



2008

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Recommended Citation

Frank A. Hirsch Jr., *The Evolution of a Suitability Standard in the Mortgage Lending Industry: The Subprime Meltdown Fuels the Fires of Change*, 12 N.C. BANKING INST. 21 (2008).

Available at: <http://scholarship.law.unc.edu/ncki/vol12/iss1/3>

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THE EVOLUTION OF A SUITABILITY STANDARD IN THE MORTGAGE LENDING INDUSTRY: THE SUBPRIME MELTDOWN FUELS THE FIRES OF CHANGE

FRANK A. HIRSCH, JR.*

I. INTRODUCTION

The subprime mortgage meltdown that began in 2007, accompanied by a huge spike in delinquencies and foreclosures on mortgage loans, has caused intense focus on possible ways to prevent the reoccurrence of imprudent lending and high-risk loan products when sold to credit challenged consumers. Suitability is a concept recognized in the securities law that imposes a duty on a securities broker to sell only securities to a buyer that are “suitable” for the buyer based on the buyer’s financial wherewithal, tax status, investment objectives, and other factors. Suitability of a mortgage product for a particular borrower is not yet a recognized legal standard with agreed upon characteristics. The notion of developing a suitability standard in the mortgage industry, however, is under serious scrutiny as the operation of the mortgage industry from 2000 to 2006 is being closely examined by executive branch leaders, legislatures, regulators, industry representatives, and consumer advocates.

In the mortgage lending context, suitability refers to the appropriateness of a mortgage loan’s terms for the borrower’s specific situation. This sounds like a benign concept, but the imposition of a suitability standard is historically contrary to established legal rules applicable to the borrower-lender

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relationship, as well as to the role of the mortgage broker in the origination and underwriting process for mortgage loans. Moreover, the suitability standard is at odds with other requirements imposed on lenders to ensure not only equal access to credit, but that the credit needs of low income customers are also met. Nonetheless, the mortgage crisis in 2007 that has continued into 2008 will force a showdown over suitability principles that may alter the legal landscape.

Part I of this article discusses the traditional legal treatment of suitability principles in the mortgage lending context and traces the evolution of the concept in the securities industry. Part II sets forth the arguments by consumer advocates and the counter-arguments by lending industry leaders regarding the application of a suitability standard to the mortgage industry. Part III of the article chronicles recent state and proposed federal legislative approaches that address the concept of suitability for mortgage lending, as well as the position of the federal regulatory agencies which oversee financial institutions. Part IV discusses several recently filed lawsuits that attempt to advance the concept of an unsuitable mortgage. Finally, Part V cautions that imposition of a suitability standard would likely result in the unintended consequence of reducing credit to minorities and increasing the cost of credit generally.

II. TRADITIONAL LEGAL TREATMENT OF SUITABILITY CLAIMS

The relationship of lenders and borrowers is typically viewed as an arms-length transaction where each side looks to advance its own interests. The creditor-borrower relationship is generally not a fiduciary one requiring lenders to guard the interests of the borrowers. For that reason, the concept of suitability has little current support in the case law on mortgage lending.¹ Historically, absent special mitigating circumstances,

1. In the loan underwriting process, lenders generally have no duty to refrain from making a loan if they arguably should know that the borrower cannot repay the loan. *See* *Armstrong Bus. Servs., Inc. v. AmSouth Bank*, 817 So. 2d 665, 676-79 (Ala. 2001); *Wagner v. Benson*, 161 Cal. Rptr. 516, 521 (Cal. Ct. App. 1980); *N. Trust Co. v. VIII S. Mich. Assocs.*, 657 N.E.2d 1095, 1102 (Ill. App. Ct. 1995); *United Jersey Bank v. Kensey*, 704 A.2d 38, 46-47 (N.J. Super. Ct. App. Div. 1997); *DeBry v. Valley Mortgage Co.*, 835 P.2d 1000, 1007 (Utah 1992).

lenders do not even owe borrowers the duty of care to avoid negligence in the lending process, although some regulators take a contrary position based upon their primary goal to ensure safety and soundness to the banking system.² Indeed, lenders do not owe a duty to borrowers to ensure accurate appraisals of the value of the real estate as collateral; instead, loan applicants should make their own determination of value.³ Similarly, a lender need not require or pay for a property inspection, and if one is obtained, the lender is free to condition loan approval on certain repairs being made, but has no duty to disclose all adverse conditions noted or to require all cited items to be repaired.⁴

In the context of the propriety of the borrower's decision to sign the loan and the economic merits of the borrower's financial situation, the lender has no judicially imposed duty to ensure ability to repay the loan,⁵ although most lenders, prior to the recent increase in subprime mortgages, were unwilling to make a loan in which they doubted the borrower's ability to repay. Other than the applicable state and federal laws which mandate certain disclosures under specified conditions, there is generally no duty placed on lenders to tell borrowers the effect of a financing transaction on the borrower's overall financial situation.⁶ A mortgage loan is acknowledged to be a business transaction where each party seeks its own economic interest, rather than a relationship of trust and confidence.⁷ Strong public policies

2. See, e.g., *In re Fremont Inv. & Loan*, FDIC-07-035b, FDIC Enforcement Decisions and Orders 9 (Mar. 7, 2007), <http://www.fdic.gov/bank/individual/enforcement/2007-03-00.pdf> (requiring Fremont to stop making loans without assessment of the borrower's ability to repay at the fully-indexed rate).

3. See *Dubinsky v. Citicorp Mortgage, Inc.*, 708 A.2d 226, 229-30 (Conn. App. Ct. 1998); *Block v. Lake Mortgage Co.*, 601 N.E.2d 449, 452 (Ind. Ct. App. 1992); *Fuller v. Banknorth Mortgage Co.*, 788 A.2d 14, 17 (Vt. 2001).

4. See *Bradley v. Prange*, 897 So. 2d 717, 720 (La. Ct. App. 2004); *Guimmo v. Albarado*, 739 So. 2d 973, 975-76 (La. Ct. App. 1999); *Fuller*, 788 A.2d at 17.

5. See *Peterson Dev. Co. v. Torrey Pines Bank*, 284 Cal. Rptr. 367, 377 (Cal. Ct. App. 1991); *Nymark v. Heart Fed. Sav. & Loan Ass'n*, 283 Cal. Rptr. 53, 56-57 (Cal. Ct. App. 1991); *Wagner*, 161 Cal Rptr. at 521; *N. Trust*, 657 N.E.2d at 1102.

