance and major secondary market purchasers refused to purchase loans that financed this insurance, lenders replaced credit insurance with "debt cancellation agreements," which essentially were credit insurance agreements but technically were not regulated by state predatory lending laws. See, e.g., *Brown Statement*, *supra* note 97, at 15.

160. See *Puccio Statement*, *supra* note 110, at 1 (suggesting that democratization of credit has caused consumers to have excessive access to overly expensive credit). But see Hevesi, *supra* note 32 (discussing data that suggest that the rate of foreclosure in the subprime market rose while foreclosures in the prime market fell); Bahchieva, Wachter & Warren, *supra* note 5 (pointing to data that there is more refinance debt than prime debt in bankruptcy).

161. Fannie Mae, *FAQ: Predatory Lending Practices*, *supra* note 59.

162. This policy also somewhat confirms consumer advocates' beliefs that

consumers' cognitive biases may prevent them from admitting that they simply cannot borrow their way out of the financial problems.

### *B. Likely Criticisms*

Some homeowners who seek to refinance their purchase money or refinance loans may be affected by the proposal. However, loan transactions that are designed to reduce the borrower's overall mortgage debt (by, for example, refinancing a higher interest loan to a lower interest one) would not be affected by this proposal, lenders could prevent their claim from being treated as unsecured, and their liens would not be avoided. Nonetheless, some will argue that this proposal, like state and local consumer protection laws, will decrease the availability of credit for the people the laws are designed to protect.<sup>163</sup> Lenders likely will argue that the risk of having their liens avoided will cause them either to increase the costs of refinance loans or to stop making these loans altogether. Lenders also might argue that making non-purchase money debt unsecured and dischargeable will disproportionately harm Hispanics and blacks because they receive a greater percentage of subprime loans than prime loans and receive proportionately more subprime loans than non-minorities.

Certainly, minority homeownership increased significantly in the 1990s, at the same time subprime home equity lending was increasing. However, most subprime loans are refinance (not purchase money) loans and, given the dramatic increase in subprime foreclosures in low-income minority communities, it is unclear whether a "democratization" or "balkanization" of credit is best for those consumers.<sup>164</sup> Moreover, even if this proposal affects

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some lenders pressure consumers into accepting certain loan terms (like prepayment penalties or credit insurance) or products even if they are not in their best interest and even if the loans only leave the borrower with more debt. For example, one homeowner reportedly refinanced a purchase money loan, and received a subprime refinance loan for \$17,398 at a 17.99% interest rate. Most of the refinance loan consisted of the debt rolled over from the purchase money loan and the new loan included \$304 in fees. The homeowner received \$93.45 in new money. Hudson, *supra* note 49, at 1. Another homeowner paid \$1,164 for five different types of insurance on a \$5,001 loan and another paid \$7,242 in insurance premiums on a \$34,075 loan. *Id.* at 33, 35.

163. For example, while one commentator argued in favor of allowing home equity loans to be modified in Chapters 11 and 13 and suggested that homeowners should be able to strip down home equity debt to the value of the home (something most courts currently allow, *see* Forrester, *supra* note 113, at 452), the article raises concerns that additional revisions to bankruptcy law (including allowing debtor to avoid non-purchase money liens against the exempt portion of a homestead) should be rejected because of the impact those changes would have on credit availability. *See* Forrester, *supra* note 113, at 454.

164. STATE OF THE NATION'S HOUSING 2003, *supra* note 2, at 15, 19.



the supply of high-cost purchase money loans, it is unclear whether lower or middle-income home buyers generally are able to keep the homes they purchase. Indeed, for some lower-income households, it may be better for them economically to use the income they would otherwise spend on the unaffordable mortgage to instead rent a home, save for their retirement or their children's college expenses, or save money to help their children buy a home in the future.<sup>165</sup>

