Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price

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Articles

DECISIONMAKING AND THE LIMITS OF DISCLOSURE: THE PROBLEM OF PREDATORY LENDING: PRICE

LAUREN E. WILLIS*

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INTRODUCTION

[Former Finance Company Employee:] Finance companies try to do business with blue-collar workers, people who have not gone to college, older people who are on fixed incomes, non English-speaking people, and people who have significant equity in their homes. In fact, my perfect customer would be an uneducated widow who is on a fixed income, hopefully from her deceased husband’s pension and Social Security, who has her house paid off, is living off of credit cards, but having a difficult time keeping up with her payments. . . .

To flip [a small unsecured loan] into a . . . home equity loan, we were trained to sell the monthly “savings”—that is, how much less per month the customer would be paying off if we flipped the loan. In reality, the “savings” that we were
trained to sell to the customers were just an illusion. The uneducated customer would jump for the “savings,” thinking that he would have more money to buy other things. What the customer would not figure out, and what we would not tell him, is that he would be paying for a longer period of time and, in the end, would pay a whole lot more.

Delinquent customers made good flipping candidates, because we could put additional pressure on them. We knew that these customers would almost always agree to refinance, because they did not have the money to pay on their current loan and did not want the finance company to institute foreclosure.

Our entire sale is built on confusion. Blue-collar workers tend to be less educated. They can be confused in the loan closings, and they look to [loan brokers] as professionals who can handle their bill and their incomes as total financial representatives. So they are more trusting toward us.

[People having difficulty meeting their present debt obligations] are desperate. They will sign at whatever rate you give them and however many points you give them.

[Senator Breaux:] Is it not required by Federal regulation that information be clearly presented to the customer—that if you refinance with us, here is how long it is going to take you, and here is how much you are going to pay—in simple English?

[Former Finance Company Employee:] It is written in simple English, and it is on all the loan documents, but I can get around any figure on any loan sheet.

—1998 Senate Hearing Testimony of former finance company employee, testifying anonymously¹

¹ Equity Predators: Striping, Flipping and Packing Their Way to Profits: Hearing Before the S. Spec. Comm. on Aging, 105th Cong. 31-37 (1998) [hereinafter 1998 Sen. Hrg.] (statement of “Jim Dough,” former finance company employee). Stories from borrowers, brokers, loan officers, and others who have been witness to predatory lending practices appear here to provide some context, to make the data here more “available” than it would be if presented in only dry statistical form.
Obtaining a home loan is the most significant, complex, and long-term economic transaction in which many Americans will ever engage. Total home-secured debt summed to over $8 trillion at the close of 2004. Yet despite the importance of the transaction to the households and neighborhoods involved and the nation’s economy as a whole, many Americans are not making optimal home loan decisions in two important respects. First, they are not obtaining home loans at competitive price terms, prices that a market of borrowers engaged in effective price-shopping would produce. Second, they are not obtaining home loans on prudent risk terms, both in that the benefits of the loan are outweighed by the risk of foreclosure posed by the loan and in that borrowers are failing to take advantage of alternatives that are preferable, in cost-benefit terms, to shouldering that risk. The sale of these overpriced and overly risky home loans constitutes what has come to be known as “predatory lending.” Two indicators that predatory lending became a problem in the late 1990s are: (1) studies indicating that large numbers of borrowers were receiving loans at prices beyond what the cost and credit risk presented by the borrower would garner from a competitive market; and (2) dramatic increases in foreclosure rates, despite economic boom times in the mid- to late-1990s, with no reason to think that borrowers’ preferences regarding risking foreclosure had changed dramatically, if at all, during that period.

2. U.S. CENSUS BUREAU, U.S. DEP’T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 2006, at 768 fig.1180. Home loan debt exceeds total domestic nonfinancial corporate credit market debt, which was just over $5 trillion at the close of 2004. Id. at 759 fig.1156.

3. Others have defined predatory lending as fraud, e.g., Robert E. Litan, Unintended Consequences: The Risks of Premature State Regulation of Predatory Lending 2 (2003) (unpublished report prepared for the American Bankers Association), available at http://www.aba.com/NR/rdonlyres/D881716A-1C75-11D5-AB7B-00508B95258D/28871/PredReport200991.pdf (“[P]redatory lenders’ effectively commit fraud by encouraging borrowers to take out mortgages on onerous terms that they cannot realistically meet.”), or by a list of lending practices that harm consumers, e.g., Predatory Lending Practices: Hearing Before the H. Comm. on Banking and Fin. Servs., 106th Cong. 477-78 (2000) [hereinafter 2000 House Hrg.] (statement of Margot Saunders, Managing Attorney, National Consumer Law Center) (listing home improvement scams, mortgage broker kickbacks, high interest rates, balloon payments, negative amortization, credit insurance packing, high prepayment penalties, repeated refinancings, spurious open end loans, and refinancing unsecured debt), but the former is incomplete and the latter is doomed to become out of date as lending practices mutate in response to changed legal or market conditions. Both sets of commentators have been responding to lending activity that results in two distinct harms to consumers: (1) paying excessive, noncompetitive prices for home loans and (2) accepting home loans presenting an excessive risk of foreclosure. In this Article, I develop a new definition of predatory lending, based on these harms. See infra Part I.B.

4. For evidence of both of these, see infra Part I.A.3.
From a legal and policy perspective, what is puzzling about this problem is that borrowers are agreeing to these overpriced and overly risky home loans against their own self-interest and despite federally mandated disclosures regarding loan price and, for some loans, risk of foreclosure. This Article argues that the problem is not so puzzling when the structure of the subprime home loan market and consumer decisionmaking within that market are carefully analyzed.

Current federal law governing home lending requires that borrowers be given an avalanche of disclosures, but has few substantive requirements for home loans. The law is premised on a largely unbounded rational actor model of borrower decisionmaking, which assumes that borrowers will take the disclosures and freely choose a loan available in the market according to the borrower's own internal price and risk preferences. This model functioned relatively well—or at least did little harm—in a world of fairly simple uniform loan products, the price and risk of which were hemmed in by usury limits and credit rationing. But the world has changed. My thesis is that for significant borrower segments shopping in today's market of risk-based pricing and multifarious loan products, the disclosures currently mandated by federal law for home loans neither effectively facilitate price shopping, nor do they result in good deliberate decisionmaking about risk.

This is an issue about which I became knowledgeable while in practice: when I was at the Civil Rights Division of the Department of Justice, I was involved in some lending discrimination matters and was then sent on detail to the Federal Trade Commission to assist in a predatory home lending case. I had also represented a couple of mortgage brokers while in private practice, so I had seen a bit of the other side. When litigating these cases, we attorneys scoured the federally required loan disclosures to determine whether every "t" was crossed and "i" dotted. However, the minute we talked to either borrowers or lenders, it became apparent that the disclosures were a litigation game—the content of disclosures had little to do with borrower decisionmaking in taking the loan.5

5. An attorney who represents lenders has made the same point: [I have] spent most of [my] professional life drafting disclosures that I feel are never read by consumers and, in truth, do very little to educate consumers about the cost of credit. From my perspective, the people that read the disclosures I help develop are plaintiffs' attorneys . . . .

. . . . Most of the lawsuits that we see involve technical mistakes with disclosures that have no practical meaning to the consumer.

Re-Examining Truth in Lending: Do Borrowers Actually Use Consumer Disclosures?, A Panel Discussion at the ABA Section of Business Law, Committee on Consumer Financial
To understand what does drive borrower decisions, I take the literature on decisionmaking from the psychology and behavioral economics fields and apply it in depth for the first time to the problem of predatory lending. To do that requires an understanding of both how the home loan marketplace has historically operated, a history that continues to "frame" home loan decisions for borrowers in that marketplace, and how that marketplace has, unbeknownst to many, changed. Therefore, in Part I of this Article, I explain how the twentieth-century market of standardized home loans at uniform low prices rationed to low-risk borrowers was largely replaced in the 1990s with risk-based pricing of a broadened supply of creatively structured home loans. Next, I provide evidence that loans at noncompetitive high prices and on quite risky terms are flourishing in this market. Reconceptualizing predatory home lending by reference to its two root harms, I propose a new, accurate and yet parsimonious definition of the problem: overpriced and overly risky home loans.

I then narrow my focus in Part II to the price side of the problem, explaining that the current legal regime of disclosure fails to effectively facilitate price shopping because it is based on an unrealistic, rational actor model of borrower behavior. In Part III, I set forth a more realistic picture of consumer decisionmaking, one that recognizes the influence of intangible cognitive and emotional costs on internal decisionmaking processes and the influence of socioeconomic context on external decisionmaking outputs. Next, I show how sellers of home loans exploit widespread cognitive heuristics, biases, and emotional coping mechanisms to sell overpriced home loans to a significant segment of the borrowing population. Here, I work both the cognitive and the emotional sides of the decisionmaking aisle, and I delve deeply into the data on how people really make decisions about their loans. Implicit in my methodology is a critique of those legal scholars who attempt to apply the decisionmaking literature to legal problems at a theoretical level, without checking their claims against real-world data. Part IV explains why the home loan market has not fixed the problem. I then offer a proposal for using the law to restructure the marketplace, to increase price competition, and to reduce the prevalence of predatory overpricing of home loans.

Behavioral decisionmaking research shows that the biases, heuristics, and emotional coping mechanisms likely to be involved in decisions about price differ from those likely to be involved in decisions...

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about risk. My methodology of dividing the overpricing problem from the problem of too much risk is therefore likely to be fruitful in other areas as well. Much of what is described here is equally applicable to other types of consumer credit, such as credit cards, payday loans, and auto financing, all of which have been criticized for predatory deployments. Federal law governing all forms of consumer credit is based on the wealth-maximizing rational economic actor model, and real-world evidence undermines the applicability of this model to vast segments of the borrower markets for all forms of consumer credit. The suggestions here for bringing the law governing the home loan borrowing process into alignment with real consumer behaviors, and reining in the manipulation of those behaviors by sellers of credit, can be tweaked to apply to these other forms of consumer credit as well. Examining home loan borrowing merely provides a focused look at one site where the effects of the current gulf between the law's model of borrower decisionmaking and real heterogeneous borrower behaviors has particularly pernicious effects.

It is theoretically possible to split even the pricing analysis here into two pieces—one piece on how the structure of the market leads people to take overpriced loans and another piece on why heuristics, biases, and coping mechanisms lead people to take overpriced home loans. Yet the sum of market structure plus consumer psychology is greater than its parts. There is an interaction effect between the two. As Arthur Leff in his classic Swindling and Selling explained:

[M]arrying the insights of those who consider the overall structure of transactions generally with the perceptions of those who focus attention on the dynamics of particular transactions may increase the amount of truth available to the world at large—which world exists, after all, in the midst of the individual and the mass all at once.

To understand why the current disclosure regime fails, and to develop tractable solutions to the problem of predatory home lending, one must analyze market structure, consumer decisionmaking, and their interaction.