6. *Gonzales v. Assocs. Fin. Serv. Co. of Kan.*, 967 P.2d 312, 325 (Kan. 1998).

7. See *Copesky v. Superior Court*, 280 Cal. Rptr. 338, 347-48 (Cal. Ct. App. 1991); *Lawrence v. Bank of Am.*, 209 Cal. Rptr. 541, 545 (Cal. Ct. App. 1985); *First Bank of Wakeeney v. Moden*, 681 P.2d 11, 13 (Kan. 1984); *Dennison State Bank v. Madeira*, 640 P.2d 1235, 1243 (Kan. 1982); *Tokarz v. Frontier Fed. Sav. & Loan Ass'n*, 656 P.2d 1089, 1092 (Wash. 1982).

support a solvent financial system and low barriers to home ownership and these policies militate against exposing mortgage lenders to fiduciary duties and litigation risks.⁸

The exceptions to these general rules include fact patterns where lenders routinely provide extra advice or services as business advisors,⁹ fail to separate their banking and investment services,¹⁰ or otherwise have specific knowledge that the applicant is placing trust and confidence in the lender to look out for the borrower's best interests.¹¹ If a lender exerts control over a borrower, or actively participates beyond the normal protection of its security interest in the loan collateral, then the lender could face potential duties not normally present.¹² If the borrower lacks access to information, is unsophisticated, has specific known infirmities, or some other unusual status, then the normal rules may not apply.¹³ In some jurisdictions, lenders have been subjected to claims of negligent misrepresentation or civil conspiracy for ordering appraisals or prescribing approved appraiser lists resulting in inaccurate appraised value of the collateral in the transaction.¹⁴

Prior to the current subprime mortgage meltdown, the only recognition of a suitability standard in the mortgage industry came from statutory imposition. The Home Ownership Equity Protection Act (HOEPA) amended the Truth in Lending Act to include, for certain high-cost or Section 32 loans, the requirement that the lender must consider the borrower's ability to repay and not just look to the value of the collateral.¹⁵ Similarly, for HOEPA loans, any refinancing within one year must be "in the borrower's interest."¹⁶

8. See *Fox & Carskadon Fin. Corp. v. San Francisco Fed. Sav. & Loan Ass'n.*, 125 Cal. Rptr. 549, 552 (Cal. Ct. App. 1975).

9. See *Barrett v. Bank of Am.*, 229 Cal. Rptr. 16, 20-21 (Cal. Ct. App. 1986).

10. See *Scott v. Dime Sav. Bank*, 866 F. Supp. 1073, 1078-80 (S.D.N.Y. 1995).

11. *Klein v. First Edina Nat'l Bank*, 196 N.W.2d 619, 623 (Minn. 1972).

12. See *Cara Corp. v. Cont'l Bank (In re Cara Corp.)*, 148 B.R. 760, 773 (Bankr. E.D. Pa. 1992).

13. See *Paulson v. Centier Bank*, 704 N.E.2d 482, 490 (Ind. Ct. App. 1998).

14. See *Larson v. United Fed. Sav. & Loan Ass'n of Des Moines.*, 300 N.W.2d 281, 287 (Iowa 1981); *Costa v. Neiman*, 366 N.W.2d 896, 899 (Wis. Ct. App. 1985).

15. See Regulation Z, 12 C.F.R. § 226.34(a)(4) (2007).

16. See *id.* § 226.34(a)(3).

Starting with North Carolina in 1999, various state predatory lending statutes codified a requirement that certain loans must provide a “tangible net benefit”¹⁷ to the borrower, imposing a suitability variation on some mortgage transactions. As of 2007, anti-predatory lending statutes have been passed in over thirty different states and regulations in at least seventeen municipalities.¹⁸ These jurisdictions, following the lead of North Carolina, incorporate various suitability-type tests. The proliferation of variant state and municipal regulatory regimes has led many mortgage industry proponents to ask for a single, unified, federal standard – but not one which includes a suitability test.

III. CONSUMER ADVOCATES’ AND INDUSTRY ADVOCATES’ POSITIONS ON SUITABILITY

A. *Consumer Advocate Positions*

Proponents of a suitability standard applicable to the mortgage lending industry point to the fiduciary duties of brokers in the securities industry and argue that this should be the model adopted for the mortgage lending industry.¹⁹ Consumer advocates argue that the existing protections are insufficient because there is information asymmetry between the lender and the borrower concerning mortgage products. They also note that the existing system of protections was not sufficient to deter the subprime mortgage meltdown.

Various forms of suitability protection are advanced by consumer advocates: a fiduciary duty imposed on lenders and

17. See N.C. GEN. STAT. § 24-10.2(c) (2007).

18. See MORTGAGE BANKERS ASS’N, MBA POLICY PAPER SERIES 2007-1, SUITABILITY – DON’T TURN BACK THE CLOCK ON FAIR LENDING AND HOMEOWNERSHIP GAINS 11 (2007), http://www.mortgagebankers.org/files/News/InternalResource/48134_Suitability-DontTurnBacktheClockonFairLendingandHomeownershipGains.pdf; see also National Conference of State Legislatures, Predatory Mortgage Lending, http://www.ncsl.org/programs/banking/predlend_intro.htm (last visited Jan. 31, 2007).

19. See, e.g., Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1337-39 (2006); see also Daniel S. Ehrenberg, *If the Loan Doesn’t Fit, Don’t Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending*, 10-WTR J. AFFORDABLE HOUSING AND COMMUNITY DEV. L. 117, 125-27 (2001).

brokers, rigid underwriting tests, some degree of subjective evaluation by a lender of whether the loan product being sold is best for that borrower, and a private right of action to sue for violations. Professors Engel and McCoy also suggest that a regulator be empowered to specify the parameters of a suitability test.²⁰ When determining a borrower's ability to repay a loan, some consumer advocates²¹ prescribe an underwriting test to deny loans as unaffordable based upon a total debt to income (DTI) ratio of between forty-five to fifty percent. Some suggest that the DTI test should only be a rebuttable presumption. Others argue that all adjustable rate mortgages must be underwritten from the beginning at the fully-indexed rate after considering all associated costs for the loan including escrows for homeowner's insurance, taxes, private mortgage insurance, and additional fees or costs.

