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Loyola Public Interest Law Reporter

The Threat of Predatory Lending

Marko Stojkovic

I. INTRODUCTION

This Article is part one of a two-part series exploring the dangers of predatory lending and how Dodd-Frank[1] and the Consumer Financial Protection Bureau have solved predatory lending and ended the possibility of another subprime debacle. In this part, what will be shown is that due to the U.S. government's deregulation and the greed of banks and predatory lenders in the housing market, predatory lending wreaked havoc on minority, low-income, and immigrant communities, and was the main cause of the 2008 economic collapse.

II. THE HARM CAUSED BY PREDATORY LENDING AND REVERSE REDLINING

a. Definition of Predatory Lending

One way to define predatory lending is as a syndrome of abusive loan terms or practices that involve one or more of the following five problems: 1) loans structured to result in seriously disproportionate net harm to borrowers; 2) harmful rent seeking; 3) loans involving fraud or deceptive practices; 4) other forms of lack of transparency in loans that are not actionable as fraud; and 5) loans that require borrowers to waive meaningful legal redress. Most predatory loans combine two or more of these problems.[2]

Another way to define predatory lending is as a pattern of loan abuses that benefit mortgage brokers, lenders, and securitizers to the serious detriment of borrowers.[3] Although not all subprime loans are predatory, the high-risk nature of subprime loans makes them ripe for abuse.[4] Abusive patterns often occur when unscrupulous lenders use the subprime lending environment to

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010).

[2] Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending,* 80 Tex. L. Rev. 1255, 1260 (2002).

[3] Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 Fordham L. Rev. 2039, 2043 (2007).

[4] Nicole Lutes Fuentes, *Defrauding the American Dream: Predatory Lending in Latino Communities and Reform of California's Lending Law*, 97 Cal. L. Rev. 1279, 1285 (2009).

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push unnecessary or overpriced home loan products on vulnerable consumers such as minorities, the elderly, and recent immigrants.[5]

Engel and McCoy list seven abusive patterns of predatory lending: 1) encouraging borrowers to take on loans that are structured to result in net harm to borrowers; 2) rent-seeking through fees and interest rates that are out of proportion to the risk the borrowers present; 3) procuring loans through illegal fraud or deception; 4) obscuring information through nondisclosure that does not amount to fraud; 5) requiring borrowers to waive legal remedies; 6) discriminating against protected groups even after controlling for risk; and 7) employing abusive servicing practices.[6]

What is clear is that the predatory loan market is "a subset of players within the subprime market who employ deceptive and abusive practices to cheat customers out of their hard-earned money."[7] Some of the most harmful predatory loans occurred in the process of reverse redlining. Reverse redlining harms consumers, the home lending market, and the U.S. economy.

b. Definition of Reverse Redlining

Reverse redlining discriminates by extending credit to minority communities on unfair terms, erecting barriers to favorable credit treatment even where borrowers are qualified.[8] Practices of reverse redlining target neighborhoods, overwhelmingly African-American and Hispanic, with inflated credit, subprime loans, and other predatory lending practices even though consumers there might be eligible for preferable credit or loans.[9] Examples of loans that occur during reverse redlining are interest-only loans, balloon payment loans, loans with prepayment penalties, negative amortization loans, no documentation loans, and adjustable-rate mortgage loans with teaser rates.[10]

c. Historical Overview of Reverse Redlining

In the 1980s, the residential mortgage market underwent a metamorphosis that catalyzed lenders to reenter minority neighborhoods. The impetus for this

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5 Id.at 1286.

6 Engel & McCoy, *supra* note 3, at 2043-45.

7 Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 Consumer Fin. L.Q. Rep. 460(2006).

8 *Saint-Jean v. Emigrant Mortg. Co.*, 50 F.Supp.3d 300, 305 (E.D. NY. 2014).

9 *Saint-Jean*, 50 F.Supp.3d 300 at 306.