Although this Article is thus focused on the problem of predatory home lending, it contains valuable lessons about when and how disclosure can realistically be used in legal regulation more generally. Substantive regulation of contract terms or product or service attributes can create inefficiencies and can be a drag on innovation, both of which can hurt consumers. But giving consumers more information in today's information-saturated economy is not enough to assure good or even truly autonomous decisionmaking.\(^8\) We may at times have to intervene in the market to create the conditions necessary for consumers to use disclosures to arrive at decisions that are efficient, autonomous, and good for them, their households, and their communities.

I. **Predatory Lending and the Home Loan Market**

A. *The Home Lending Revolution*

1. *The Twentieth Century Marketplace: Standardized Terms, Limited and Advertised Prices, and Low Risk.—* For much of the twentieth century, home loans were largely standardized instruments, restricted in price, terms, foreclosure risk, and supply. The price of home loans was directly controlled. State usury limits for home loans generally ranged from 6% to 10%,\(^9\) and the federal government capped rates and fees for loans insured by its Federal Housing Administration (FHA) and Veterans Administration (VA) loan programs.\(^10\)

Loan structure was shaped by both formal restrictions on terms and by market incentives. Federal regulation prevented federally chartered lenders from originating variable rate loans,\(^11\) and most states placed a similar prohibition on state-chartered lenders.\(^12\) Most states restricted home loan structure by prohibiting prepayment pen-

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8. By truly autonomous decisionmaking, I mean decisionmaking that gives a person an objective ability to make decisions congruent with her meta-preferences and a subjective feeling of control over her decisions.


alties and balloons.\textsuperscript{13} Federally chartered lenders were likewise prohibited from offering loans with these terms.\textsuperscript{14} FHA and VA insurance were only available for long-term fully amortizing fixed-rate loans.\textsuperscript{15} The Government Sponsored Enterprises (GSEs), the Federal National Mortgage Association (FNMA or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac), established to provide liquidity to the home loan marketplace by purchasing home loans, only purchased FHA and VA loans or, later, conventional\textsuperscript{16} loans meeting similar parameters.\textsuperscript{17} As a result, FHA, VA, and conventional loans all evolved into a predominant standardized product—the thirty-year fixed-rate fully amortizing uniform monthly payment loan.\textsuperscript{18}

Risk and supply were both constrained, directly and indirectly. Price controls indirectly hemmed in risk and supply.\textsuperscript{19} The “three Cs” of underwriting standards—capacity, credit, and collateral—imposed by the government for FHA/VA loans, by the GSEs for GSE-purchased loans, and by lenders for other conventional loans, directly controlled risk.\textsuperscript{20} Capacity was controlled by capping borrower debt-to-income ratios. Creditworthiness was determined by fairly crude univariate

\footnotesize{13. \textit{See} Kathleen E. Keest \& Elizabeth Renuart, The Cost of Credit: Regulation and Legal Challenges §§ 3.9 \& 5.8.3 (2d ed. 2002 \& Supp. 2004). A balloon is a large lump sum payment due on a loan; a simple balloon loan would be a loan on which only interest payments are made over the life of the loan, with the principal due in a lump sum “balloon” at the end of the loan term.

14. \textit{Id.} § 5.8.5.


18. For a history of these loans, see Vandell, \textit{supra} note 10, at 301-12, and Colton, \textit{supra} note 15, at 1-9.

19. Usury limits were adopted to prevent the extreme poverty and debt servitude that could be caused by a desperate borrower’s irrational willingness to take on the risk of a high interest loan that the borrower would not be able to afford. Edward L. Glaeser \& Jos{\textordmasculine} Scheinkman, \textit{Neither a Borrower nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws}, 41 J.L. \& Econ. 1, 3, 27 (1998).

measures of credit and income history. To allow for the costs of collection, lenders required collateral to be appraised high enough so that the maximum loan-to-value ratio (LTV) would be 80%, although private and government mortgage insurance allowed borrowers to insure themselves out of this limit.\(^{21}\) Collateral could be downgraded on the basis of neighborhood characteristics, which allowed government and private discrimination to dampen credit supply to households in nonwhite neighborhoods through redlining.\(^{22}\) A fourth "C," "character," while not particularly effective in controlling risk,\(^{23}\) limited the supply of credit on the basis of subjective evaluation of the applicant and allowed discrimination again to limit the supply of credit to nonwhite applicants.\(^{24}\)

Lenders had limited information from which they could forecast the risk of borrower default and loan servicing costs and therefore faced the potential for adverse selection by costly, risky borrowers. As explained by the Stiglitz-Weiss model, lenders managed their inability to sort borrowers well by cost and risk through rationing credit to only the most apparently creditworthy borrowers.\(^{25}\) Lenders charged a below-market-clearing rate and provided a below-market-clearing supply of home loan credit to keep low-risk borrowers and avoid costly bor-

\(^{21}\) Vandell, supra note 10, at 302.

\(^{22}\) Redlining is the practice of refusing to make loans in minority neighborhoods. The practice derives from federal government maps that placed red lines around racial or ethnic minority communities to indicate areas in which the government would not insure home loans. The practice quickly spread to mortgage lenders, who would redline areas in which they would not extend home loan credit. Kenneth T. Jackson, Crabgrass Frontier: The Suburbanization of the United States 197-98 (1985); Douglas S. Massey & Nancy A. Denton, American Apartheid 51-52 (1993); Vandell, supra note 10, at 302.

\(^{23}\) Cf. Straka, supra note 20, at 218-23 & figs. 2 & 3 (observing that home loan underwriting by objective criteria outperforms subjective underwriting judgments).

\(^{24}\) See, e.g., Complaint ¶ 17, United States v. Decatur Fed. Sav. & Loan Ass'n, No. 1 92-CV-2198-CAM (N.D. Ga. Sept. 17, 1992), available at http://www.usdoj.gov/crt/housing/documents/decaturcomp.htm (alleging that lender discriminated by not extending home loans to blacks). Using 1990 data, researchers at the Federal Reserve Board found that, controlling for loan applicant and collateral characteristics, the probability of being denied a mortgage was 1.8 times higher for black and Latino mortgage applicants than for comparable whites in a major metropolitan area. Alicia H. Munnell et al., Mortgage Lending in Boston: Interpreting HMDA Data, 86 Am. Econ. Rev. 25, 26 (1996). Women were also denied equal access to home loan credit. Nat'l Comm'n on Consumer Fin., Consumer Credit in the United States 152-53 (1972); see also, e.g., Kirchberg v. Feenstra, 450 U.S. 455 (1981) (invalidating Louisiana statute giving only husbands the unilateral right to execute a mortgage on property jointly owned with a spouse).

rowers. Credit rationing thus restricted the availability, price, and risk of home loan credit.

The resulting marketplace was one in which prices could easily be advertised because rates did not vary with borrower characteristics. Each lender charged a single low rate for each of a very small number of loan products, resulting in a short menu of prices for standardized conventional, FHA, and VA loans. Although riskier borrowers might have been willing to pay higher prices, this demand was unmet due to the restrictions on price.

2. The Brave New World of Proliferating Products, Price, and Risk.—In the past thirty years, price caps and standardized terms have virtually disappeared, and constraints on risk and supply have loosened dramatically. In response to the interest rate disintermediation crisis of the 1970s, most state usury limits were raised significantly, abolished, and/or preempted for home loans by federal law, and the FHA and VA price caps were raised. These changes eliminated one constraint on price, risk, and supply. The structure of home loans became less standardized with the introduction of adjustable rate mortgages (ARMs), again spurred by the disintermediation crisis. This creative loan structuring was made legally possible by the removal of usury restrictions and of prior state and federal legal prohibitions on variable rate structures.28

26. In the 1970s, most lenders were dependent on deposits as a source of loan funds, because home loans had not yet been widely securitized. The credit crunch of the 1970s caused interest rates to rise, such that lenders with outstanding fixed rate home loans were taking in less interest income than they needed to pay in interest on deposits to convince depositors to keep their deposits at the lender instead of in alternative, higher-interest-earning investment vehicles. Because the depository institutions were no longer able to perform their intermediary role between depositors and borrowers, this phenomenon is called disintermediation. Jonathan McCarthy & Richard W. Peach, Monetary Policy Transmission to Residential Investment, FED. RES. BANK OF N.Y. ECON. POL'Y REV., May 2002, at 139, 140.

27. Title V of The Depository Institutions Deregulation and Monetary Control Act (DIDMCA), 12 U.S.C. § 1735f-7a (2000), preempted state regulation of first mortgages by all federal lenders and their subsidiaries and all large lenders (i.e., lending over $1 million/year). See also Eskridge, supra note 9, at 1108-09. A provision of the National Bank Act of 1864, codified at 12 U.S.C. § 85, was interpreted in Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978), to allow national banks to export the interest rates of their home states to all other states, thus effectively eliminating usury caps for all home loans originated by national banks that chartered themselves in states with no rate caps. James J. White, The Usury Trompe L'Oeil, 51 S.C. L. REV. 445, 445 (2000). Caps on FHA and VA rates were originally set by statute, then set by the relevant administrative agencies according to market rates, and then, in 1983, all price caps on FHA loans were removed. Mansfield, supra note 10, at 480-84; Vandell, supra note 10, at 303 tbl.1.

28. See Browne, supra note 11, at 183-88 (federal regulators permitted federally chartered lenders to originate ARMs beginning in the early 1980s). The Alternative Mort-
Supply was potentially increased in other ways as well. Federal legislation strengthening the secondary market for home mortgages by allowing the GSEs and state-regulated financial institutions to invest more heavily in private mortgage-backed securities loosened credit supply.\textsuperscript{29} Beginning in the late 1980s, the federal government began to enforce laws prohibiting discrimination in home lending.\textsuperscript{30} Fair lending enforcement broadened the supply of home loan credit to previously excluded communities, although consolidation in the banking industry simultaneously led to the withdrawal of branches from some minority communities.\textsuperscript{31}

But dramatic changes in prices, standardization, risk, and credit supply have only come about as a result of technological advances in computer data storage, processing, and networking in the 1990s. Asymmetric information and adverse selection, with the borrower having more information about her default risk and doing the selecting, formed the underpinnings of the Stiglitz-Weiss model of credit rationing.\textsuperscript{32} Advances in creditworthiness data collection and processing have revolutionized the ability of lenders to model borrower behavior so as to more accurately forecast lending default, prepayment, and

gage Transaction Parity Act (AMTPA), 12 U.S.C. §§ 3801-3806, preempted state regulation of all "alternative" mortgages, whether made by federally or state-chartered lenders or subsidiaries. To fall within AMPTA's preemption ambit, the loan must be structured in a more complex way than the traditional fixed-rate fully amortizing product, such as an adjustable-rate or balloon loan. AMTPA effectively removed prior state-law prohibitions on ARMs. Mansfield, \textit{supra} note 10, at 510. It also opened the door for state-chartered institutions to structure home loans with prepayment penalties and balloons, where federal regulators permitted the equivalent federally chartered type of institution to do so. KEEST & RENUART, \textit{supra} note 13, § 3.9. The federal regulators have at times claimed authority to preempt state prepayment penalty and balloon prohibitions and at times left these to state law. \textit{Id.}


31. Between 1975 and 1997, consolidation led to a 40% drop in the number of bank and thrift lenders. ROSS & VANCER, \textit{supra} note 17, at 23. This particularly affected minority communities; a \textit{U.S. News & World Report} study found that in 1970, the number of bank branches per person in minority and white neighborhoods was roughly equal, but by 1993, there were only a third as many branches per person in minority neighborhoods as in white neighborhoods. Penny Loeb et al., \textit{The New Redlining}, \textit{U.S. News & World Rep.}, Apr. 17, 1995, at 51.

servicing costs with automated underwriting.\textsuperscript{33} Whereas lenders were once limited to using a few objective independent univariate criteria for underwriting plus a degree of subjectivity provided by the human underwriter, today lenders can use multivariate regression-based objective risk modeling. Computer capacity allows such modeling to use millions of data points mined from past borrowers, their loans, and their personal and collateral characteristics to generate a constantly updated predictive tool that is more accurate and more sensitive to the interactions among variables. Each small change in one variable can be met by a change in another variable; for example, a high debt-to-income ratio that might have led to a per se rejection in the old underwriting method can now be "outweighed" by a low LTV and a strong credit history.