The suitability obligation for securities brokers who are regulated by the Securities and Exchange Commission (SEC) and by the National Association of Securities Dealers (NASD)²² has been interpreted to apply only to broker recommendations, not to an order for self-directed trading, and imposes two main obligations.²³ The first level of suitability focuses on the investment product rather than on the customer; brokers must reasonably conclude the securities they recommend are suitable for at least some investors. The second obligation relates to customer-specific suitability. The broker must ascertain whether

20. See Engle & McCoy, *supra* note 19, at 1341-42.

21. See, e.g., Center for Responsible Lending, www.responsiblelending.org (last visited Jan. 29, 2008); Consumer Federation of America, www.consumerfed.org (last visited Jan. 29, 2008); National Consumer Law Center, www.consumerlaw.org (last visited Jan. 29, 2008).

22. See NASD Rules of Fair Practice, NASD Manual (CCH) ¶ 2310(a), IM 2310-2 (requiring that a NASD member "have reasonable grounds for believing that [a] recommendation is suitable" for a customer, based on available facts, including facts about the customer's other securities holdings and his or her financial situation and needs – as well as make reasonable efforts, before executing a recommended transaction, to obtain information about, "1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable . . . in making recommendations to the customer").

23. The "know your customer" rule of the New York Stock Exchange is also cited to justify the need to treat mortgage borrowers fairly and to treat each individually with respect to their largest investment asset – their home. See N.Y.S.E. Rule 405, N.Y.S.E. Guide (CCH) ¶ 2405.

the security is suitable for the particular investor based upon the investor's financial status, tax status, investment objectives, and other reasonable factors.

B. The Mortgage Industry's Position

In general, industry advocates including trade associations such as the Mortgage Bankers Association (MBA),²⁴ the National Association of Mortgage Brokers (NAMB),²⁵ and the American Financial Services Association (AFSA)²⁶ either oppose a suitability standard, or argue that if some standard is developed, then it must be clear and objective in nature, adopted as a federal standard, and should not provide for a private right of action. The MBA advances several justifications for opposing a suitability standard. First, the MBA argues that even objective underwriting standards, such as a DTI ceiling of forty-five percent, may result in the denial of credit when other underwriting factors might justify a loan such as potential earning capacity in a loan to a medical student or a law clerk.²⁷

Second, the MBA argues that suitability tests conflict with other public policy duties placed on lenders to promote fair access to credit, community reinvestment, and increases in homeownership.²⁸ If applying suitability tests to mortgage transactions causes credit denial rates to increase, which will be reported annually in Home Mortgage Disclosure Act (HMDA) reports,²⁹ then lenders will be potentially accused of violating some other

24. See MORTGAGE BANKERS ASS'N, *supra* note 18, at 19-23; see also Letter from Wright H. Andrews, Wash. Counsel, Nat'l Home Equity Mortgage Ass'n, to Jennifer J. Johnson, Sec'y, Bd. Of Governors of the Fed. Res. System 10-11 (June 7, 2006), http://www.federalreserve.gov/SECRS/2006/June/20060613/OP-1253/OP-1253_1_1.pdf. The MBA merged with the National Home Equity Mortgage Association (NHEMA) in October 2006.

25. See Mortgage Bankers Association, www.mortgagebankers.org (last visited Jan 29, 2008); National Association of Mortgage Brokers, www.namb.org (last visited Jan. 29, 2008).

26. See American Financial Services Association, www.AFSA.org (including 350 member organizations operating as mortgage lenders, consumer finance companies, auto finance leasing companies, credit card issuers, and industrial banks).

27. MORTGAGE BANKERS ASS'N, *supra* note 18, at 19.

28. See MORTGAGE BANKERS ASS'N, *supra* note 18, at 20. See *id.* at 20.

29. Home Mortgage Disclosure Act, 12 U.S.C. §§ 2801-10 (2000); see also Regulation C, 12 C.F.R. § 203 (2007).

federal statutes such as the Fair Housing Act (FHA),³⁰ the Equal Credit Opportunity Act (ECOA),³¹ or the Community Reinvestment Act (CRA),³² all of which carry significant class action and reputational risks.

Third, the MBA argues that an uncertain new suitability standard will limit borrower choices, and raise the costs of mortgages based on the increased liability exposure to lenders.³³ If borrowers may argue lack of suitability as a defense to foreclosures, then a lender's ability to realize on its security interest will be impaired,³⁴ and lenders will accordingly charge higher interest rates on mortgage loans.

Fourth, the MBA contends that the primary reasons for defaults on mortgage loans are not loan product choices, but rather family or economic challenges such as unemployment or loss of income (41.5%), illness or death in the family (22.8%), excessive obligations (10.4%), and marital difficulties (8.4%).³⁵

Fifth, the MBA contends that the suitability standard is not appropriate for the mortgage lending industry in terms of policy imperatives or business models.³⁶ Moreover, the MBA argues that the suitability standard is not necessarily working well even in the securities context.³⁷ The suitability rules of the NASD are founded in principles of fraud prevention where a showing of *scienter* – or intentional knowing or reckless conduct by a market professional –

30. Fair Housing Act 42 U.S.C. §§ 3601-19 (2000); *see also* 24 C.F.R. §§ 100-121 (2007).

31. Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691f (2000); *see also* Regulation B, 12 C.F.R. § 202 (2007).

32. Community Reinvestment Act, 12 U.S.C. §§ 2901-08 (2000); *see also* Regulation BB, 12 C.F.R. § 228 (2007). The CRA only applies to bank and savings banks lenders.

33. MORTGAGE BANKERS ASS'N, *supra* note 18, at 22.

34. *See*, KAREN M. PENCE, BD. OF GOVERNORS OF THE FED. RES. SYSTEM, FORECLOSING ON OPPORTUNITY: STATE LAWS AND MORTGAGE CREDIT 1 (2003), *available at* <http://www.federalreserve.gov/pubs/FEDS/2003/200316/200316pap.pdf> (stating that when loans go into foreclosure significant money is lost by lenders estimated to range from thirty to sixty percent of the outstanding loan balance when considering legal fees, foregone interest and property expenses).

35. *See* MORTGAGE BANKERS ASS'N, *supra* note 18, at 24 (citing a Freddie Mac study from 1999-2005 based on a sample of loans from its Workout Prospector database).

36. *See id.* at 28-31.

