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CONSUMER LAW SYMPOSIUM

Forward to States in the Vanguard: Protecting Consumers During the Financial Crisis

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In July 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act,[2] which fills many of the gaps in mortgage regulation that brought the United States economy to its knees. This new law and the debates leading up to it grabbed the headlines for several years. What is less well known is the critical role that states and local communities have played in attempting to chill risky lending and address the fallout from home foreclosures.

States have been enacting anti-predatory lending laws since the 1990s, many of which ultimately served as models for the Dodd-Frank Act. In parallel moves, state attorneys general have been enforcing discrimination and consumer protection laws against abusive lenders. And, as the subprime crisis has morphed into a foreclosure crisis, states have adopted tools to keep people in their homes.

In April 2010, Suffolk University Law School and the National Consumer Law Center sponsored a conference, *States in the Vanguard: Protecting Consumers during the Financial Crisis,* which was devoted to understanding state actions to protect consumers. This issue of the *Suffolk University Law Review* grew out of the *States in the Vanguard* conference and includes papers presented at the conference as well as articles that the *Law Review*

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2. *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

independently solicited.

The articles cover topics ranging from predatory lending to housing code enforcement, but two consistent themes pervade: the problem of *too little* credit and the foreclosure crisis. For years, academics, policymakers, and activists who work on consumer protection issues focused on the terms and practices associated with risky and costly loans secured by borrowers' homes. More recently, their focus has shifted from abusive home mortgage lending to concerns about foreclosures as the spillover effect of the financial crisis has caused an escalation in mortgage defaults. At the same time, market actors have responded to high default rates and concerns about the valuation of mortgage-backed securities by restricting credit. The consequence has been a dramatic shift in the availability of credit; a scarcity of credit has replaced the glut of credit. Now, many people find it difficult to purchase homes or refinance mortgage loans.

I. TENSION: CREDIT REGULATION AND CREDIT AVAILABILITY

Jim Carr and Katherine Lucas-Smith's piece, *Five Realities about the Current Financial and Economic Crises*, approaches credit availability from several angles. The authors begin by discussing the problem of too much high-risk credit. They chronicle how, for over ten years, federal regulators failed to take action despite growing evidence that lenders were making home mortgage loans borrowers could not afford to repay. They also explain how the same regulators stymied efforts by states to curtail abusive lending. Carr and Lucas-Smith then turn to the current problem of too little credit and note that even though banks' balance sheets have recovered and their profits have rebounded, they have made it extremely difficult for borrowers to obtain loans to purchase homes or refinance existing loans.

Carr and Lucas-Smith also highlight the racial impact of high-risk lending. They document how lenders targeted communities and borrowers of color with their most toxic loans. Then, when the borrowers defaulted—either because the loans were unaffordable at the get-go or because the borrowers lost their jobs because of the financial collapse—neighborhoods with high concentrations of African Americans and Hispanics were hit harder than white areas.[3]

In the final sections of their article, Carr and Lucas-Smith critique various federal efforts to resolve the foreclosure crisis, including the HAMP loan modification program. They also make detailed and extensive policy recommendations for steps the country should take to promote a housing and economic recovery.

Leah A. Plunkett and Ana Lucía Hurtado focus on what are colloquially

3. For evidence of the role that race played in subprime lending and foreclosures, see KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 30, 121, 145 (forthcoming January 2011).

called payday loans. These loans are essentially advances on borrowers' paychecks. In *Small-Dollar Loans, Big Problems: How States Protect Consumers from Abuses and How the Federal Government Can Help*, Plunkett and Hurtado document the problem of high interest payday loans and state legislation regulating (or not regulating) such loans. They, too, focus on the intersection of the problems of too little and too much credit and contend that there is too much unrestricted payday lending and too little reasonably priced short-term credit.

Payday lending has spawned debates about why most banks do not make payday loans and whether it is even possible to develop a profitable, short-term loan product that is not exploitative. To try to get a handle on this question, the FDIC ran a small-dollar loan pilot program at several banks. In the end, the FDIC reported that the pilot "illustrate[d] how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products."[4] Taken together, the FDIC report and the Plunkett and Hurtado article suggest it may be possible to regulate usurious payday lending and still meet consumer demand for short-term credit with reasonably priced products that do not expose banks to excessive risk.