Now that prices are no longer restricted by legal regulation, a change in price can be combined with other variables to result in a constant predicted return to the lender regardless of the riskiness of the loan. As a result, lenders today can price discriminate based on risk rather than grossly pricing credit.\textsuperscript{34} Lenders' potential to predict loan performance may not be realized where the cost of gathering information needed for input into the lender's underwriting model remains high. For example, credit reporting agencies may not have dossiers on borrowers who have not been part of the traditional credit market.\textsuperscript{35} But the cost of collecting, storing, and analyzing more and more credit-relevant data is inexorably decreasing. The observable result, as theory would predict, has been a move toward risk-based pricing and away from credit rationing's limits on loan price, risk, and

\textsuperscript{33} Straka, \textit{supra} note 20, at 210-18. Individual creditworthiness data is gathered by credit reporting agencies and, typically using a proprietary model developed by Fair, Isaac and Co., turned into an individual's credit (FICO) score. Individual lenders (and/or the GSEs for a loan the originator intends to sell to a GSE) translate this credit score and other borrower, loan, and collateral information into a prediction of loan performance, sometimes called an "origination score," using their own proprietary models. Ross & Yinger, \textit{supra} note 17, at 22-23; Straka, \textit{supra} note 20, at 211-14.

\textsuperscript{34} Thus, assumptions previously made by some economists and policymakers that lenders must price credit grossly and cannot price discriminate with respect to individual consumers are not generally true today. Alan Schwartz & Louis L. Wilde, \textit{Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests}, 69 Va. L. Rev. 1387, 1462 (1983).

\textsuperscript{35} See Klausner, \textit{supra} note 25, at 1567-68 (theorizing that the costs of acquiring information about potential borrowers in low-income areas may lead lenders to rationally forgo such lending opportunities). Discrimination wrought by redlining and the subjective judgment of loan underwriters in the old world of mortgage credit can thus infect the new world, even as objective credit modeling creates the possibility of greater fairness in access to credit.
supply as lenders have gained the ability to better sort borrowers according to risk and cost.\textsuperscript{36}

Large scale securitization\textsuperscript{37} of home loans starting in the early 1990s has further expanded the availability of credit, particularly from nondepository lenders not regulated by federal banking authorities.\textsuperscript{38} Legal changes in the mid-1980s that allowed for the development of the private home loan securities market laid the groundwork,\textsuperscript{39} but the ability of securities markets to use computer data modeling to more accurately price loan pools created the drive to securitization.\textsuperscript{40}

\textsuperscript{36} A 2003 American Bankers Association report explains:

"[O]ver two decades ago, Joseph Stiglitz and Andrew Weiss demonstrated that it was rational for lenders to ration credit where they could not accurately identify the riskiest borrowers. . . . With the development and refinement of credit scoring techniques, lenders are now able to classify borrowers by their risk characteristics and thus are able to price their loans accordingly."


37. Securitization is the process of obtaining financing by selling the pooled rights to future income stream from individual receivables, here, mortgage loans. Whole loans can be pooled and securitized, or they can be divided into future interest, principal, and prepayment penalty payment streams or "strips." Kathleen C. Engel & Patricia A. McCoy, \textit{Predatory Lending: What Does Wall Street Have to Do with It?}, 15 \textit{HOUS. POL'Y DEBATE} 715, 718 (2004). \textit{See generally} Steven L. Schwarcz, \textit{The Alchemy of Asset Securitization}, 1 \textit{STAN. J.L. BUS. & FIN.} 133 (1994).

38. The market share of originations by nondepository lenders (mortgage companies) was about 60% in 2000, roughly paralleling the share of originations funded through the secondary market. Colton, \textit{supra} note 15, at 34 fig.6, 36 fig.8. Note, however, that many of these nondepository lenders are affiliated with lenders regulated by the federal banking authorities; many bank holding companies have both prime banking units and subprime lending units or affiliates. \textit{See Edward M. Gramlich, Federal Reserve Board Governor, Remarks at the Financial Services Roundtable Annual Housing Policy Meeting, Chicago, Ill.: Subprime Mortgage Lending: Benefits, Costs, and Challenges} (May 21, 2004), at tbl.4, \textit{available at} http://www.federalreserve.gov/boarddocs/speeches/2004/20040521/default.htm (demonstrating that in 2002, commercial banks and thrifts accounted for 41% of subprime originations and subsidiaries and affiliates of banks accounted for 47% of subprime originations, leaving only 12% of these originations to independent mortgage companies).\textsuperscript{39}


40. \textit{See Michael LaCoeur-Little, The Evolving Role of Technology in Mortgage Finance}, 11 \textit{J. HOUS. RES.} 173, 192-94 (2000) (explaining that in the mid-1990s, e.g., computer processor conversion from 386 to Pentium chips reduced the secondary market's valuation time for each home mortgage by a factor of ten and the advent of the Internet reduced the time and expense of securitization transactions).
As a result, the share of mortgages funded through the secondary market more than doubled from 1984 to 2001, when it reached about 60% of home loan originations.\textsuperscript{41} About half of these are securitized through the GSEs, but an increasing proportion are issued by private conduits.\textsuperscript{42}

Collectively, these changes have ushered in what is called "subprime" lending, meaning home loans at prices higher than those available in the traditional low-risk "prime" market, justified in theory by the increased costs and risks entailed in lending to a broader and less creditworthy borrower market.\textsuperscript{43} Between 1993 and 2004, subprime lending increased from less than 1% to over 20% of the market in originations, with over one trillion dollars in outstanding subprime loans as of the first quarter of 2005.\textsuperscript{44} While loan sharks have always existed to provide some high-cost loans to risky borrowers, only with the inflow of money from Wall Street through securitization could the

\textsuperscript{41} Colton, supra note 15, at 36 fig.8.

\textsuperscript{42} Ross \& Yinger, supra note 17, at 22 (reporting on loans sold in 2000); McCarthy \& Peach, \textit{supra} note 26, at 142.

\textsuperscript{43} Banking regulators define "subprime borrowers" as those with one of the following: two or more thirty-day delinquencies in the last year; one or more sixty-day delinquency in the last two years; judgment, foreclosure, repossession, or charge-off in the last two years; bankruptcy in the last five years; or a debt-service-to-income ratio of 50% or higher. Office of the Comptroller of the Currency, Economic Issues in Predatory Lending 8 n.§ (July 30, 2003) [hereinafter OCC Working Paper]. While "subprime" was thus originally defined with reference to the credit quality of the borrower, no lender reports data by creditworthiness characteristics. Subprime versus prime lending was therefore estimated by identity of the lender as one who primarily served one market or the other.

However, new reporting requirements for loans covered by the Home Mortgage Disclosure Act (HMDA), 12 U.S.C. §§ 2801-2810 (2000), are likely to effectively define subprime loans by price. HMDA-reporting lenders must now report price information for home loans they originate at prices above certain thresholds. The threshold for first-lien loans is three points above the prevailing rate on Treasury securities of comparable maturity; for subordinate mortgages, the threshold is five points above that rate. The Federal Reserve Board chose these thresholds "in the belief that they would exclude the vast majority of prime-rate loans and include the vast majority of subprime-rate loans." Press Release, Office of the Comptroller of the Currency, U.S. Dep't of Treasury, Frequently Asked Questions About the New HMDA Data 3-4 (Mar. 31, 2005), available at http://www.occ.gov/ftp/release/2005-37a.pdf. With no existing definition of prime and subprime by loan characteristics, the reporting requirements themselves are likely to create these definitions.

volume of loans from unregulated lenders reach today’s proportions.\textsuperscript{45}

Only between 10\% and 20\% of subprime loans are used for home purchases.\textsuperscript{46} Instead, most subprime loans are home equity loans or cash out refinancings, meaning that the borrower is taking equity out of the home, primarily for debt consolidation and general consumer credit purposes.\textsuperscript{47} The reason for this is that most homebuyers, particularly first-time homebuyers, have not amassed large downpayments. Accordingly, most purchase money loans do not involve large up-front fees or points and are at high LTVs, with little equity remaining in the home as security for the loan. Conversely, subprime loans generally rely more heavily on the equity in the home and up-front fees, in addition to higher interest rates, to cover higher origination, servicing, and default risk costs than do prime loans.\textsuperscript{48} Because subprime lenders require more equity to secure the loan, subprime loans are less likely to be used for home purchase.\textsuperscript{49}
In addition to facilitating riskier, pricier subprime lending and secondary market investment in that lending, computer-driven financial modeling also allows home loans today to be structured and priced in a mind-boggling array of ways. Particularly in the subprime sector, although increasingly in the prime market as well,\(^5\) the days of cookie-cutter thirty-year fully amortizing home loans are gone. Due to what has been termed “nichification,” loan structuring and pricing can be extremely transaction specific, reflecting a host of borrower, property, market, and loan features.\(^5\) The note rate alone can be complicated; in addition to or without adjusting the rate with the movement of a common index, an ARM can adjust automatically up-

the fact that subprime loans are infrequently used for home purchase undermines this view. To the contrary, homeownership rates would have increased more during the 1990s, absent the loss of homeownership caused by predatory refinancings and second mortgages. \(\text{See, e.g., Roberto G. Quercia et al., Assessing the Impact of North Carolina's Predatory Lending Law, 15 Hous. POL'Y DEBATE 573, 587-88 & tbl.3 (2004) (providing empirical evidence that predatory practices are concentrated in the refinancing market).}\)