37. *See id.* at 31.

are required for liability.³⁸ Suitability standards are only triggered based upon a securities professional recommending a specific purchase and where the broker's professional status implies a duty of fair dealing.³⁹ The securities industry lacks the federal legislative policy imperatives of the FHA, ECOA, HMDA, and CRA which require affirmative efforts to expand credit availability.⁴⁰ Order taking, to which the NASD suitability rule does not apply, is more descriptive of what happens in the mortgage industry when borrowers decide whether to borrow and their specific loan requirements. "If a mortgage lender had a requirement to assess suitability of the loans to a borrower, it would be as though, in the securities context, the suitability of the security for the buyer were determined not by the *buyer's* broker-dealer, but rather by the *seller's* broker, foisting a fiduciary duty upon the *wrong party on the other side* of the transaction."⁴¹

Finally, the vagueness of the suitability standard in the securities industry has led to investor claims which are often driven by general stock market declines.⁴² In 1998 for example, the NASD expressed concern when ninety-five percent of filings under members' errors and omissions policies were fueled by unsuitability claims.⁴³ Mortgage lenders similarly fear an onslaught of litigation if a suitability standard is imposed, especially in the current depressed housing market. As the alternative to a suitability standard, mortgage industry lenders suggest improved financial literacy, licensing of brokers, revised and simplified disclosure requirements, and a uniform federal law governing lending abuses which utilizes clear and objective standards.⁴⁴

38. See Lewis D. Lowenfels & Alan R. Bromberg, *Suitability in Securities Transactions*, 54 BUS. LAW. 1557, 1587-88 (1999); MORTGAGE BANKERS ASS'N, *supra* note 18, at 27 (citing *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1993); *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989); *Bloor v. Carro, Spanback, Londin, Rodman & Fass*, 754 F.2d 57, 61 (2d Cir. 1985)).

39. See *Kahn v. Sec. & Exch. Comm'n*, 297 F.2d 112, 115 (2d Cir. 1961) (Clark, J. concurring).

40. See MORTGAGE BANKERS ASS'N, *supra* note 18, at 28.

41. *Id.* at 30 (third emphasis added).

42. *Id.* at 31.

43. *Id.* (citing Lowenfels & Bromberg, *supra* note 38, at 1557).

44. See *id.* at 33.

IV. STATE AND FEDERAL LEGISLATIVE INITIATIVES

A. *State Legislative Initiatives*

Various states have recently passed legislation which incorporates some aspect of a suitability test in the context of mortgage lending. Other states have considered, or are still considering, similar laws adopting suitability concepts. Remaining in a lead role with respect to predatory lending vigilance, North Carolina modified its 1999 predatory lending law in August 2007 to add certain restrictions for designated high-cost home loans,⁴⁵ defined as “rate spread home loans.” The annual percentage rate (APR) on these loans must be in excess of two different trigger points.⁴⁶ Effective January 1, 2008, the new law adopts a variant of suitability standard requiring lenders of “rate spread” loans to determine whether the borrower “has the ability to repay the loan according to its terms and to pay applicable real estate taxes and hazard insurance premiums.”⁴⁷ In making the required determination of a borrower’s ability to repay, lenders making rate-spread loans must consider the borrower’s: (1) credit history; (2) current and expected income; (3) current obligations; (4) employment status; and (5) “financial resources other than the obligor’s equity in the property that secures repayment of the” loan.⁴⁸ If the loan has an adjustable rate, then the lender must consider the borrower’s ability to repay at the fully indexed rate.⁴⁹

Rate spread lenders in North Carolina are also specifically obligated to take reasonable steps to verify the borrower’s ability to repay by considering tax returns, bank statements, payroll

45. See N.C. GEN. STAT. § 24-1.1E (2007).

46. See *id.* § 24-1.1F(a)(7)(a)-(a)(7)(b). Rate spread home loans are defined by two triggers: whether the difference between the APR of “the loan and the yield on U.S. Treasury securities having comparable periods of maturity is” greater than or equal to three percent on first lien loans and five percent on second loans as compared to yields on U.S. Treasury securities of comparable maturity (similar to HOEPA triggers), and whether, when comparing the APR of the loan to the “conventional mortgage rate” of the Federal Reserve Board, the difference is greater than or equal to 1.75 percent for first lien loans and 3.75 percent for second lien loans. *Id.*

47. *Id.* § 24-1.1F(c).

48. *Id.* § 24-1.1F(c)(1).

49. See *id.* § 24-1.1F(c)(3).

receipts, and other similarly reliable documents, which effectively eliminates no-documentation and low-documentation loans if they are high cost.⁵⁰ North Carolina's law, however, does not mandate escrows for taxes and insurance.⁵¹ Mortgage brokers handling rate spread loans are not designated as fiduciaries, but they must disclose to borrowers any reasonably accessible "material information" that might influence the borrower's decision whether to proceed with the loan,⁵² including the total compensation that the broker expects to receive from each potential loan product option which forces disclosure of yield spread premiums, commissions, and fees. North Carolina deleted from the final version of its law a previous duty on brokers to "provide applicants to whom credit has been denied opportunities to correct or explain adverse or inadequate information, or to provide additional information."⁵³

Other states have also recently enacted laws which include some form of a suitability concept. In 2007, Minnesota enacted legislation which covers all loans (not just high-cost loans) which requires that lenders verify a borrower's ability to pay the principal, interest, real estate taxes, insurance premiums, and the mortgage insurance premiums.⁵⁴ For adjustable rate mortgages, Minnesota requires analysis of the borrower's ability to repay at the fully-indexed rate.⁵⁵ The statute specifically creates an "agency relationship" between mortgage brokers and borrowers.⁵⁶

A recently enacted statute in Maine applies only to high-cost loans and imposes upon lenders the suitability concept that they reasonably believe the borrower is able to make the scheduled payments on the loan after considering and verifying the borrower's employment status, income, obligations, credit history,

50. *See id.* § 24-1.1F(c)(2).

51. *See, e.g., id.* (mandating that lender verify the borrower's ability to pay, including their ability to pay related taxes and insurance, but not requiring escrows for taxes and insurance).

52. N.C. GEN STAT. § 53-243.10(5) (2008).

53. H.R. 1817, 2007 Sess. sec. 7, § 53.243.10(10) (N.C. 2007), available at <http://www.ncleg.net/Sessions/2007/Bills/House/PDF/H1817v5.pdf>.