10 *City of Los Angeles v. Bank of America Corp.*, 2014 WL 2770083 at *10 (C.D. Cal. 2014).

change was the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA),[11] which was designed to ensure that, even in the face of record high interest rates, borrowers in states with low usury ceilings could still obtain loans to purchase their first homes. The DIDMCA preempted state usury ceilings for loans secured for a borrower's first home and permitted higher conventional mortgage rates. The financial industry responded with the innovation of "risk-based pricing," which was the birth of the subprime market.[12]

The emergence of the subprime market led banks to begin lending to previously redlined borrowers by charging higher interest rates and fees to account for the higher risk posed by lending to individuals with lower incomes and net worth.[13] This process is known as "risk based pricing."[14] Risk based pricing implies that pricing is accurately calibrated to credit risk. In reality, prices in the subprime market are only partially based on differences in borrowers' risk.[15] Other factors, including mortgage broker compensation, discrimination, and rent-seeking, can and do push up subprime prices.[16] These non-risk factors help explain why subprime borrowers are generally more likely to come from a protected class or an underserved group.[17]

"Redlining" occurs when financial institutions intentionally withhold loans from minority, low-income, or immigrant communities by drawing a 'red line' on a map to indicate disfavored areas for loans. The return of lenders to minority and low-income neighborhoods under this risk-based pricing rubric is reverse redlining.[18]

In the 1990s, lending disparities demonstrated that reverse redlining was widespread throughout the home lending industry. The rise of predatory lending practices in the 1990s manifests that the struggle against redlining is not over and has taken new turns. After decades of redlining practices that starved and destroyed many urban communities for credit and denied loans to minorities, immigrants, and low-income families, with reverse redlining, financial in-

[11] Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980).

[12] Fuentes, *supra* note 4, at 1288.

[13] Fuentes, *supra* note 4, at 1288-1289.

[14] Howard Lax et al., *Subprime Lending: An Investigation of Economic Efficiency,* 15 Housing Pol'y Debate 533, 565 (2004),

[15] Lax et al., *supra* note 14, p. 545.

[16] *Id.*

[17] *Id.*

[18] *Id.*

stitutions flood these same neighborhoods with exploitative loan products that drain residents of their wealth. Reverse redlining may be just as problematic for minority families and older urban communities, as was the withdrawal of financial services with redlining. Instead of contributing to homeownership and community development, reverse redlining strips the equity homeowners have struggled to build and depletes the wealth of communities to feed the greed of banks and financial services firms.[19]

There are no precise quantitative estimates of the extent of predatory lending. However, the growth of subprime lending, coupled with growing law enforcement activity in this area, indicates a surge in a range of exploitative practices. Predatory loans charge higher rates and fees than warranted by the financial risk, which traps homeowners in unaffordable debt and often costs homeowners their homes and life savings.[20]

d. Reverse Redlining Was Recognized as a Form of Predatory Lending in 2001 in *Associates Home Equity Services, Inc. v. Troup*

In *Associates Home Equity Services, Inc. v. Troup*, the homeowners, who were the defendants, claimed that the original lender and assignee of the note and mortgage for their home, which was the plaintiff, committed reverse redlining.[21] The Troups had an expert summarize the concept of predatory lending:

> In using the term "predatory lending" I refer to lenders who target certain populations for onerous credit terms. The population generally targeted includes, among others, the elderly, minorities, and residents of neighborhoods that do not have ready access to mainstream credit. Credit terms not warranted by the objective facts regarding the creditworthiness of these individuals are imposed upon them because for various reasons the lenders feel they can take advantage of a borrower. Typically predatory lenders take advantage of borrowers due to their lack of sophistication in the lending market, due to their lack of perceived options for the loan based on discrimination or some other factor, or due to deceptive practices engaged in by the lender that mislead or fail to inform the borrower of the real terms and conditions of the loan. The record in this case indicates that this is consistent with what occurred in the Troup transaction.[22]

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19 Gregory D. Squires, *Predatory Lending: Redlining in Reverse*, NHI Shelterforce Online (Aug. 11, 2016, 9:46 PM), http://www.nhi.org/online/issues/139/redlining.html.

20 *Id.*

21 *Associates Home Equity Services, Inc. v. Troup*, 778 A.2d 529, 534 (N.J. Super. Ct. App. Div. 2001).

22 *Troup*, 778 A.2d 529 at 537.