50. Within the last few years, standardization of terms and pricing in the prime market has decreased, potentially introducing the problems currently more prevalent in the subprime market to the prime market. Until recently, the cost to the lender of price and term nichification in the prime market was not worth the added returns to be garnered thereby; a separating equilibrium had formed between subprime loans with high processing (application and loan structuring) costs and prime loans with low processing costs. Joseph Nichols et al., \textit{Borrower Self-Selection, Underwriting Costs, and Subprime Mortgage Credit Supply}, 30 J. REAL EST. FIN. & ECON. 197, 215 (2005). Either the processing costs have decreased or the returns to those costs have increased, as is evidenced by the increasing use of interest-only, variable-rate, and other creatively structured loans in the prime market. \textit{See, e.g., Tara Siegel Bernard, Buy Now, Pay Later, WALL ST. J., Mar. 28, 2005, at R5 (noting that 33% of all new home loans are now interest-only and outlining a variety of newly common loan structures that diverge from the fully amortizing thirty-year fixed-rate product); Kenneth R. Harney, Low Down-Payment Loans Can Prove Costly to Umsar, BALT. SUN, Jan. 16, 2005, at 1L (reporting securities market concerns about default and foreclosure potential of recent interest-only and “no doc” home loan mortgages that are “flooding” the home loan market).}\)

51. Jack Guttentag, \textit{Another View of Predatory Lending} 12 (Wharton Fin. Insts. Ctr., Working Paper No. 01-23-B, 2000). Guttentag describes a software system commonly used for home loan pricing. When developed in the early 1990s, the system used only a few pieces of data to determine loan price. A decade later, the system used so many factors to determine price that there were forty million possible combinations of pricing factors. \textit{Id.}\)
ward each year, or in certain years, by a certain amount regardless of index movement. For example, the rate could begin fixed for three years and then convert to an adjustable rate (a 3/1 ARM), or begin at one rate and then move up by a percentage point each year for two years before it hits its regular rate (a 2/1 buydown), or some combination of these.52

The total loan price can be extracted through a host of loan terms and ancillary items in addition to the interest rate. Origination fees, meaning anything charged as part of origination, can be a large component of a loan's price. These fees include points that may or may not buydown the interest rate and a host of "junk fees" (e.g., document preparation fees, underwriting analysis fees, tax escrow fees, escrow fund analysis fees).53 A lender can use inflated prices for ancillary products, such as credit insurance, to extract more from the borrower.54 When financed into the loan, origination fees and ancillary products form the basis for additional interest charges over the life of the loan. During the loan repayment period, late fees and foreclosure fees can be quite lucrative.55 Prepayment penalties have become such a major source of cash flow that they can be securitized apart from the interest and principal payment stream components of home loans.56

Computer price modeling means there need not be any correlation between the components of the cost of the loan to the lender and the components of the price of the loan as charged to the borrower. That is, there need not be any correlation between origination costs and what are called "origination fees" or between costs due to delinquency or default and what are called "late fees" or "foreclosure fees."


54. See, e.g., Brian Collins, Citi Pays $215 Million to Settle Alleged Fraud at Associates, NAT'L MORTGAGE NEWS, Sept. 23, 2002, at 2 ("It was not uncommon for Associates to charge $5,000 for credit insurance on a $35,000 loan and add it to the loan amount."). Lenders receive average commissions of 30% on sales of single-premium credit insurance. HUD-TREASURY REPORT, supra note 46, at 88 n.84.

55. See, e.g., Kenneth R. Harney, Fairbanks Capital Settles with HUD, WASH. POST, Nov. 1, 2003, at F1 (recounting story of borrower who was charged over $3500 in late fees and related charges); Bar-Gill, supra note 6, at 1393 (late fees in credit card contracts are a significant source of revenue for lenders).

56. Engel & McCoy, supra note 37, at 718.
The note interest rate, adjusted downward for any points paid at closing, has traditionally reflected various components of the lender's costs—cost of funds, risk to lender's return due to borrower default or prepayment, and servicing costs—but today the interest rate need not reflect these costs nor need it be adjusted to account for points paid. Rather, a lender can creatively manipulate each component of the price of a loan to effect a desired predicted return. For example, a loan can carry no origination fee but a higher interest rate to cover origination costs so long as it also carries a prepayment penalty to guarantee that even if the borrower refinances before interest payments cover origination costs, the lender will recover these costs.

In theory, creative loan structuring and price nichification can be beneficial to consumers. Pricing nichification could help moderately credit-impaired “A minus” borrowers because loans can be more accurately priced, rather than lumping a range of borrower risk types together, with the lower risk “A minus” types in that group, in effect, subsidizing the higher risk “D” types. Product nichification can also theoretically provide loan terms better suited to each individual borrower’s needs. Creatively structured products all have some legitimate uses. A doctor in residency could benefit from a loan with a monthly payment amounts that starts low but jumps up simultaneously with the increase in income she expects when her residency ends. A borrower who knows she will receive a trust fund on a particular date, or a homeowner planning to sell her home at retirement, could benefit from a loan that has a balloon maturing at the appropriate time. In some scenarios, manipulation of the prices of various aspects of the transaction can help a borrower obtain a wise, not unduly risky, and fairly priced loan for which the borrower would otherwise not qualify.

However, nichification also means consumers today are faced with a “bewildering array” of home loan products. Evidence from the field indicates that complex loan products developed to satisfy small niche markets are now being sold to a broader range of borrow-

57. See, e.g., Collins et al., supra note 36, at 4-7 (describing the benefits of more finely grained risk-based pricing over crude credit rationing). In theory, lenders can also develop expertise within a limited niche, which could lead to greater efficiencies passed on to borrowers.

ers, for whom these products are not always appropriate.\textsuperscript{59} Comparison shopping is more difficult for loans with nonstandardized structures because consumers must determine how to trade off, e.g., origination fees, interest rates, and prepayment penalties. Consumers must make extensive financial forecasts to accurately assess the suitability of loans with increasing monthly payment structures, balloons, or prepayment penalties.

Compounding these difficulties, nichification also means that subprime loan terms and prices cannot be effectively advertised.\textsuperscript{60} Within the prime market, lenders continue for the most part to engage in average cost pricing, meaning that once the borrower meets a creditworthiness threshold, loans are priced to reflect the lender's average cost of funds over all prime borrowers, from the most to the least risky.\textsuperscript{61} Although this is starting to change, prime lenders usually offer a small number of loan structures (e.g., fixed rate or an indexed adjustable rate, fifteen- or thirty-year term). Each structure has a corresponding price that is charged to all prime borrowers, with some variation depending on loan type (e.g., purchase money, refinance, or FHA).\textsuperscript{62} Prime lenders will frequently advertise the price for a single, popular product such as a thirty-year fixed rate conventional loan. The prices for their other products usually do not differ greatly and are made easily accessible to the applicant who wants to price shop, frequently through the newspaper or Internet.\textsuperscript{63}

In contrast, subprime loan pricing is too complicated and variable to advertise prices. As a U.S. Department of Housing and Urban Development report notes: "With the adoption of risk-based pricing . . . , consumers may not be able to shop around for rates using advertisements—no one rate can be advertised that would be offered to all borrowers." Even a competitive pricing structure for subprime loans will result in a range of prices according to the cost and risk

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\textsuperscript{59} A recent article in The American Banker describes extensive "changes in thresholds for granting loans and terms that were once considered niche products" such as "widespread consumer and lender acceptance of mortgages with the potential for severe payment shocks or gradual escalation in monthly payments." Shenn, \textit{supra} note 20, at 1.

\textsuperscript{60} For further discussion, see \textit{infra} Part IV.A.2.

\textsuperscript{61} \textsc{Kenneth Temkin et al., Subprime Markets, The Role of GSEs, and Risk-Based Pricing} 27 (U.S. Dep't of Hous. & Urban Dev. Mar. 2002).

\textsuperscript{62} HUD-Treasury Report, \textit{supra} note 46, at 2 (citing "greater homogeneity in loan terms" in prime market).

\textsuperscript{63} \textit{Cf.} Pennington-Cross et al., \textit{supra} note 44, at iv ("[W]hy do subprime lenders not advertise more, and why do local newspapers not publish, as they do for prime lenders, current interest rates and fees for local subprime lending institutions?"). But see \textit{supra} note 50, for evidence that products in the prime market are becoming less standardized.

\textsuperscript{64} \textsc{Temkin et al., supra} note 61, at 32.
presented by each borrower and loan. There are no generic standards defining which borrower qualifies for which price. Pricing formulae are complicated and change rapidly in response to feedback from the market about current loan performance. Therefore, a subprime lender cannot transmit sufficient information in an advertisement for a borrower to identify the price for which she would qualify from that lender.

The result is that subprime loan pricing and structure are non-transparent to many consumers, creating information asymmetries between borrowers and loan sellers that can be exploited by the latter. In the process of setting a subprime loan's individualized price, loan sellers can add a discretionary element (or "overage") to the price, limited only by the price negotiations, if any, between borrower and lender.65 Analysts reporting on securities backed by subprime loan pools deem "excess spread"—i.e., note interest rates above what the borrowers' cost and risk profiles would call for—to be a "credit enhancement" for the loan pool.66 The nonuniformity resulting from risk-based pricing and the opacity resulting from nichification and lack of price advertising create opportunities for sellers to exercise discretion in mortgage pricing to the detriment of borrowers.67

The home loan marketplace today is thus a very different one than existed in the middle of the twentieth century, or even in 1990. Loan supply is limited only by the willingness of investors to purchase mortgage backed securities. Loan risk is limited only by borrower self-protection and the outside bounds within which the market can price that risk to produce adequate returns for lenders or investors.68 Loans terms are limited only by the creativity of the marketplace.

65. Avery et al., New Information Reported Under HMDA and Its Application in Fair Lending Enforcement, 91 FED. RES. BULL. 344, 369-70 (2005) (listing "discretionary pricing" as among the reasons for home loan price variation); TEMKIN ET AL., supra note 61, at 28 (noting that in the subprime market, lenders adjust loan price based on the risk of the borrower and the negotiating powers of the borrower and loan seller).

66. CREDIT & COLLECTIONS WORLD, supra note 48.

67. Collins et al., supra note 36, at 9 ("As products become more complex, the asymmetry of information between well informed . . . and less well informed buyers and sellers increases, and the potential for unfair, discriminatory, and inefficient transactions grows."); Greenspan, supra note 36 ("The adoption of risk-based pricing, together with elements of discretion that are often afforded loan officers or brokers in the pricing of credit, does raise the concern that some borrowers, in fact, may not be treated fairly."); see also Kathleen C. Engel & Patricia A. McCoy, A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 TEX. L. REV. 1255, 1284-84 (2002) (contrasting relatively standardized prime loans with more complicated subprime loans, and noting the increased comprehension difficulties created for subprime shoppers).

68. There is also some legal limit on risk through prohibitions on asset-based lending. 15 U.S.C. § 1639 (2000).
Loan prices are limited only by the price competitiveness of the marketplace. And loan price advertising persists in the prime market, but not the subprime market.