54. Act of Apr. 20, 2007, sec. 2, § 58.13(1)(a)(23), 2007 Minn. Sess. Laws Ch. 18 (West).

55. *See id.*

56. *Id.* at sec. 6, § 58.161(1).

and other relevant factors.⁵⁷

Illinois passed its own form of a mortgage broker predatory lending bill in November 2007. Senate Bill 1167⁵⁸ requires mortgage brokers to make sure that the proposed loan best meets the financial needs of the borrower,⁵⁹ and also to verify that the borrower can afford the various costs of a mortgage loan.⁶⁰ Full disclosure is required to the borrower by the broker including the broker's total compensation for various loan proposals.⁶¹ If the broker presents the borrowers with different loan deals, then the broker must make an apples-to-apples comparison on monthly payments.⁶² Enforcement of the new law is left to the state Attorney General under the Illinois Consumer Fraud statute.⁶³ The law goes into effect June 1, 2008.⁶⁴

Many other states, especially those hard-hit with foreclosures, are considering legislation which includes suitability concepts applied to mortgage brokers or lenders.⁶⁵ For example, recently enacted legislation in Colorado, among other reforms, establishes loan product suitability standards and a quasi-fiduciary responsibility for mortgage brokers.⁶⁶

Mortgage suitability legislation has been rejected, however, in some states. For instance, in 2006 Ohio considered, but ultimately rejected, a proposal to impose fiduciary duties on mortgage brokers and also on lenders in certain situations.⁶⁷ The proposed fiduciary duties would have applied to all mortgage brokers, loan officers,⁶⁸ and also to employees of non-bank

57. See An Act to Prevent Maine Homeowners from Predatory Lending, sec. A-20, § 8-206-D(1)(G)(1)-(2), 2007 Me. Laws Ch. 273.

58. S. 1167, 95th Gen. Assem. (Ill. 2007).

59. See Act of Nov. 2, 2007, § 5-7(a), (a)(1), 2007 Ill. Laws 691.

60. See *id.* § 5-6(a).

61. See *id.* § 5-7(a)(1).

62. See *id.* § 5-10.

63. *Id.* § 4-15.

64. Illinois General Assembly, Bill Status for S.B.1167, Actions, <http://www.ilga.gov/legislation/BillStatus.asp?DocNum=1167&GAID=9&DocTypeID=SB&LegID=29250&SessionID=51#actions> (last visited Jan. 29, 2008).

65. See, e.g., H.R. 07-1322, 2007 Leg., Reg. Sess. (Colo. 2007); S. 07-203, 2007 Leg., Reg. Sess. (Colo. 2007).

66. See H.R. 07-1322, sec. 3, § 12-61-904.5.

67. See, e.g., S. 185, 126th Gen. Assem., Reg. Sess. § 1322.081 (Ohio 2006).

68. See *id.*

mortgage lending companies when: (1) the transaction does not involve a mortgage broker, and (2) the borrower has less than \$25,000 in total net assets (defined as excluding consideration of the equity in the home, social security, pension values and life insurance policies).⁶⁹

B. Federal Proposed Legislation Includes Suitability Standards

Federal mortgage reform legislation might include some variation of suitability standards, but it is too early to tell what any final legislation will require. In November 2007, H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, passed the House.⁷⁰ This bill requires that a lender determine in good faith that a consumer has the ability to repay his mortgage, at its fully-indexed rate if the mortgage is a variable rate product, and that any refinancing transaction provide a net tangible benefit to the borrower.⁷¹ The House Bill closely tracks the suitability concepts incorporated into the North Carolina law. Perhaps not coincidentally, North Carolina Representatives Mel Watt and Brad Miller were sponsors of H.R. 3915. For “qualified safe harbor mortgages,”⁷² a rebuttable presumption is established as to

69. *Id.* § 1349.41(B).

70. See GovTrack.us, H.R. 3915: Mortgage Reform and Anti-Predatory Lending Act of 2007, <http://www.govtrack.us/congress/bill.xpd?bill=h110-3915>.

71. See Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. sec. 201, § 129B(a)(1), (a)(3)-(a)(5) (2007); *id.* at sec. 202, § 129B(b)(1)-(b)(3).

72. *Id.* at sec. 203, § 129B(c)(3)(C)(i)-(c)(3)(C)(v)(III). A qualified safe harbor mortgage is defined as:

any residential mortgage loan--(i) for which the income and financial resources of the consumer are verified and documented; (ii) for which the residential mortgage loan underwriting process is based on the fully-indexed rate, and takes into account all applicable taxes, insurance, and assessments; (iii) which does not provide for a repayment schedule that results in negative amortization at any time; meets such other requirements as may be established by regulation; and (v) for which any of the following factors apply with respect to such loan: (I) The periodic payment amount for principal and interest are fixed for a minimum of 5 years under the terms of the loan. (II) In the case of a variable rate loan, the annual percentage rate varies based on a margin that is less than 3 percent over a single generally accepted interest rate index that is the basis for determining the rate of interest for the

suitability.⁷³ The House bill does not make mortgage brokers or lenders fiduciaries of borrowers and does not set an objective test for suitability such as a specific debt to income ratio cap at forty-five to fifty percent.

In December 2007, Senate Banking Committee Chairman Chris Dodd (D-CT) introduced S. 2452, the Homeownership Preservation and Protection Act (HPPA),⁷⁴ which amends the Truth in Lending Act. HPPA would apply to high-cost loans and defines “subprime mortgage loans” according to the HMDA triggers and “nontraditional mortgage loans” as interest-only or payment option ARMs.⁷⁵ HPPA includes in the loan suitability standard the ability of the borrower to repay the loan. The bill requires the lender to consider the borrower’s: (1) income; (2) credit history; (3) debt-to-income ratio; (4) employment status; (5) residual income; and (6) other financial resources.⁷⁶ If a borrower’s debt-to-income ratio is greater than forty-five percent, then a mortgage is assumed to be unaffordable, unless the originator can show, at a minimum, sufficient residual income to afford the loan.⁷⁷

HPPA expressly creates a fiduciary duty for mortgage brokers in their relationship with borrowers.⁷⁸ HPPA also specifies that all mortgages – not just subprime or non-traditional – have certain protections, including a duty on lenders and brokers of good faith and fair dealing when working with borrowers in the execution of all mortgage contracts.⁷⁹ Loan originators have the

mortgage. (III) The loan does not cause the consumer’s total monthly debts, including amounts under the loan, to exceed a percentage established by regulation of his or her monthly gross income or such other maximum percentage of such income as may be prescribed by regulation under paragraph (6).

Id.

73. *Id.* at sec. 203, § 129B(c)(1)-(c)(2).

74. Home Ownership Preservation and Protection Act of 2007, S. 2452, 110th Cong. (2007).

75. *See id.* at sec. 101, § 103(cc)(4), (5).

76. *Id.* at sec. 201, § 129A(a)(1)(B)(i)-(vi).