The court held that a borrower may establish a claim of reverse redlining by demonstrating that the financial institution's lending practices and loan terms are 'unfair' and 'predatory,' and that the financial institution either intentionally targeted on the basis of race, or that there is a disparate impact on the basis of race.[23]

e. Countrywide Exemplified Reverse Redlining in the 2000s

On December 21, 2011, the Department of Justice ("DOJ") filed a complaint against Bank of America's Countrywide subsidiary, alleging that Countrywide had charged 200,000 minority homeowners higher interest rates and fees than Caucasian borrowers who were similarly qualified, with similar credit ratings.[24] The complaint also alleged that Countrywide failed to offer minority homeowners conventional mortgages for which they qualified and which they would have been offered, had they been Caucasian.[25] Instead, Countrywide committed reverse redlining and systematically pushed minority borrowers into exploitative subprime mortgages, with higher rates and fees.[26]

Many of Countrywide's victims were in California, and of Mexican origin. Countrywide's victims in the East and Midwest were mostly African American. Although not specifically detailed in the DOJ's complaint, many borrowers lost their homes to foreclosure when they were unable to meet the harsh repayment terms to which they had agreed, mostly unwittingly. To settle the complaint, Bank of America agreed to pay $335 million in restitution and penalties to the 200,000 identified minority victims.[27]

f. The Damaging Effects of Predatory Lending and Reverse Redlining on Minority and Low-Income Communities

Predatory lending has devastated individuals and society. Through high origination fees, overpriced charges for unnecessary products, and separate billing for components of a service that should be included in a single charge,

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23 *Id.*

24 Richard Rothstein, *A comment on Bank of America/Countrywide's discriminatory mortgage lending and its implications for racial segregation*, Economic Policy Institute (Aug. 11, 2016, 9:59 PM), http://www.epi.org/publication/bp335-boa-countrywide-discriminatory-lending/.

25 *Id.*

26 *Id.*

27 *Id.*

predatory lenders rob homeowners of equity built up from responsible loan payments and appreciation. Predatory lenders rob homeowners of wealth.[28]

Additionally, predatory lending causes default and foreclosure. Predatory brokers cause default by coercing a borrower to sign loan documents that contain terms unsuited to the borrower's ability to pay. An example of predatory brokers causing default is asset-based lending, which is where the amount of the loan is based on the value of the property without regard to the borrower's income or other financial responsibilities. By disregarding debt-to-income ratios and basing the loan on only loan-to-property value ratios, predatory lenders set up the borrower to fail.[29]

Losing a home to a predatory lender, whether by foreclosure or abandonment, is not only a dreadful monetary loss, but also a painful emotional loss. Home loss displaces families, adversely affects the stability of domestic relationships, and can be psychologically harmful. When a person loses a home, the person loses the chance to participate in the "American dream" of home ownership. For elderly homeowners, who may have lived in the home for many years, losing their home means losing the very place in which they established their lives, memories, family, and personal history.[30]

Losing one's home to a predatory lender also causes significant social harm. Neighborhood stability and revitalization efforts are disrupted when houses are left unoccupied during the foreclosure process and remain empty after the sheriff's sale.[31] Empty houses reduce the value of other properties in the neighborhood.[32] Homes that have been foreclosed on can also become the objects of vandalism or sites of criminal activity, which further lowers property values and drains public safety resources.[33]

Subprime foreclosures and reverse redlining have caused a net loss in home ownership in minority and low-income communities.[34] As foreclosures create more vacant homes, neighborhoods decline, tax revenue is lost, and crime rises, which results in blighted communities.[35]

28 Lloyd T. Wilson, *Effecting Responsibility in the Mortgage Broker-Borrower Relationship: A Role for Agency Principles in Predatory Lending Regulation*, 73 U. Cin. L. Rev. 1471, 1481 (2005).

29 *Id.* at 1482.

30 *Id.* at 1483.

31 *Id.* at 1483.

32 *Id.* at 1483.

33 *Id.* at 1483.

34 Wilson, *supra* note, at 1283.

35 *Id.* at 1483.

Predatory loans and reverse redlining have perpetuated the racial wealth gap between minorities and Caucasians.[36] While 73% of Caucasian households owned their own homes in 2011, only 47% of Hispanics and 45% of Blacks were homeowners. Additionally, Black and Hispanic homeowners saw less return in wealth on their investment in homeownership: for every $1 in wealth that accrues to median Black households as a result of homeownership, median Caucasian households accrue $1.34; meanwhile for every $1 in wealth that accrues to median Hispanic households as a result of homeownership, median Caucasian households accrue $1.54.[37]

If public policy successfully eliminated racial disparities in homeownership rates, so that Blacks and Hispanics were as likely as Caucasian households to own their homes, median Black wealth would grow $32,113 per capita and the wealth gap between Black and Caucasian households would shrink 31%. Median Hispanic wealth would grow $29,213 per capita and the wealth gap with Caucasian households would shrink 28%.[38]