3. Evidence of Predatory Home Lending.—An examination of home lending today demonstrates that the marketplace is not very price competitive, leading to overpriced home loans, and that borrowers are not very self-protective when it comes to loan risk, leading to overly risky home loans.

On average, subprime loan prices expressed as an annual percentage rate (APR) are about three to four points higher than prime loan prices, a difference that can amount to significantly greater monthly and total loan costs. A $100,000 thirty-year loan at 6.5% carries monthly payments of about $630 and total finance charges of less than $130,000; that same loan at 9.5% carries monthly payments of about $840 and total finance charges of over $200,000. But some subprime loans are at much higher prices than the average, leading to astoundingly greater costs to the borrowers. In 2003, a year when prime rates averaged less than 6% and points and fees averaged about 0.50%, Citigroup, Wells Fargo, and Household, all major U.S. lenders, reported originating subprime loans with APRs exceeding 20%, and Household originated loans with APRs in excess of 30%. A $100,000 thirty-year loan at 20% carries monthly payments of over $1670 and total finance charges of over $500,000.

69. APR is roughly the cost of a loan, including interest, fees, and points, expressed as an annual percentage rate, with the assumption that the borrower will hold the loan to term. Freddie Mac, Credit Smart, Glossary, supra note 52.

70. TEMKIN ET AL., supra note 61, at 19 (reporting average prime loan APRs to be between 7% and 8%, and subprime loan APRs to be about 10% to 12% in 1999); Elizabeth Laderman, Subprime Mortgage Lending and the Capital Markets, FRBSF ECON. LETTER (San Francisco), Dec. 28, 2001, at 2 (showing industry data that loans originated by subprime lenders averaged 3.7 points higher than loans originated by prime lenders from 1998 to 2001).


72. See KEVIN STEIN, CAL. REINVESTMENT COALITION, WHO REALLY GETS HOME LOANS? YEAR ELEVEN: MORTGAGE LENDING TO AFRICAN-AMERICAN AND LATINO BORROWERS IN 5 CALIFORNIA COMMUNITIES IN 2003, at 2-3, 25 app. III (2005) (using data reported by lenders to the California Department of Corporations); McCarthy & Peach, supra note 26, at 143 (noting that initial fees and charges for a mortgage averaged just over 0.50% in 2002); see also WASH. STATE DEPT. OF FIN. INSTS., EXPANDED REPORT OF EXAMINATION FOR Household Finance Corporation III passim (2002) [hereinafter HOUSEHOLD EXAMINATION] (reviewing borrower complaints and finding home loans with interest rates ranging from 10% to 25%, in many cases in addition to 7.25% in points).
Although the higher prices of subprime loans are justified in theory by higher anticipated costs to the lender, many subprime loans exhibit signs of excessive price, more than would be justified by the borrowers' risk and cost. It is estimated that as many as half of the borrowers with subprime loans were qualified for lower prime interest rate loans, based on their credit history and loan profile.\(^7\) A 2004 memo from the vice president at a subprime subsidiary of Countrywide, the largest mortgage lender in the United States, "encouraged loan officers . . . to downgrade borrowers' credit ratings in order to steer them into more expensive loans" and "suggest[ed] five ways loan agents can steer borrowers, including those with good credit, into the sub-prime category, including listing only one income when there are two wage earners, increasing the amount of the loan and not listing any of a borrower's assets."\(^7\)

Further, many of those with subprime credit profiles are being charged much more than what their higher risk and cost should garner. The manner in which loans are graded varies by lender, but generally prime home loans are graded as "A" quality paper. Subprime home loans are generally graded as "A minus" or "Alt A," "B," "C," and "D" paper, in increasing order of price, in theory to correspond with a declining order of borrower creditworthiness and predicted loan performance.\(^7\) An analysis of "A minus" loans, loans at the lowest risk

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\(^7\) Federal Reserve Board Governor Gramlich explained: "[B]orrowers with FICO [credit] scores below 620 are viewed as higher risk and generally ineligible for prime loans. . . . But it is noteworthy that about half of subprime borrowers have FICO scores above this threshold, indicating that a good credit history alone does not guarantee prime status." Gramlich, supra note 38; see also James H. Carr & Lopa Kolluri, Predatory Lending: An Overview, in Financial Services in Distressed Communities: Issues & Answers 31, 37 (Fannie Mae Found. ed., 2001) ("[R]esearch by Freddie Mac reports that as much as 35 percent of borrowers in the subprime market could qualify for prime market loans. Fannie Mae estimates that number closer to 50 percent."); Freddie Mac, Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families 5-6, 10-35 (1996), available at http://www.freddiemac.com/corporate/reports/moseley/chap5.htm (estimating 10% to 35%); see also Stein, supra note 72, at 9 (explaining that Citigroup's 2003 review of borrowers who received loans from its subprime unit, Citifinancial, revealed that over 25,000 of them were qualified for lower cost prime loans); Pennington-Cross et al., supra note 44, at iv (concluding, in an industry-sponsored study "that borrowers may not be consistently or appropriately assigned the right mortgage by the market").

\(^7\) Annette Haddad, Countrywide Fires Manager, Citing Ethics, L.A. TIMES, Nov. 20, 2004, at C1. Another subprime lender told investors that more than three-fourths of its high-cost loans went to people with relatively good credit, and a former loan officer confirmed that customers with A credit would pay the same prices as customers with D credit. Diana B. Henriques & Lowell Bergman, Profiting from Fine Print with Wall Street's Help, N.Y. TIMES, Mar. 15, 2000, at A1.

\(^7\) In addition to borrower creditworthiness, loan performance predictions take prepayment risk and servicing costs into account. Pricing is not yet finely graduated into a smooth price-performance line. Rather, loan performance is predicted roughly to sort
level and lowest price level for subprime loans, found that at least 1% of the note interest rate alone being charged to these borrowers could not be explained by risk or cost of the loans.\textsuperscript{76} In addition to interest, origination fees and points are frequently in excess of the slightly higher origination costs to be expected for subprime risk loans, and without any reduction in interest rates as is typically bought by points paid in the prime market.\textsuperscript{77} The CEO of one predatory lender told the \textit{New York Times} that his company "had recently reduced its origination fees to an average of about 10 percent because of . . . the 'sound-bite effect of the high origination fees.'"\textsuperscript{78} This was after it had come to light that the lender had been charging fees as high as 25%, in addition to interest.\textsuperscript{79}

On the risk side, despite economic boom times in this country and record homeownership rates, foreclosures on owner-occupied dwellings during the mid- to late-1990s more than doubled in many of the central cities where predatory loans are concentrated.\textsuperscript{80} The \textit{New York Times} reported in April 2003: "[I]n the last nine years, despite a decrease of 20 percent in foreclosures on prime-rate mortgages, the

\begin{Verbatim}
\textit{loans into A through D price buckets. As information technology advances, pricing will no doubt become more finely tuned. See Straka, supra note 20, at 228 ("Potentially, all or most loans, regardless of risk, can be quickly approved and offered at statistically appropriate competitive risk-based prices.").)
\end{Verbatim}

\textsuperscript{76} Lax et al., supra note 48, at 567-69. This study examined note interest rates only and did not consider the further differentials in pricing caused by higher origination points and fees paid by subprime borrowers. \textit{Id}. at 569.


\textsuperscript{78} Henriques & Bergman, supra note 74, at A1 (emphasis added).

\textsuperscript{79} \textit{Id}. The same article reported the story of a woman who thought she had borrowed about $51,000, but later discovered she had signed for over $64,000 because 26% in fees were added to the loan at origination. \textit{Id}.

\textsuperscript{80} See, e.g., 2000 \textit{House Hrg.}, supra note 3, at 203-04 (statement of William Apgar, Assistant Secretary for Housing and FHA Commissioner) (citing studies demonstrating that in Chicago, foreclosures doubled between 1993 and 1998, and foreclosures of subprime loans increased by a factor of forty; in Atlanta, although foreclosures overall decreased between 1996 and 1999, subprime foreclosures more than tripled and by 1999, were 16% of all foreclosures but only 9% of originations); \textit{PA. Ass'N of CMT. ORGS. FOR REFORM NOW (ACORN), Equity Strippers: The Impact of Subprime Lending in Philadelphia (2000), reprinted in 2001 Sen. Hrg., supra note 77, at 410, 414 (foreclosures in Philadelphia increased over 100% between 1995 and 2000 due to increase in subprime originations and foreclosures).}
national foreclosure rate has risen by 68 percent..."81 As explained above, subprime loans are predominately refinancings or second mortgages, not home purchase loans, and therefore subprime lending has not substantially increased homeownership rates. To the contrary, the most comprehensive national study of foreclosures and subprime loans indicates that over 20% of all first-lien subprime refinance loans originated in 1999 had entered foreclosure by December 2003, a mere four years later; 60% of these borrowers had lost their homes and another 10% to 20% were still in foreclosure as of December 2003.82 Some securitized subprime loan pools have foreclosure rates as high as 28%.83 Subprime lenders are responsible for a tremendous proportion of foreclosures, given that at the time most subprime borrowers received the loans, they had a successful track record of mortgage payments to their previous lender.84 Further, the risk of foreclosure for many of these loans should have been evident at the time of origination; subprime loans that result in foreclosure do


82. ROBERTO G. QUERCIA ET AL., KENAN INST. FOR PRIVATE ENTER., THE IMPACT OF PREDATORY LOAN TERMS ON SUBPRIME FORECLOSURES: The Special Case of Prepayment Penalties & Balloon Payments 21-22, 31 tbl.1 (2005). The database used for this analysis represents 39% of the subprime market in 1998 and 67% of that market in 2002. Id. at 12. Another study reported that between 2000 and 2003, the number of foreclosure sales in Pennsylvania was over 55,000, more than the number of households in Pennsylvania's third-largest city, and attributed the majority of these foreclosures to subprime loans. PA. DEP'T OF BANKING, LOSING THE AMERICAN DREAM: A REPORT ON RESIDENTIAL MORTGAGE FORECLOSURES AND ABUSIVE LENDING PRACTICES IN PENNSYLVANIA 23-27 (2005).

83. 2000 House Hrg., supra note 3, at 385 (statement of Cathy Lesser Mansfield, Associate Professor of Law, Drake University). The loans in the particular pool examined were originated in 1998 and examined in 2001, meaning that in about two years these loans were already failing at these rates. Id. The loans were originated by WMC Mortgage, a major wholesale lender. Id.; see also Sandra Fleishman, Landmark Predatory Lending Suit Settled, WASH. POST, Feb. 24, 2005, at E1 (reporting a foreclosure rate of one in three loans made over a three-year period by one lender).