77. *See id.* at sec. 201, § 129A(a)(3)(A)-(B).

78. *Id.* at sec. 301, § 129B(b).

79. *Id.* at sec. 301, § 129B(a)(4).

duty to make reasonable efforts to make advantageous loans to borrowers in relation to the borrower's financial circumstances.⁸⁰

C. Federal Regulatory Interagency Guidance Rejects Endorsement of Suitability

The primary federal regulators of the banking system have recently declined to either endorse the appropriateness of a suitability standard as applied to mortgage lending, or to specify the criteria for such a concept. In June 2007, the federal bank regulatory agencies – the Office of the Comptroller of the Currency (OCC), the Federal Reserve System (FRS), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) – issued final guidance on subprime mortgage lending (Interagency Guidance).⁸¹

The Interagency Guidance provides direction for banks, savings associations, and credit unions, and their subsidiaries, holding companies, and non-bank subsidiaries covering such areas as risk management practices, workout arrangements, consumer protection principles, control systems, and supervisory reviews. The subprime mortgage guidance has caused those in the industry some concern that it will be used by plaintiffs' lawyers to form the basis for a standard of care for alleging the unsuitability of loans. The Agencies have tried to dispel the notion that the Interagency Guidance establishes a suitability requirement by the following statement:

The Agencies disagree with the commenters who expressed concern that the proposed statement appears to establish a suitability standard under which lenders would be required to assist borrowers in choosing products that are appropriate to their needs and circumstances. These commenters argued that lenders are not in a position to

80. S. 2452, sec. 301, § 129B(a)(5).

81. Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37,569 (July 10, 2007).

determine which products are most suitable for borrowers, and that the decision should be left to borrowers themselves. It is not the Agencies' intent to impose such a standard, nor is there any language in the Statement that does so.⁸²

Despite this declaration, plaintiffs' lawyers will likely use the Interagency Guidance to argue for suitability principles. Ultimately, Congress could mandate the Agencies, or specific federal regulators, to develop some standards for a suitability test applicable to mortgage lending in general or to subprime or high cost loans in particular.

V. LAWSUITS SEEKING IMPOSITION OF SUITABILITY TESTS TO MORTGAGE LENDERS/BROKERS

In the face of little historical precedent for the imposition of suitability duties on mortgage originators, but emboldened by state legislative initiatives, in 2007 plaintiffs have filed numerous lawsuits which seek the judicial adoption of suitability tests. Several example cases are highlighted below. Two of the cases below have reached resolution, with the plaintiff borrower recovering in one case, *Leff v. Equihome Mortgage Corp.*, and the defendant lenders winning a dismissal in *Green v. Beazer Home Corp.* The remaining cases described in this section have yet to be resolved and demonstrate the variety of theories advanced by plaintiffs.

A. *Recovery for Plaintiffs: Leff v. EquiHome Mortgage Corp.*

In May 2007, a federal jury awarded \$220,000 to an 82-year-old borrower who sued a mortgage company for actions that the borrower claimed violated the New Jersey Consumer Fraud Act.⁸³ The borrower alleged that the mortgage company, EquiHome, engaged in an unconscionable business practice in violation of the

82. *Id.* at 37,572.

83. *See Leff v. First Horizon Home Loan Corp.* (*Leff v. EquiHome Mortgage Corp.*), No. 05-3648 (GEB), 2007 U.S. Dist. LEXIS 65094, at *2-4 (D. N.J. Sept. 4, 2007).

New Jersey Consumer Fraud Act by soliciting a mortgage that was not suitable for him.⁸⁴ The borrower argued that EquiHome representatives convinced him to refinance his non-recourse reverse mortgage with no monthly payments, a credit line of \$76,000, and no risk of foreclosure.⁸⁵ The loan product sold to him was a \$223,000, thirty-year conventional fixed-rate mortgage with monthly payments of \$1,300 and a cash pay-out of \$52,000.⁸⁶ The plaintiff, whose primary income source was \$940 per month from Social Security,⁸⁷ defaulted on the loan within one year of its closing. Prior to trial, the defendants removed the case to federal court in New Jersey.⁸⁸ A jury found that EquiHome's conduct in soliciting the loan violated the New Jersey Consumer Fraud Act and entered a verdict in the plaintiff's favor which was automatically trebled under the New Jersey Consumer Fraud Act.⁸⁹ The final judgment, entered on July 16, 2007, awarded the plaintiff \$111,075 in attorney's fees, \$9,712 in costs and trebled compensatory damages of \$660,000, totaling \$780,787.⁹⁰ Although no opinion was published discussing the application of a suitability standard, it is likely that future plaintiffs will argue unsuitability concepts under state law unfair and deceptive acts and practices statutes.

B. Dismissed on Lenders' Motion: Green v. Beazer Homes Corp.

In April 2007, a Columbia, South Carolina homeowner filed in federal district court in South Carolina a putative class action against homebuilder Beazer Homes and Beazer Homes

84. See Civil Action Complaint and Jury Demand at 28, *Leff v. First Horizon Home Loan Corp.* (*Leff v. EquiHome Mortgage Corp.*), No. L 283-05 (N.J. Super. Ct. filed June 6, 2007).

85. See *id.* at 3-4.

86. See *id.* at 42.

87. *Id.* at 4.

88. Notice of Removal at 1-2, *Leff v. First Horizon Home Loan Corp.* (*Leff v. EquiHome Mortgage Corp.*), No. 05-3648 (MLC) (D. N.J. 2007).

89. *Leff*, 2007 U.S. Dist. LEXIS 65094, at 4, 4 n.1.

90. Final Judgment at 1-2, *Leff v. First Horizon Home Loan Corp.* (*Leff v. EquiHome Mortgage Corp.*), No. 05-3648 (GEB-TJB) (D. S.C. 2007).