Furthermore, if public policy successfully equalized the return on homeownership, so that Blacks and Hispanics saw the same financial gains as Caucasians as a result of being homeowners, median Black wealth would grow $17,113 and the wealth gap between Black and Caucasian households would shrink 16%.[39] Median Hispanic wealth would grow $41,652 and the wealth gap with Caucasian households would shrink 41%.[40]

g. Case Law Outlawing Reverse Redlining

i. *City of Memphis v. Wells Fargo Bank, N.A.*

In *City of Memphis*, consumers alleged that Wells Fargo targeted African-American borrowers by steering African-Americans into loans that they could not afford, which caused a disproportionately high number of foreclosures in predominantly African-American communities in Memphis and Shelby County.[41] Wells Fargo's reverse redlining resulted in "higher-cost loans, a higher rate of foreclosure, a higher concentration of foreclosures, and a shorter

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36 Fuentes, *supra* note 4, at 1290.

37 Laura Sullivan, Tatjana Meschede, Lars Dietrich, & Thomas Shapiro, *The Racial Wealth Gap – Why Policy Matters*, Institute for Assets & Social Policy, Brandeis University (Aug. 11, 2016, 10:03 PM), https://iasp.brandeis.edu/pdfs/2015/RWA.pdf.

38 *Id.*

39 *Id.*

40 *Id.*

41 *City of Memphis v. Wells Fargo Bank, N.A.*, 2011 WL 1706756, at *1 (W.D. Tenn. 2011).

average length of time to foreclosure for Wells Fargo's African-American borrowers from predominantly African-American neighborhoods."[42] Wells Fargo offered borrowers in African-American neighborhoods subprime mortgages with excessive interest, points, and fees when those borrowers actually qualified for prime loans.[43] Other African-American borrowers were given loans they could not afford when they should not have received a loan at all.[44]

During the loan approval process, loan officers would instruct African-American borrowers to state their income on the loan application without providing proof of income.[45] Loan officers would also offer customers lines of credit or credit cards that were secured by the customers' homes without properly underwriting the borrowers to ensure creditworthiness.[46] Wells Fargo's reverse redlining kept qualified borrowers from receiving a loan on the most favorable terms.[47] The court held that the consumers adequately pled their claim that Wells Fargo's lending practices had a disparate impact on African-Americans in Memphis and Shelby County in violation of the Fair Housing Act[48] ("FHA") and denied the defendants' motion to dismiss.[49]

ii. *Munoz v. International Home Capital Corp.*

The consumers in *Munoz* were Hispanics, who predominantly spoke Spanish and generally did not read or write English.[50] According to the consumers' allegations, the lender gave them loans on grossly unfavorable terms and intentionally targeted them for unfair loans on the basis of their racial status.[51] The court held that the consumers adequately pled a prima facie case of discrimination in violation of the FHA.[52]

iii. *Ramirez v. GreenPoint Mortg. Funding, Inc.*

In *Ramirez*, African-American and Hispanic consumers brought action against the defendant for its Discretionary Pricing Policy, which had "a dispro-

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42 *Id.* at *12.
43 *Id.* at *13.
44 *Id.*
45 *Id.*
46 *Id.*
47 *Id.*
48 Fair Housing Act, 42 U.S.C. §§ 3601 – 3619.
49 *City of Memphis*, 2011 WL 1706756, at *15.
50 *Munoz v. International Home Capital Corp.*, 2004 WL 3086907 at *1 (N.D.Cal. 2004).
51 *Id.* at *1.
52 *Id.* at *4.

portionately adverse effect on minority borrowers compared to similarly-situated whites in that minority borrowers pay disparately more discretionary charges (both in frequency and amount) than similarly-situated whites."[53] The court held that the plaintiffs' allegations were sufficient to allege disparate impact claims under the Equal Credit Opportunity Act and FHA and denied the defendant's motion to dismiss.[54]

III. PREDATORY LENDING WAS THE MAIN CAUSE OF THE 2008 ECONOMIC COLLAPSE

The US government's effort to expand home ownership in minority communities was the first falling domino that caused the 2008 economic collapse. FHA insurance and securitization of loans (lenders sell loans to the secondary mortgage market, which packages them into securities to sell to investors) reduced the risk to lenders and increased the capital available for mortgage lending.[55] Additionally, the federal government established affordable housing goals for the two major secondary mortgage market actors, Fannie Mae ("Fannie") and Freddie Mac ("Freddie"). Fannie and Freddie buy approximately 50% of the mortgages for low-income and moderate-income households.[56]