84. See, e.g., Harold L. Bunce et al., Subprime Foreclosures: The Smoking Gun of Predatory Lending, in HOUSING POLICY IN THE NEW MILLENNIUM CONFERENCE PROCEEDINGS 257, 266-68 (Susan M. Wachter & R. Leo Penne, U.S. Dep't of Hous. & Urban Dev. eds., 2001). Although one would expect subprime loans to default at higher rates than prime loans because many subprime loans are made to higher risk borrowers, there is nothing to indicate that subprime borrowers know how very much higher their likelihood of foreclosure is. Lenders, when selling these loans to consumers, work to convince borrowers otherwise. See Deposition Testimony of Gene A. Marsh at 82-83, Pagter v. First Alliance Mortgage Co., No. CV766996 (Cal. Super. Ct. Dec. 28, 1999) [hereinafter Marsh Testimony] (discussing subprime lender training manual that explains to loan officers that "[t]he customers must feel this loan is risk free for them").
so about twice as quickly as do prime loans that end up in foreclosure.\textsuperscript{85}

Moreover, the households paying these high prices and facing this high risk of foreclosure are disproportionately African American, Latino, and low- to moderate-income\textsuperscript{86} households that already have fewer financial resources to spare and significantly lower homeownership rates\textsuperscript{87} to begin with. The elderly have also been particularly hard hit.\textsuperscript{88} The targeting of minority and elderly communities for predatory loans has been dubbed “reverse redlining.”\textsuperscript{89} The sum of

\textsuperscript{85} Bunc\textit{e} et al., \textit{supra} note 84, at 263-65.

\textsuperscript{86} Of home loans originated in 2004 by lenders required to report price and race data, about 32\% of conventional purchase money loan and about 35\% of conventional refinance loans to African-Americans were priced above the threshold price spread set by the Federal Reserve Board to approximate the dividing line between prime and subprime mortgages (see \textit{supra} note 43 for explanation of this dividing line), whereas the corresponding figures for non-Hispanic white borrowers were about 9\% and 13\%, meaning that black borrowers were three to four times more likely than white borrowers to receive subprime loans. Avery et al., \textit{supra} note 65, at 377 tbl.10 & 379. Despite Federal Reserve Board researcher attempts to control for borrower, loan, and lender characteristics, some race disparities remained otherwise unexplained. Id. Disparities were stark at some well-known lenders. James R. Hagerty & Joseph T. Hallinan, \textit{Blacks Are Much More Likely to Get Subprime Mortgages}, \textit{WALL ST. J.}, Apr. 11, 2005, at A2 (“At Washington Mutual Inc., the nation’s third-largest mortgage lender, blacks were about 4.4 times as likely as whites to pay [higher, subprime] rates . . . . That compares with 3.3 at Wells Fargo & Co., the second largest-mortgage lender [and] 2.8 at Countrywide Financial Corp., the No. 1 lender . . . .”); \textit{id.} (showing that almost 50\% of African Americans who borrowed in 2004 from one of Citigroup’s lenders have loans with APRs at least three points over the Treasury-bill rate, whereas less than 20\% of whites who borrowed from Citigroup have rates this high); Nichols et al., \textit{supra} note 50, at 214 (finding African Americans, Indians, Hispanics, and Asians more likely to use subprime mortgages than whites, even after controlling for borrower income, debt, and credit history); Carr & Kolluri, \textit{supra} note 73, at 37 (stating that black households have roughly twice the credit problems of, but obtain subprime refinance loans at roughly four times the rate of, non-Latino white households).

\textsuperscript{87} Although national homeownership rates are at an all-time high of about 69\%, gross disparities exist within that number; the homeownership rate for non-Hispanic whites is just over 75\%, but the rates for African Americans and Latinos are just under 50\%. U.S. Census Bureau, \textit{Housing Vacancies and Homeownership: Annual Statistics 2005}, http://www.census.gov/hhes/www/housing/hvs/annual05/ann05t20.htm (last visited Mar. 23, 2006).

\textsuperscript{88} \textit{See GAO Report, supra} note 45, at 99-105 (reporting on targeting of consumers over age sixty-five for predatory home loans); \textit{HUD-TREASURY REPORT, supra} note 46, at 36 (finding that loans to borrowers over age fifty-five constituted 35\% of subprime mortgages but only 21\% of prime mortgages); Marsha J. Courchane et al., \textit{Subprime Borrowers: Mortgage Transitions and Outcomes, 29 J. REAL EST. FIN. & ECON.} 365, 372 (2004) (finding that 20\% of subprime borrowers were over age fifty-five, whereas only 13\% of prime borrowers were this old).

\textsuperscript{89} \textit{E.g., Gregory D. Squires, The New Redlining, in Why the Poor Pay More: How to Stop Predatory Lending} 1, 3-4 (Gregory D. Squires ed., 2004) (“In other words, many of those families and neighborhoods that have long been underserved by traditional lenders find themselves victimized by what could be considered a form of reverse redlining. They are offered far more in the way of financial “services” than is in their financial interests.”).
interest and fees charged on predatory loans at levels above what a competitive market would produce is conservatively estimated to cost affected U.S. consumers $9.1 billion annually,\textsuperscript{90} an average of $3800 per subprime loan household per year.\textsuperscript{91} Compare the $3800 per household loss caused by predatory loan overpricing to the median African-American household net worth of $7500 as of the 2000 Census.\textsuperscript{92}

These statistics provide the outlines of the problem, but behind these numbers lie the stories of borrower after borrower. One such borrower tells her own story thus:

I grew up in West Virginia and went through the 6th grade. . . . [I]n 1987, my husband Richard and I were very proud that we were finally able to purchase our own small home. He worked as a maintenance worker and passed away in June 1994. I became the sole owner. In July 1994, I paid off the $19,000 owed on the home from the insurance from my husband's death. Before my husband's death, I had never had a checking account or a credit card. I had always paid my bills in cash and tried to be an upstanding, responsible citizen. . . .

In 1995, I received a letter from Beneficial Finance offering to lend me money to do home improvements. I thought it was a good idea to put some new windows and a new heating system in my home. I signed a loan with Beneficial in May 1995. . . . My monthly income at that time was $458 from Social Security and my payments were more than half of this. They took a loan on my house of about $11,921. The very next month, Beneficial talked me into refinancing the home loan for $16,256. I did not understand that every time I did a new loan, I was being charged a bunch of fees.\textsuperscript{93}

I began getting calls from people trying to refinance my mortgage all hours of the day and night. I received a letter from United Companies Lending telling me that I could save

\textsuperscript{90} Stein, supra note 77, at 2-3. These figures include financed single-premium credit insurance, excessive up-front fees, prepayment penalties, and excess interest, but do not include equity lost in foreclosures. \textit{Id.}

\textsuperscript{91} This assumes that the $9.1 billion in losses are spread evenly over the 2.4 million subprime loans cited by Stein. \textit{Id.} at 14 n.49.

\textsuperscript{92} See U.S. Census Bureau, U.S. Dep't of Commerce, Net Worth and Asset Ownership of Households: 1998 and 2000, at 12 (2003). The net worth of white households was just under $80,000. \textit{Id.}

\textsuperscript{93} Note that this borrower was not alone in this misapprehension. Twenty-eight percent of consumers responding to a 2001 national survey did not know that home mortgage refinancing results in added fees. Marianne A. Hilgert et al., Household Financial Management: The Connection Between Knowledge and Behavior, 89 Fed. Res. Bull. 309, 313 (2003).
money by paying off the Beneficial loan. On September 28, 1995, I signed papers in their office. More fees were added and the loan went to $24,300, at an interest rate of 13.5 percent.

Just a few months later, I received a letter from Beneficial telling me I could save money by paying off United and going back to Beneficial. . . .

In February 1996, Beneficial advised me that it was time for me to refinance again. The loan papers show that I was charged a finance charge of $18,192 plus other fees and an interest rate of 14 percent. By the end of February, I had five different loans in 10 months. I did not understand that they were adding a lot of charges each time.

After that I was called by Equity One by telephone to refinance . . . . On May 28, 1996, I signed papers with Equity One . . . which . . . increased my total loan from $45,000 to over $64,000. I got $21.70 cash out of the loan. . . .

Then on June 13, Equity One suggested that I needed another loan to pay off a side debt and they loaned me $1,960, at over 26 percent interest. . . . This loan brought my monthly payments to Equity One to $434 a month. My monthly income . . . was $470. . . .

Then on August 13, Equity One started me on another loan . . . to help me by lowering my payments. This loan included $2,770 in new fees and costs. There were a whole lot of papers with this . . . loan that I did not understand. The payments were still too much.

I missed my first payment . . . in December 1996. . . . [T]hey would not take a late payment from me unless I made up for the missed payment. I could not do it. Later in 1997, I lost my home to foreclosure . . . .

B. A New Definition of Predatory Lending

The Chairs of both the Senate Banking Committee and the House Financial Services Committee have complained that predatory lending cannot be defined, but I offer a new definition of the term, based on the two first-order harms to borrowers that have been ob-

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95. See Michele Heller, House Panel Calls Reg Reform Priority, AM. BANKER, Apr. 5, 2001, at 4, 4 (quoting U.S. House Financial Services Chair Michael Oxley as saying, “I might suggest we look at enforcing the existing statutes and regulations before we go whole-hog at going after something as difficult to define as predatory lending.”); Michele Heller & Rob Garver, Gramm Takes Stand Against Predator Bills, AM. BANKER, Aug. 24, 2000, at 1, 1 (2000) (quoting U.S. Senate Banking Chair Phil Gramm as saying, “[T]here is no definition of
served in today's home loan market: overpriced and overly risky loans. 96

Overpriced loans would include: (1) high-priced subprime loans given to "A" grade borrowers, borrowers who present a prime, low risk and cost profile to the lender; and (2) subprime loans to borrowers who present a subprime risk and cost profile, but at prices beyond what these risks and costs should garner, such as a "C" loan given to a "B" borrower. An overpriced loan is priced higher than otherwise comparable loans that were available on the market to the borrower and at a greater savings than the tangible search costs that the borrower would have incurred by price shopping. The line between overpriced and competitively priced loans can thus be drawn by reference to market data. As Part III of this Article explains in detail, overpriced loans are priced 97 to exploit borrower vulnerabilities, rather than through a price-competitive market.

Overly risky loans are loans that present a high risk of foreclosure and loss of home to the borrower when other, less harmful and on the whole preferable, alternatives to such a loan exist. Alternatives could include: declaring bankruptcy but taking a homestead exemption; selling the home on the open market rather than losing it at a foreclosure sale; 98 and/or forgoing the benefits of the loan, i.e., the loan proceeds. Overly risky loans are loans that leave the borrower in the position of such a risk of default and loss of equity in the home that the loan itself is financially unwise and would not have been taken but for exploitation of borrower vulnerabilities. A loan presenting appropriate risk, on the other hand, is one that is based on an objectively reasonable forecast that the borrower is highly likely to repay, rather than a loan made in anticipation of default and forfeiture of the underlying home asset. The line between higher-than-prime-risk sub-

96. I exclude from my definition predatory servicing practices, a problem distinct from the attributes of the loans and that can occur with any type of loan. Predatory servicing also has a "price" component—when the servicer extracts unwarranted or inflated fees from the borrowers—and a "risk" component—when the servicer improperly causes borrowers to go into default and foreclosure. See generally Kurt Eggert, Limiting Abuse and Opportunism by Mortgage Servicers, 15 HOUS. POL’Y DEBATE 753, 756-61 (2004).