The proposal may, however, hurt homeowners who seek to refinance a purchase money loan for a home that they could never afford. Though regrettable, existing financial conditions suggest that the American Dream of owning the home of your dreams may already be beyond the reach of many lower and middle-income consumers. Unfortunately, some consumers seem unwilling to believe that they cannot afford the home they desire even if the "dream" home seems too good to be true, even if they are told about the dangers associated with high-cost loans, or even if paying their housing expenses prevents them from saving for their own retirement or their children's college education.<sup>166</sup> This leads them to spend more than 30% (sometimes as much as 50%) of their household income on housing, which puts them at risk of either losing their homes or falling prey to predatory lending practices if they have an income interruption or need to make repairs to their homes.<sup>167</sup> Societal changes, including increased risks of unemployment and divorce, essentially require that potential homeowners view shelter (whether owned or rented) as the Dream instead of assuming that the American Dream consists of a "starter" house, then a larger "dream" house later in life. Though

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165. See THOMAS P. BOEHM & ALAN M. SCHLOTTMANN, HARVARD UNIV. JOINT CTR. FOR HOUS. STUDIES, HOUSING AND WEALTH ACCUMULATION: INTERGENERATIONAL IMPACTS 3-4 (Oct. 2001) (discussing the role of parental homeownership on the timing of transition for young households to homeownership); Dickerson, *supra* note 14 (citing sources that indicate parental wealth plays a crucial role in determining whether and when people attend college or purchase a home). Cf. Engel & McCoy, *supra* note 5, at 1359-60 (accepting criticism that increased regulation of predatory lending may cause credit constraints and endorsing the outcome because of the authors' view that some loans simply "should not be made in the first place").

166. Michael Moss & Andrew Jacobs, *Blue Skies and Green Yards, All Lost to Red Ink*, N.Y. TIMES, Apr. 11, 2004, § 1, at 1 (discussing plight of homeowners who purchased unaffordable homes in the Poconos). See also Paul Gores, *Blacks Here Most Likely to Get Riskier Home Loans*, MILWAUKEE J. SENTINEL, May 8, 2003, at 1D (reporting a consumer counseling supervisor's concern that people regularly ignore risks associated with high-interest loans because of their determination to do anything to quickly buy a house). See also SMITH, *supra* note 49, at 2 (discussing a borrower's vulnerabilities during transaction with a predatory lender, including "low income and/or low wealth, financial [naiveté] . . . or . . . gullibility," and lack of competition among subprime lenders).

167. WARREN & TYAGI, *supra* note 23, at 83.

this suggestion may strike some as paternalistic, changes in the labor market now may dictate that the starter “home” be a rented apartment and the final dream home be a modest house that the owner purchases after renting for a longer period of time.

Even if this proposal restricts the amount of credit available to potential homeowners and appears to be somewhat paternalistic, it will have net positive effects if it prevents homeowners from becoming over-indebted and acts, in effect, as social insurance to protect them from income shocks caused by unemployment, divorce, or medical (or other unanticipated) expenses.<sup>168</sup> Moreover, these restrictions may help eliminate the externalities created when homeowners lose their homes and should help stem the damage caused by the dramatic rise in consumer debt and foreclosures.<sup>169</sup> Stated differently, rather than viewing the decreased availability of home equity or refinance loans as a harm to homeowners, using the bankruptcy Code to regulate non-purchase money mortgages may prevent homeowners from placing their homes at risk to pay for the furniture in the home or the car in the driveway.

## VI. CONCLUSION

Many refinance and home equity loans, especially subprime ones, are systematically stripping homeowners of equity wealth. These loans do not enable homeowners to purchase their homes, and in fact, cause many to lose their homes. To discourage homeowners from converting unsecured debt into secured mortgage debt and to encourage lenders to provide loans that the borrower can afford to repay, non-purchase money mortgage debt should be treated by bankruptcy laws as presumptively dischargeable unsecured consumer debt. Even if this proposal deprives some owners of the ability to use the proceeds from a high-cost loan to make repairs to their homes or to pay off high-interest credit card debt, it at least will prevent more owners from losing the homes themselves.

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168. *Id.*

169. See Engel & McCoy, *supra* note 5, at 1347 (listing external costs of unaffordable mortgage loans, including “homelessness, dependence on the state, and neighborhood decline due to abandoned properties”).