These actions increased access to capital, especially by predatory lenders who engaged in reverse redlining. Wall Street became a major player by securitizing subprime and predatory loans.[57] The involvement of investment banks in subprime lending grew from $18.5 billion in 1997 to $56 billion in 2000.[58]

With passage of the Financial Services Modernization Act of 1999,[59] the consolidation of financial services providers received the blessing of the US government. Between 1970 and 1997 the number of banks in the US dropped from just under 20,000 to 9,100, primarily as a result of mergers among institutions.[60] The Financial Services Modernization Act removed many post Depression-era laws that provided for greater separation of the worlds of banking, insurance, and securities.[61] After this reform, financial service providers entering each of the spheres of banking, insurance, and securities became much

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53 *Ramirez v. GreenPoint Mortg. Funding, Inc.*, 633 F.Supp.2d 922, 927 (N.D.Cal.2008).
54 *Id.* at 928.
55 Squires, *supra* note 14.
56 *Id.*
57 *Id.*
58 *Id.*
59 Gramm–Leach–Bliley Act, Pub. L. No. 106–102, 113 Stat. 1338 (1999).
60 Squires, *supra* note 14.
61 *Id.*

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easier. One result is that commercial banks and savings institutions, which used to make the vast majority of mortgage loans, now make about a third of home loans.[62] Mortgage banking affiliates of depository institutions, independent mortgage banks, insurance companies, and other institutions that the federal government did not regulate before 2010, which includes predatory lenders, became a far bigger part of the mortgage market.[63]

A critical implication of the deregulation was the declining influence of the Community Reinvestment Act ("CRA").[64] In conjunction with the FHA and other fair lending initiatives, the CRA is credited with generating more than $1 trillion in new investments for low-income and moderate-income neighborhoods and for increasing the share of loans going to economically distressed markets and minority markets.[65] Concentration and consolidation among financial institutions that had taken place for years – trends that were exacerbated by the Financial Services Modernization Act – reduced the impact of the CRA by making it easier for many financial institutions that were not covered by the CRA to enter the mortgage market.[66] The share of mortgage loans subject to intensive review under the CRA dropped from 36.1% to 29.5% between 1993 and 2000.[67]

US government policy over many years played a major part in causing the 2008 economic collapse.[68] In 1999, Fannie and Freddie were under pressure from the Clinton Administration to increase lending to minorities and low-income homebuyers.[69] The regulators in the Clinton and Bush Administrations enforced the reduced lending standards that were essential to the growth in home ownership and the housing bubble.[70]

The pressure on Fannie and Freddie started because of the 1992 Boston Federal Reserve Bank study of discrimination in home mortgage lending, which concluded that, although there was no overt discrimination in banks' allocation of mortgage funds, loan officers tended to give Caucasians preferential treatment. The study was highly influential with regulators and members

62 *Id.*

63 *Id.*

64 Community Reinvestment Act, Pub. L. No. 95-128, 91 Stat. 1147 (1977).

65 Peter J. Wallison, *The True Origins of This Financial Crisis*, The American Spectator (Feb. 6, 2009), http://spectator.org/42211_true-origins-financial-crisis/.

66 *Id.*

67 *Id.*

68 *Id.*

69 *Id.*

70 *Id.*

of the incoming Clinton Administration. In 1992, an affordable housing mission was added to the charters of Fannie and Freddie. In 1993, bank regulators initiated a major effort to reform the CRA regulations.[71]

The effort to reduce mortgage-lending standards was led by the U.S. Department of Housing and Urban Development through the 1994 National Homeownership Strategy, published at the request of President Clinton.[72] Among other things, the Strategy called for "financing strategies, fueled by the creativity and resources of the private and public sectors, to help homeowners that lack cash to buy a home or to make the payments."[73] Once the standards were relaxed for low-income borrowers, denying these benefits to the prime market would seem impossible. Bank regulators, who were in charge of enforcing the CRA standards, could hardly disapprove of similar loans made to better-qualified borrowers.[74]

Most likely the lower lending standards required by the CRA influenced what banks and other lenders were willing to offer to borrowers in prime markets, such as mortgages with low down payment requirements, which allowed borrowers to buy a larger home for the same initial investment.[75] The spread of these looser regulations and standards on the prime loan market vastly increased the availability of credit for mortgages, the speculation in housing, and ultimately the bubble in housing prices.[76]