97. "Priced" here is shorthand for some amalgamated value of both formal price terms and nonprice terms of the loan that have a financial value to the lender and cost to the borrower, such as prepayment penalties and arbitration clauses.

98. A foreclosure sale being likely to be both: (1) more emotionally costly than an ordinary sale, over which the homeowner has some sense of agency and control; and (2) less financially profitable than an ordinary sale, given the inefficiency of foreclosure markets.
prime lending and overly risky predatory lending is not possible to
draw without a defined ceiling of maximum acceptable risk levels,
and/or a cost-benefit analysis of the loan and alternatives to that loan.
This line-drawing involves a host of normative calls and will be the
subject of a subsequent article.

Although a prime loan could be predatory if it were overpriced
and/or overly risky, the prime market traditionally has been quite
price-competitive and has involved very low risk. This is because: (1)
the cost to sellers of distinguishing between the small differences in
risk and cost among prime risk borrowers has been higher than the
returns to be had from offering lower prices to the very lowest risk and
cost “A plus” customers, and so the prime market has continued to
involve mostly standardized, advertised terms and prices;99 and (2)
prime borrowers, for a variety of reasons, can more easily focus on
price during home loan shopping.100 Therefore, as a practical matter,
predatory lending has been a subset of subprime lending.101 However,
this may be changing, particularly on the risk side, as more com-
plex and higher risk loan products enter the prime market.102

Even more than subprime loans generally, predatory loans are
almost always refinancings or second mortgages because equity in the
home, not usually present for purchase money loans, is needed to
drive the process. The predatory lender typically extracts a high price
through large up-front fees financed by existing equity and profits
from high-risk loans through the equity that can be recovered at
foreclosure.103

While a loan on overly high-risk terms could be made on fair
price terms, and a loan on opportunistic noncompetitive price terms
could be on appropriate risk terms, the two harms can be related.
From the borrower’s perspective, inflated price terms can create

99. See infra Part IV.A.1.
100. See infra Part III.A.3.
101. See HUD-TREASURY REPORT, supra note 46, at 2 (“While predatory lending can occur
in the prime market, it is ordinarily deterred in that market by competition among lend-
ers, greater homogeneity in loan terms and greater financial information among
borrowers.”).
102. See supra note 50.
103. Thus, most predatory loans are at low LTVs. An exception occurs when a preda-
tory lender refinances a borrower repeatedly, charging fees and prepayment penalties at
each flip, until there is no equity left in the home, preventing the borrower from refinanc-
ing elsewhere. On paper, a foreclosure appears to cost the lender because equity does not
cover the face value of the loan. However, the lender could find such a series of loans
profitable on account of multiple financed fees and penalties. See GAO REPORT, supra note
45, at 4 (recognizing that, due to up-front fees, lenders can make high returns even on
loans that default).
higher risk to the extent that a borrower, who might have a high likelihood of being able to make payments on competitive price terms, is less likely to be able to afford the monthly payments on an overpriced loan and therefore is placed at high risk of default.\textsuperscript{104} Risk of default is partly endogenous to the loan transaction in a number of other respects as well. The longer the loan period the more opportunities for adverse life events to interfere with the ability to make payments. A large balloon payment can create a risk of default if refinancing or payoff is not possible when the balloon comes due. A larger total loan means that there is less equity in the home to extract through a refinancing to tide a borrower through loan payments during an adverse life event.

Risk of default is certainly partly exogenous, varying with, e.g., economic conditions generally, neighborhood and property appreciation conditions, and the borrower's personal ability and willingness to make payments. But that the risk of default is not entirely exogenous can be seen from the fact that risky predatory loans are typically refinancings, often on higher price and risk terms than the mortgages previously held by the homeowners and successfully paid by them each month.\textsuperscript{105}

The new definition I propose here differs significantly from the definitions proposed in the literature on predatory lending to date. Others have offered two sorts of definitions of the term. The first defines predatory lending as outright fraud: deception of the rational wealth-maximizing consumer achieved through incomplete or inaccurate disclosures, resulting in a loan on terms the consumer would not have agreed to had the disclosures been properly given. As the executive director of the National Home Equity Mortgage Association, a major subprime home lending industry trade group, has stated: "The

\textsuperscript{104} Cf. Kirstin Downey, Disparities Found in Sub-Prime Lending, WASH. POST, Apr. 11, 2005, at A2 (quoting Wharton School Professor Susan M. Wachter as stating that subprime loans "respond to risk and create risk").

\textsuperscript{105} Risk affects pricing on the seller's side because sellers attempt to price loans so as to ensure at least a competitive (if not higher) rate of return, over a pool of loans, based on default and prepayment likelihood, cost of origination and servicing, and opportunity costs (cost of funds). Generally, loans with higher probabilities of default should be priced higher to cover the probabilistically anticipated losses of principal and future interest payment streams and collection costs caused by default. Various pricing mechanisms, such as ARMs that adjust with indexed interest rates and prepayment penalties, can reduce lender opportunity cost risk. Lenders can charge borrowers late fees and foreclosure fees to cover servicing and cash flow costs of delinquency and default. Low LTVs also shift default risk from lender to borrower because the lender can recover its losses from equity at foreclosure.
essential problem is misrepresenting the terms to customers. By defining predatory lending narrowly as fraud, industry groups can argue that current disclosure laws are sufficient to solve the problem: these laws simply need to be enforced more vigorously.

The problem with this definition is that while a few lenders and brokers have been caught crossing the line into fraud—covering up loan terms with a forearm while pointing out the line at the bottom of the page where the borrower should sign, forging borrower signatures, and the like—most need not go to such lengths to get borrowers to sign up for loans that are neither competitively priced nor financially prudent. Even with all disclosures fully given, and even with no false information given by the seller, borrowers are agreeing to loans that are not in their self-interest. As the Federal Reserve Bulletin has noted: "[I]n many cases the terms of such contracts are not technically illegal but rather are inappropriate for and disadvantageous to consumers."

The second type of definition, frequently offered by consumer advocates, is to define predatory lending by reference to long lists of specific predatory practices. But predatory home lending should be defined based on the harms that we seek to prevent, rather than based on a list of predatory practices, for two reasons. First, loan seller practices mutate in response to bans on particular practices and are limited only by the ingenuity of loan sellers. Consumer advocates have reached some consensus as to the types of lending practices that need to be stopped today: packing loans with expensive and rarely useful credit insurance, charging high fees and points including unearned yield spread premiums, and stripping homeowners of equity through flipping loans to generate more fees and through repay-

106. William Wan, Mortgage Cost Linked to Race, Study Finds, AUSTIN AM.-STATESMAN, May 2, 2002, at A6; see also Litan, supra note 3, at 2 (defining predatory lending as fraud).

107. Which is not to say that sellers of loans are not also frequently giving borrowers false information. Part of the problem with the loan purchasing process is that, because the transactions and disclosures are so poorly understood by borrowers and due to the various heuristics, biases, and emotional coping mechanisms described below, it is easy for sellers to engage in fraud during the process, despite the disclosures.


109. E.g., 2000 House Hrg., supra note 3, at 204-05 (statement of William Appgar, Assistant Secretary for Housing and FHA Commissioner), 477-78 (testimony of Margot Saunders, Managing Attorney, National Consumer Law Center); cf. Engel & McCoy, supra note 67, at 1260 (defining predatory lending as a syndrome of practices that involve "(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").
ment schedules calculated to lead to foreclosure. But while consumer advocates propose legislation to close loopholes in the laws, lenders and brokers just as quickly find new loopholes to slip through.\textsuperscript{110} Without developing the law on a foundation of common understanding of the harm we are trying to stop, new practices resulting in the same harm will simply rise to take the place of any that are banned, such as has already occurred in the use of open-ended credit to circumvent protections in the Home Ownership and Equity Protection Act (HOEPA).\textsuperscript{111}

Second, defining predatory lending by a list of particular loan features and then banning those features as they become known creates a bloated regulatory scheme. Simply multiplying the number of laws on the books may have the unintended consequence of restricting access to credit to marginal borrowers—often the same low-income, elderly, and/or minority borrowers the anti-predatory lending laws are intended to assist. This credit restriction can occur directly through credit rationing by a lender market unwilling to take on the risks imposed by the new laws or indirectly through increasing the legal compliance costs of lenders and thereby increasing the price of credit.

Predatory lending is thus more accurately and completely, yet parsimoniously, defined as noncompetitively overpriced and overly risky home loans. The structure of today's home loan market, explained above, in conjunction with borrower decisionmaking vulnerabilities, explained below, facilitates the sale of these loans. Borrower vulnerabilities include a multitude of cognitive and emotional difficulties encountered by some segments of borrowers in the home loan process and the heuristics, biases, and coping mechanisms these borrowers use to respond to those difficulties. These processes are exploited by loan originating professionals to prevent segments of borrowers from stimulating and benefiting from price competition within the subprime loan industry to deflect these borrowers' atten-

\textsuperscript{110} See, e.g., E. Scott Reckard & Mike Hudson, More Mortgage Lenders Targeted; In the Aftermath of Ameriquest, Regulators Say They're Continuing to Probe 'Sub-Prime' Firms, L.A. TIMES, Jan. 31, 2006, at C1 (reporting conclusion of former assistant attorney general of Iowa that "predatory lenders have stayed ahead of government crackdowns and a changing market by abandoning some bad practices while inventing new ones to squeeze borrowers").

\textsuperscript{111} See, e.g., HOUSEHOLD EXAMINATION, supra note 72, at 54-56 (explaining how a lender structured home loans as open-ended home equity lines of credit, even though the loans were for all practical purposes ordinary amortizing closed-end loans, so as to avoid HOEPA's requirements); see also HUD-TREASURY REPORT, supra note 46, at 17 ("Any list of predatory practices is destined to be incomplete because bad actors are constantly developing new abusive practices, sometimes to evade new government regulation.").
tion from the risk presented by the loans, and to restrict these borrowers' effective choice set when they are deciding whether to borrow at all. The following analysis is limited to the price side of the problem, leaving the risk side to another project.

II. FEDERAL LAW REGULATING THE PRICING OF HOME-SECURED LOANS: DISCLOSURE AS PANACEA

A. The Rational Actor Decisionmaker Model

Neoclassical economics and the law and economics movement it spawned have assumed that individual decisionmaking takes a certain form. That rational *homo economicus* model of decisionmaking, when stated as more than a nonfalsifiable postulate that people's actions reveal their rational choices, holds that decisionmakers choose options that maximize their expected utility. Implicit assumptions are that people can and will know all alternatives and understand their costs and benefits, probabilistically weighting for uncertain outcomes. People then evaluate the alternatives with reference to resultant states of well-being by assessing possible end-states in light of their own internal fixed orderings of preferences. Only once they have performed this evaluation of the situation do people then select the alternative that will maximize personal utility. Under this theory, having more alternative choices available is always better because they create the potential to increase utility through better matching the decisionmaker's internal preferences.