II. FORECLOSURE: FALLOUT AND PREVENTION

Predatory lending took hold in the Midwest beginning in the 1990s and high rates of foreclosure naturally followed on its heels. Cleveland was one of the first cities to experience both phenomena and Kermit Lind, a professor at Cleveland-Marshall College of Law and the author of *Can Public Nuisance Law Protect Your Neighborhood from Big Banks?*, was one of the first people in the country to document the effect that foreclosures have on neighborhoods. In his article, Lind not only describes the destructive impact of foreclosed and vacant homes, but also catalogs and evaluates the various legal tools available to address bank-owned property that is in disrepair. Lind spotlights public nuisance claims and describes how private individuals, municipalities, and non-governmental entities can harness laws providing relief against public nuisances. Lind's article is not hopeful. Bringing actions against banks for anything from housing code violations to nuisance abatement is cumbersome and expensive, especially when the lenders are not located in the same state as the property.

Geoffry Walsh's article tackles foreclosures from a different angle by exploring the intersection of constitutional law and state efforts to halt the rush to foreclosure. In particular, Walsh looks at laws imposing a moratorium on foreclosures and laws that require mediation of foreclosure complaints.

4. FDIC, *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program*, 4 FDIC Q. 28, 28 (2010), *available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf.

Walsh's article is an exceptional contribution to the fields of constitutional law, property law, and consumer protection. He chronicles constitutional challenges under the Contracts Clause to Depression-era foreclosure laws and then fast-forwards to the 1980s when states responded to the recession by enacting foreclosure moratoria, which spurred another round of litigation over the constitutionality of laws that imposed moratoria on foreclosures or mandated mediation.

Across the country and at all levels of government, there are once again movements to curtail foreclosures through mediation and loan modifications. In his article, Walsh describes the various models that states have adopted to force or encourage mediation. From there, he analyzes the constitutionality of the state programs, taking into account historical application of the Takings and Contracts Clauses to foreclosure relief programs. In the final section of the article, Walsh describes potential legal challenges to efforts by local judges and elected officials to channel foreclosures into mediation and modification programs.

As this issue of the *Law Review* goes to print, defaults and foreclosures remain dangerously high. Over seven million people are behind on their mortgages and hope for job growth has not materialized. The housing market is not recovering and increasing numbers of people will find that their only choice is to walk away from their homes, which will further accelerate the decline in the housing market. The resulting dislocation has tremendous social costs for borrowers and the larger society. Children's educations are disrupted, which can lead to increases in teen pregnancy, drug abuse, and high school drop-out rates. Families lose connections that could have helped them get through rough patches or led to opportunities for work.[5]

With credit scarce and foreclosures rampant, the country faces numerous challenges. For more than three years, one solution has regularly appeared on the policy table, yet has never been adopted. That solution is mortgage cramdowns where courts, either in bankruptcy or in foreclosure actions, reduce the principal balance of borrowers' loans to make them affordable.[6] Cramdowns allow people to stay in their homes. They stabilize families and neighborhoods. And, they may be the most profitable step lenders can take. This is not just a theoretical argument. A recent study by economists at the Federal Reserve Bank of Cleveland demonstrated that an amendment to the Bankruptcy Code in the 1980s that permitted cramdowns of loans secured by family farms had "little if any economically significant impact on the cost and availability of [farm loan] credit."[7]

5. Kathleen C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355, 356-60 (2006).

6. *See* Doris Dungey (Tanta), *Just Say Yes to Cram Downs*, CALCULATED RISK (Oct. 7, 2007 11:09 AM), http://www.calculatedriskblog.com/2007/10/just-say-yes-to-cram-downs.html.

7. Thomas J. Fitzpatrick IV & James B. Thomson, Fed. Reserve Bank of Cleveland, *Stripdowns and*

Whether the United States government will move in the direction of cramdowns, mandate other forms of relief for homeowners, or maintain the status quo is uncertain. What we do know is that states and localities have been the locus of the earliest and most innovative efforts to confront the spillover effects of the financial crisis. And the *Suffolk University Law Review* is the first journal to publish a series of articles on these efforts.

Bankruptcy: Lessons from Agricultural Bankruptcy Reform, ECON. COMMENT., Aug. 3, 2010, *available at* http://www.clevelandfed.org/research/commentary/2010/2010-9.pdf.