Mortgage in *Green v. Beazer Homes Corp.*⁹¹ The complaint sought declaratory and injunctive relief as well as damages against Beazer Homes for conspiring to sell homes to “unqualified low-income purchasers” who obtained financing from Beazer Home Mortgage.⁹² The plaintiff claimed that Beazer’s actions caused an excessive number of foreclosures that led to “abnormal depreciation” of property values in plaintiff’s neighborhood subdivision.⁹³ According to the plaintiff, the builder and mortgage company owed the putative class members a duty to sell houses to persons in their neighborhoods who could make timely mortgage payments.⁹⁴ Beazer moved to dismiss the case for lack of standing and for failure to state a claim.⁹⁵ The case was dismissed on September 10, 2007 and was not appealed.⁹⁶ The court ultimately found that the plaintiff lacked standing because she did not allege that she had sustained any injury and could not show that the defendants’ alleged actions caused anything more than collateral injury.⁹⁷ The court also dismissed plaintiff’s negligence, civil conspiracy, and RICO claims for failure to state a claim.⁹⁸ In dismissing the negligence claim, the court held that the relationship between the plaintiff and the defendants was too attenuated to establish a duty of care.⁹⁹

C. *Pending Litigation*

1) *Hennessy v. Dawson*

This case, filed on behalf of forty putative class representatives in the New York Supreme Court, alleges that the lenders named as defendants engaged in predatory lending by

91. Complaint at 5, *Green v. Beazer Homes Corp.*, CV-No.07-01093 (D. S.C. 2007).

92. *Green v. Beazer Homes Corp.*, No. 3:07-1098-CMC, 2007 U.S. Dist. LEXIS 66887, at *2-3 (D. S.C. Sept. 10, 2007).

93. Complaint, *supra* note 91, at 2.

94. *Id.* at 7.

95. *See Green*, 2007 U.S. Dist. LEXIS 66887, at *1-2.

96. *See id.* at *10.

97. *See id.* at *7.

98. *See id.* at *8-10.

99. *Id.* at *9.

making mortgage loans which were “unsuitable” for plaintiffs.¹⁰⁰ The twenty-five named defendants include lenders such as Invest Financial Corp., PHH Mortgage Corp., Countrywide Home Loans, Homecomings Financial, Washington Mutual, and IndyMac Bank.¹⁰¹ The complaint also seeks a preliminary injunction preventing the foreclosure of plaintiffs’ loans, and relies upon a forecast of expert testimony that the approved loans were “unsuitable and that there were . . . warning signs of potential fraud at their closings.”¹⁰² The court has not ruled on plaintiffs’ injunction request.

The *Hennessy* plaintiffs allege that the main defendant, Peter J. Dawson, orchestrated a “Ponzi” scheme that solicited elderly clients to take out mortgage loans on their largely paid-for homes in order to fund supposed high-return investments.¹⁰³ Dawson allegedly deposited the mortgage loan proceeds into his “disbursement account” and paid the plaintiffs’ mortgage payments for a short period of time.¹⁰⁴ Dawson allegedly stole funds from the plaintiffs’ mortgage loans for himself, using new customers’ money to fund payments on prior customers’ loans.¹⁰⁵

Plaintiffs also sued their lenders, alleging that their loans were oppressive and unconscionable, and contending that the closing attorney should not have closed such suspect loans.¹⁰⁶ The pleadings suggest a three-part test for “unsuitability.”¹⁰⁷ A loan may be unsuitable for a borrower who lacks the: (1) income; (2) ability; or (3) willingness to repay the loan at issue.¹⁰⁸ The elderly and retired plaintiffs claim that their loans were unsuitable because they lacked sufficient income or ability to repay, and that

100. Affirmation in Support of Plaintiffs’ Motion for a Preliminary Injunction at 4, *Hennessy v. Dawson*, No. 06-019368 (N.Y. Sup. Ct. Mar. 20, 2007) [hereinafter Preliminary Injunction Motion]. This section, Part V.C.1, is excerpted from an article by the author and Matthew P. McGuire. See Matthew P. McGuire & Frank A. Hirsch Jr., *Subprime ‘Suitability’ Case Rides Crest of Litigation Wave*, CONSUMER FIN. SERVICES L. REP., May 2, 2007, at 3-4.

101. See *id.* at 1.

102. *Id.* at 3.

103. See *id.* at 4.

104. *Id.*

105. See *id.*

106. See Preliminary Injunction Motion, *supra* note 100, at 2, 12.

107. See *id.* at 9-10.

108. See *id.*

the lenders did not engage in sufficient due diligence to qualify them plaintiffs for their loans.¹⁰⁹

2) *Tingly v. Beazer Homes Corp.*

In *Tingly v. Beazer Homes Corp.*, the plaintiffs filed a putative class action in North Carolina state court in March 2007.¹¹⁰ The defined class consisted of “[a]ll North Carolina residents who purchased homes in subdivisions in North Carolina containing homes constructed by Beazer where the foreclosure rate for the subdivision [was] significantly higher than the statewide average.”¹¹¹ The plaintiffs alleged that Beazer Homes built subdivisions with home prices accessible to low income individuals and then, through a “scheme” with Beazer Mortgage, targeted renters in apartment complexes near the subdivisions.¹¹² The complaint alleged that Beazer Homes and Beazer Mortgage “advise[d] or encouraged the prospective” low income buyers to falsify information on mortgage loan applications.¹¹³

The plaintiffs’ suitability argument accused Beazer of liability for borrowers’ obligations for mortgage payments on loans for which they never would have qualified but for the defendants’ “scheme” to “target and victimize” low income individuals.¹¹⁴ The resulting higher-than-average rate of foreclosures in these subdivisions and ensuing property value decreases were alleged to be the fault of Beazer and a violation of North Carolina’s unfair and deceptive trade practices statute, which provides for treble damages, attorneys fees, and costs.¹¹⁵

3) *City of Cleveland v. Deutsche Bank*

In January 2008, the City of Cleveland filed suit in Ohio

109. *See id.*

110. Class Action Complaint, *Tingly v. Beazer Homes Corp.*, No. 07-CVS-5916 (N.C. Super. Ct. Mar. 23, 2007).

111. *Id.* at 3.

112. *Id.* at 4-5.

113. *Id.* at 5.

114. *Id.*

115. *See id.* at 5-6; *see also* N.C. GEN. STAT. § 75-16, 16.1 (2007).

state court against twenty-one lenders for routinely making “money available to unqualified borrowers who had no realistic means of keeping up with their loan payments over the long term” which allegedly caused foreclosures and consequential harm to Cleveland.¹¹⁶ The city asserts one claim for common-law nuisance against almost every major securitizer of mortgage loans made in Ohio between the 2003 and 2007. The complaint seeks compensatory damages in an unspecified amount from the lenders “for their respective roles in proliferating toxic sub-prime mortgages” causing Cleveland to incur costs for monitoring, maintaining, and demolishing foreclosed properties as well as decreased tax revenues.¹¹⁷ While the *City of Cleveland* lawsuit does not facially attempt an unsuitability claim, it clearly is based upon factual allegations of multiple lenders making unaffordable loans to borrowers thus causing inevitable foreclosures.