A 1997 Urban Institute report found that local and regional lenders seemed more willing than Fannie and Freddie to serve creditworthy low-income to moderate-income and minority applicants. Subsequently, Fannie and Freddie modified their automated underwriting systems to accept loans with characteristics that they had previously rejected.[77] This opened the way for large numbers of nontraditional and subprime mortgages.[78] These mortgages did not necessarily come from traditional banks lending under the CRA, but from lenders like Countrywide Financial, which was the nation's largest subprime mortgage lender.[79]

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71 Peter J. Wallison, *The True Origins of This Financial Crisis*, The American Spectator (Feb. 6, 2009), http://spectator.org/42211_true-origins-financial-crisis/.

72 *Id.*

73 *Id.*

74 *Id.*

75 *Id.*

76 *Id.*

77 Peter J. Wallison, *The True Origins of This Financial Crisis*, The American Spectator (Feb. 6, 2009), http://spectator.org/42211_true-origins-financial-crisis/.

78 *Id.*

79 *Id.*

Fannie and Freddie used their affordable housing mission to avoid additional regulation by Congress. Fannie and Freddie argued that if Congress constrained the size of their mortgage portfolios, they could not afford to adequately subsidize affordable housing. By 1997, Fannie was offering a 97% loan-to-value mortgage. By 2001, Fannie was offering mortgages with no down payment at all. By 2007, Fannie and Freddie were required to show that 55% of their mortgage purchases were Lenders Mortgage Insurance loans and, within that goal, 38% of all purchases were from underserved areas, usually inner cities, and 25% were to be loans to low-income and very-low-income borrowers. Meeting these goals almost certainly required Fannie and Freddie to purchase loans with low down payments and other deficiencies that would mark them as subprime.[80]

The decline in underwriting standards is evident in the financial disclosures of Fannie and Freddie. From 2005 to 2007, Fannie and Freddie bought approximately $1 trillion in subprime loans, which amounted to about 40% of their mortgage purchases during that period.[81]

Fannie and Freddie's purchases of subprime loans affected the rest of the market for subprime mortgages in two ways. First, competition for subprime loans with private-label issuers increased.[82] Between 2001 and 2004, the overall subprime mortgage market grew from $160 billion to $540 billion.[83] Communities were inundated with billboards and flyers from subprime companies offering to help almost anyone buy a home.[84]

Predatory lenders stepped in and took advantage of minority and low-income communities by disproportionately selling predatory loans in those communities.[85] Moreover, predatory lenders masked the true costs of the loans they were selling, and told prospective borrowers that they could always refinance their mortgages before adjustable rates kicked in.[86]

Subprime mortgages were promoted and financed by Wall Street. Mortgage brokers and lenders received enormous fees for steering consumers into predatory loans, so the amount of predatory loans exploded, going from being

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80 *Id.*

81 Wallison, *supra* note 48.

82 *Id.*

83 *Id.*

84 *Id.*

85 Ray Brescia, *Blaming the Victim, Redux: More Hijinx Around the Causes of the Financial Crisis*, The Huffington Post (May 5, 2013), http://www.huffingtonpost.com/ray-brescia/blaming-the-victim-redux_b_2804916.html.

86 *Id.*

a very small part of the market to becoming the dominant mortgages at the peak of the housing boom in the 2000s.[87] For example, "no documentation loans" and "stated income loans" (in which the loan file contains only an income figure with no documentation and the lender does not verify the borrower's income) went from being a rare loan type designed for business owners with complicated finances to comprising nearly half of subprime loans.[88] A second example is negative amortization loans, in which the borrower pays less than the accruing interest each month, so that the principal amount owed actually increases over time.[89] Negative amortization loans were initially designed for borrowers who could afford the much larger monthly payments that would become due in a few years when fully amortizing payments were required.[90]

Predatory loans were then aggressively marketed to borrowers who could barely afford the initial, very reduced payments, much less the larger later ones.[91] Subprime mortgages, with built-in large payment increases, grew twentyfold, from a small market in the 1990s to over $600 billion dollars of loans made in 2006.[92]

With predatory loans, mortgage brokers and lenders were paid double or more for putting a borrower into one of these loans as compared to providing a standard thirty-year prime loan.[93] The firms that packaged these loans and sold them to investors also earned far more from these loans. Subprime lenders packaged the predatory loans as securities with little regard for how those loans would perform.[94]

Then, Wall Street dove even more deeply into the subprime mortgage market.[95] Firms such as Bear Stearns, Lehman Brothers, and Goldman Sachs started bundling predatory home loans and selling these loans to investors — bypassing Fannie and Freddie and dealing with predatory lenders such as

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87 *Id.*

88 *Id.*

89 *Id.*

90 Mike Calhoun, *Dodd-Frank Measures Fundamentally Reform the Mortgage Market*, Roosevelt Institute (Aug. 12, 2016, 10:28 PM), http://rooseveltinstitute.org/wp-content/uploads/2015/11/Calhoun_Dodd-Frank_Mortgage_Market.pdf.

91 *Id.*

92 *Id.*

93 *Id.*

94 *Id.*

95 Charles Duhigg, *Pressured to Take More Risk, Fannie Reached the Tipping Point*, New York Times (Oct. 4, 2008), http://www.nytimes.com/2008/10/05/business/05fannie.html?em=&pagewanted=print&_r=0.

Countrywide directly.[96] After this, Countrywide and other predatory lenders pressured Fannie and Freddie to purchase more and more subprime loans.[97] The next step was that Fannie and Freddie's investors pressured Fannie and Freddie to take more risks by buying more subprime loans.[98]

Second, the increased demand from Fannie and Freddie and the competition with private-label issuers drove up the value of subprime mortgages, reducing the risk premium that had previously suppressed originations.[99] As a result, many more marginally qualified or unqualified applicants for mortgages were accepted.[100]

In 2008, James B. Lockhart, the chief federal regulator of Fannie and Freddie, adjusted Fannie and Freddie's lending standards, so that Fannie and Freddie could purchase as much as $40 billion in new subprime loans.[101] However, later in 2008, when Fannie was in dire straits financially, Treasury Secretary Paulson told Daniel Mudd, who was Fannie's President and CEO, that Mudd could agree to a takeover or have one forced upon him.[102] Freddie was given the same message.[103] Less than 48 hours later, Mr. Lockhart and Mr. Paulson ended Fannie and Freddie's independence, accepting up to $200 billion in taxpayer money to replenish Fannie and Freddie.[104] Within weeks, Lehman Brothers declared bankruptcy, Merrill Lynch dove into the arms of Bank of America, and the U.S. government bailed out American International Group (AIG), which signaled the start of the 2008 economic collapse.[105]

The flood of foreclosures from predatory loans was delayed as long as borrowers could refinance when they fell behind on payments or could not afford impending payment increases.[106] But, once housing prices leveled off and then fell, predatory loans failed in droves, accelerating the plunge in housing prices.[107]

The result was widespread hardship for homebuyers, collapsing housing prices for all homeowners and communities, losses for investors, and the de-

96 *Id.*
97 *Id.*
98 *Id.*
99 *Id.*
100 Wallison, *supra* note 48.
101 *Id.*
102 *Id.*
103 *Id.*
104 *Id.*
105 Duhigg, *supra* note 60.
106 Calhoun, *supra* note 57.
107 *Id.*

struction of the US economy.[108] For minority, low-income, and immigrant families, generations spent toiling and struggling to build wealth was lost.

Therefore, although there were regulations in place to prevent predatory lending and the 2008 economic collapse, the US government relaxing laws and deregulating the banking, insurance, securities, and mortgage industries enabled banks and lenders to monstrously grow, victimizing and destroying minority and low-income communities with predatory lending. Then, the predatory loans that greedy banks and lenders originated with reverse redlining destroyed those very same banks and lenders, which destroyed the US economy and caused the 2008 economic collapse. The combination of the US government's deregulation and the greed of banks and predatory lenders caused the 2008 economic collapse. Because of the catastrophic economic mess and disgusting discrimination of reverse redlining that the U.S. government in part enabled, Dodd-Frank and the Consumer Financial Protection Bureau were created to clean up the mess, avoid another economic meltdown, and prevent and deter discrimination in the housing, financial, and credit markets. This process will be covered in the second Article of this two-part series.

IV. CONCLUSION

The threat of predatory lending is inherent in securitization. This threat became reality as predatory lending grew into a formidable and deadly beast that destroyed the housing market and minority, low-income, and immigrant communities. Predatory lending reached its height of destruction by eradicating the US economy and was the main cause of the 2008 economic collapse. Part two of this series will examine the Dodd-Frank solution, which slayed the predatory lending beast.

108 *Id.*