4) AG Lawsuit Challenge: *Massachusetts v. Fremont*

On October 16, 2007, Martha Coakley, as Attorney General for the Commonwealth of Massachusetts, filed the first lawsuit based on the state’s Predatory Home Practices Act of 2004 against Fremont General Corp. d/b/a Fremont Investment and Loan.¹¹⁸ The lawsuit was filed in the Superior Court for Suffolk County and alleges Fremont engaged in unfair and deceptive lending to Massachusetts borrowers.¹¹⁹ Among other specific allegations, the lawsuit charged Fremont with making unsuitable loans which were “exceedingly risky” and “would foreseeably fail.”¹²⁰ Fremont ceased making residential mortgage loans in Massachusetts in March 2007 under the terms of the cease and

116. Complaint at 4, *City of Cleveland v. Deutsch Bank Trust Co.*, No. CV 08 646970 (Ohio Ct. Com. Pl. Jan. 10, 2008), available at <http://ohiopragticalbuslaw.files.wordpress.com/2008/01/cleveland-foreclosuredocument1-11-08.pdf>. The complaint alleges that the Defendants “explicitly countenanced loans made to borrowers either on financially irrational terms or without any information to corroborate the borrowers’ wherewithal to pay.” *Id.* at 6-7.

117. *Id.* at 26-27.

118. See Complaint, *Commonwealth v. Fremont Inv. & Loan*, No. 07-4373-F (Mass. Super. Ct. Oct. 16, 2007).

119. See *id.* at 1.

120. *Id.* at 14.

desist order settlement with the FDIC,¹²¹ but still services many of the loans previously made.¹²² Fremont issued a statement that it “believes the lawsuit is without merit and will defend itself vigorously.”¹²³ The lawsuit was removed by Fremont, but then remanded back to state court, and it is in the early discovery phase and is expected to continue.

V. CONCLUSION

As the old adage goes: bad facts make bad law. The subprime mortgage market meltdown of 2007 and 2008 and the egregious conduct that gave rise to it have caused legislatures, regulators, and judges to seek a quick fix to a complex situation. Unintended consequences often result from such a rush to action. The potential application of some variant of a suitability standard will be explored in congressional debate over H.R. 3915 and Dodd’s Senate Bill 2452.

Consider the possible results of this debate. If a fiduciary duty is imposed on brokers and lenders for all mortgage transactions, it would be a landscape-altering event at odds with substantial judicial precedent that the borrower-creditor relationship is at arms-length. If a fiduciary duty is imposed on brokers and lenders only for certain subprime or high-cost loans (*e.g.*, using HOEPA or HMDA points and fees triggers), it would be a significant event that would make such lending even higher risk, more costly, and harder to qualify for in the future. If some variation of a suitability concept, short of a fiduciary obligation, such as a duty to determine a borrower’s ability to repay using objective factors such as a DTI ratio is adopted, then the effect on the mortgage lending market will be more sanguine.

If Congress instructs federal regulators to develop objective facts and relevant data around a suitability standard, then another scenario unfolds. Because there is no clear template for a suitability standard applied to mortgage lending, any move toward

121. *Id.* at 6.

122. *Id.*

123. Press Release, Fremont Gen. Corp., Fremont General Responds to Lawsuit Filed by Massachusetts Attorney General’s Office 1 (Oct. 5, 2007), http://media.corporate-ir.net/media_files/irol/10/106265/10_05_07.pdf.

a suitability standard will be untested. If a suitability standard has any subjective elements, then issues of requisite intent to trigger liability will have to be determined, perhaps by protracted litigation. If class actions are not prohibited upon some standard, then battles will ensue concerning this procedural claim aggregation device.

A federal law would be deemed to preempt state law that offers borrowers additional protections above and beyond the federal standard unless the federal statute specifically provided a minimum of consumer protections that could be supplemented by additional state protections in states where the legislature has deemed them necessary. A significant congressional battle is likely to center on this question of whether any federal law is the floor (to be supplemented by state law) or the ceiling (to preempt any state law in the same arena). Multistate lenders, of course, will prefer a uniform federal standard, while states may argue that they have strong interests in protecting the rights of their citizens from the actions of predatory lenders.

Of course, if Congress fails to embrace any type of suitability standard applicable to mortgage lending, then the states may continue to legislate their own versions of such a test. Regulators might also prohibit certain loan products or prescribe lending in certain situations. The predominant model for state regulation, the North Carolina statute, stops short of a fiduciary duty and sets the borrower's ability to repay as a suitability standard applicable only to a certain subset of high-cost loans and not to the entire industry.

The most serious result of adoption of a broad suitability standard might be the rollback of positive gains made in access to credit and homeownership for minorities. Based on market conditions and tightened underwriting standards, mortgage loan denial rates will undoubtedly increase. Credit denials will likely hit minorities harder than others.¹²⁴ The 2007 HMDA data, to be

124. See generally COMPLIANCE TECHS. & GENWORTH FIN., THE 2007 ANNUAL MINORITY LENDING REPORT (2007), available at <http://www.areaa.org/cms/2007%20Annual%20Minority%20Lending%20Report.pdf> (finding that, based upon 2006 Home Mortgage Disclosure Act (HMDA) data, in 2006, compared to 2005 levels, mortgage lending to minorities dropped more than seven percent overall). When the

released by March 31, 2008, and perhaps the 2008 data, will disclose whether this harm has occurred. If it has, then mortgage lenders will face traditional redlining challenges for inadequate loans to protected classes. Lenders will be caught between conflicting federal policies expressed by the ECOA, HMDA, and CRA on the one hand and by suitability standards on the other. The costs of credit could rise for everyone based upon lenders having to face increased litigation expenses and liability risks.

This current subprime crisis should be kept in perspective as a major market correction following the huge run-up in the United States mortgage origination volume from 2001 to 2004. Total mortgage origination volume, which historically ran at approximately \$1 trillion a year, peaked at almost \$4 trillion in 2003 when, as a result of unprecedented rate cuts, homeowners refinanced, took cash out of their home equity, and speculated that housing prices would continue to rise indefinitely. The peak, of course, was followed by the down cycle that began in 2006 and continued thereafter with credit markets seizing up in the middle of 2007. The mortgage lending market has experienced crises in the past, such as the S&L crises of the 1980s, and survived without major changes in basic legal principles governing the borrower-creditor relationship. This crisis should be no different in that regard. Suitability is a dubious quick fix.

2007 HMDA data is reported this spring, a further decline in lending to minorities is expected.