The thicker versions of rational choice theory would add that consumers' marketplace decisions reflect their own financial self-interest. For marketplace decisions to do so, neoclassical versions of the model assume that people are motivated and able to price shop, that they will costlessly observe and evaluate all alternatives with refer-

112. The discussion here draws on Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1060-75 (2000). See also Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions, in Choices, Values, and Frames* 209, 210-11 (Daniel Kahneman & Amos Tversky eds., 2000) [hereinafter CVF] (listing axioms of expected utility theory). My summary no doubt slight rational choice theory's adaptations to accommodate behavioralist critiques, but my focus here is to understand the model as reflected in the current legal paradigm so that we might understand how that paradigm fails to, and how we might better, serve the needs of all home loan consumers.

113. This implies linear responses to probability changes (or mildly hyperbolic responses to probability changes to account for the declining marginal utility of wealth).

114. They may also engage in subjective state-dependent preference ordering, to account for the effect of emotional state on instantaneous preferences. These are still viewed as "fixed" in the expected utility rational actor model, in the sense of not being manipulable by external framing.
ence to a pre-existing set of internal preferences, and that when they at first do not understand an attribute such as price, they will costlessly obtain the information and education necessary for that understanding. The marketplace result in this model is efficiency: resources being put to their most valued use, as measured by people's internal preferences, within the constraints of wealth inequality.

Modern advocates of rational choice theory recognize that people may lack sufficient cognitive skills, information, or time to make decisions this way, and that the tangible costs of obtaining the requisite skills, information or time—"search costs"—may be prohibitive. Bounded rationality, a term coined by Herbert Simon, accepts the core axiom of the *homo economicus* theory that people will try to make decisions that maximize expected utility, but recognizes that they may fail to achieve this goal due to these constraints. When search costs exceed the gains in decisionmaking benefits to be had by further search, embracing a "stopping rule" is rational. However, an efficient stopping rule is difficult to establish because without the additional search, one cannot know what information will be found and what effect that information might have on a decision. A common response to high search costs and the difficulty of establishing a stopping rule is "satisficing," Simon's term for choosing by examining alternatives sequentially until a satisfactory alternative, one that minimally meets one's requirements, is found and then taking that option, rather than engaging in further search and analysis. The search process itself may influence the aspired outcome level, depending on what information is learned about likely alternatives. But provided that search costs are low, even a somewhat bounded theory of the rational consumer predicts that consumers' marketplace decisions will be welfare-maximizing.

Given this model, government interference with the market is only justified to respond to market failures. One such market failure occurs when consumer search costs are high, and no seller has sufficient incentive to reduce those search costs as a means of claiming market share. The government would then be justified in intervening to reduce search costs, such as by providing information to consumers

115. See generally Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. Econ. 99 (1955). Simon's own research went much farther, as he recognized not merely tangible search costs, but also intangible limits on decisionmaking, such as information overload, discussed further below. The part of his research incorporated into the *homo economicus* model is generally limited to tangible search costs.


in a format they have the skills to use, and at a time when they can use it. Just as more choice is better, more information about these choices is generally better because it allows consumers to choose the option that will be the most welfare-enhancing.

Current federal law governing home lending requires that borrowers be given a stack of disclosures, but, with the removal of usury constraints, has few substantive prohibitions. Implicit in the disclosure form of regulation is the premise that either: (1) all borrowers are financially knowledgeable wealth maximizers, competent and motivated to comparison shop for credit, or (2) an informed minority of borrowers fits this description and loan sellers cannot distinguish between the shoppers and the uninformed and so must offer competitive price terms to all.\textsuperscript{118} The disclosure regime admits of some boundedness to consumer rationality—if borrowers were unboundedly rational and the market perfectly competitive, there would be no need for the government to intervene in the market by requiring disclosures at all—but concludes that the main correction the market needs is informational. The informational fix assumes that consumers will make self-interested, well-informed, rational probabilistic financial choices using the disclosures. Embracing the thicker conception of rational choice theory, the assumption as to price is that borrowers will not agree to take a loan if a cheaper one can be found at a tangible search cost that does not exceed the difference in price.

\textit{B. Current Federal Law}

Congress passed the Truth-in-Lending Act (TILA)\textsuperscript{119} with the explicit goal of increasing price competition in the consumer credit market by giving consumers information in a form they could use to comparison price shop. In enacting TILA in 1968, Congress declared:

\begin{quote}
The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an aware-
\end{quote}

\begin{footnotes}
\textsuperscript{118} A minority of informed rational price shoppers can produce low prices for all consumers in a market only if there is no price discrimination between consumers who price shop and those who do not—i.e., terms and prices are relatively standardized throughout the market. As explained above, this is an inaccurate description of today's home loan marketplace. \textit{See supra Part I.A.2; infra Part IV.A.}

\end{footnotes}
ness of the cost thereof by consumers. It is the purpose of
this subchapter to assure a meaningful disclosure of credit
terms so that the consumer will be able to compare more
readily the various credit terms available to him and avoid
the uninformed use of credit. 120

The Real Estate Settlement Procedures Act (RESPA) 121 was subse-
quently passed in 1974 with the aim of giving borrowers information
with which to price shop for home loan settlement services. 122 In
1994, in response to the overpriced and overly risky home loans that
were coming into the market, Congress passed the Home Ownership
and Equity Protection Act (HOEPA), 123 again primarily a disclosure
statute aimed at helping borrowers make better price shopping deci-
sions, as well as better decisions about foreclosure risk.

The first place Congress envisioned that consumers would en-
counter federal regulation of the home loan marketplace is in adver-
tising, as a result of TILA. TILA requires that when advertisements for
consumer credit contain price information, the price must be ex-
pressed in APR terms. 124 The APR is intended to express the total
annual cost of borrowing, including interest and other scheduled
charges and fees imposed by the lender, such as origination fees and
points, so that borrowers can comparison price shop between a loan
with a higher interest rate but lower up-front costs and a loan with
lower initial costs but a higher interest rate. Prior to passage of TILA,
not only did lenders not integrate these two price components, but
they also advertised interest rates using inconsistent methods, some
advertising annual rates and others advertising monthly or even
weekly rates. 125 By performing financial calculations to convert inter-
est and up-front costs into a single uniform metric, lender price adver-
tising pursuant to TILA is intended to overcome price shopping
barriers that may be due to a lack of skills. Even if the consumer does
not know precisely what APR means or what it includes, so long as she
knows to search for the lowest advertised APR, she will effectively com-
parison price shop. However, the law assumes that lenders will adver-

122. Id. § 2601(a) (aiming to provide borrowers with "greater and more timely informa-
tion" so as to protect them from "unnecessarily high" settlement costs).
fining HOEPA loans is at Regulation Z, 12 C.F.R. § 226.32.
124. TILA permits the annual interest rate also to be disclosed, but only alongside the
125. Nat'l Comm'n on Consumer Fin., supra note 24, at 169-70.
tise price and that consumers will use these advertisements to price shop.

The next point at which federal law attempts to assist borrower price shopping occurs within three days after the lender receives the consumer's application for home loan credit. At this time, RESPA requires loan sellers to provide applicants information about a plethora of settlement costs, including origination fees, points, and broker fees that will be charged upfront and charges imposed by third parties such as appraisal or title insurance fees.126 Within three days of receiving the borrower's application, the loan seller must disclose these on a good faith estimate (GFE), in which the figures may be expressed as a range of estimated dollar values.127 For a loan carrying a variable rate, the lender must also give the borrower a booklet on adjustable rate mortgages, information about the index and/or formula used to adjust the rate, and either a historical example or an example using the maximum note rate illustrating how a $10,000 loan would be affected by interest rate changes.128 If it is a purchase money home loan, the seller must give the borrower a booklet on settlement costs129 and an estimated version of the final TILA disclosure described in more detail below.

These early disclosures recognize that borrowers need price information early enough to use it to price shop for settlement services, and in the case of purchase money loans, the loan itself. The settlement cost and variable rate loan booklets are intended to give consumers the information needed to understand the information in the GFE and to understand the potential range of costs that an ARM may impose. But once given the information, the assumption is that consumers will use it to price shop. In addition to the disclosure requirement, RESPA prohibits unearned kickbacks and referral fees, such as payments by third party settlement services providers to lenders or from lenders to brokers for referring borrower business.130 The anti-kickback provision is an implicit recognition that the disclosures alone

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127. 24 C.F.R. § 3500.7. The GFE is supposed to bear a "reasonable" relationship to the final costs, but RESPA imposes no liability on lenders who fail to meet this requirement. HUD-TREASURY REPORT, supra note 46, at 63 ("RESPA does not impose liability for an inaccurate or incomplete GFE, or even for failing to provide one."). Although the GFE need not appear in any particular format, the Department of Housing and Urban Development (HUD) has developed a sample GFE, a copy of which may be found at 24 C.F.R. § 3500 app. C.
128. 12 C.F.R. § 226.19(b).
will not always lead to price shopping, at least not when the lender and settlement service providers collude.

If the loan is a high-cost closed-end (meaning a lump sum loan, not a line of credit) nonpurchase money home loan under HOEPA, additional disclosures must be given to the borrower three days before closing. These include:

1. the amount borrowed and whether credit insurance is included;
2. the APR;
3. the monthly payment amount;
4. for variable rate loans (ARMs) the maximum monthly payment possible under the contract;
5. the amount of any balloon; and
6. a statement that the applicant is not required to complete the transaction even though she has signed the application.

HOEPA was passed in response to predatory lending and is intended to provide high-cost loan consumers with disclosures that will encourage price shopping. HOEPA, using high interest rates and fees as a proxy for decisionmaking impediments, recognizes that consumers who agree to high-cost loans may mistakenly believe that they are obligated to take the loan at whatever price is quoted once they have signed the application.

HOEPA also substantively prohibits adding unfavorable terms—interest rate escalations triggered by borrower default, balloons on loans shorter than five years, negative amortization, and some prepayment penalties—to high-cost loans. In effect, this prevents lenders from "piling on," i.e., heaping unfavorable terms, terms that can exact quite a price from borrowers, onto borrowers from whom a high price

131. Currently, a high-cost loan under HOEPA is one with: (1) for a first-lien mortgage, an APR of more than eight points, and for a second-lien mortgage, of more than ten points, above the yield on Treasury securities of comparable maturities; or (2) points and fees, including mortgage broker fees but excluding other third party charges, that exceed 8% of the loan amount or the current equivalent of $400 in 1994-dollars, whichever is greater. 15 U.S.C. § 1602(aa) (2000 & Supp. II 2004); 12 C.F.R. § 226.32(a).
132. 15 U.S.C. § 1639(b); 12 C.F.R. § 226.31(c). These may be estimated figures. 12 C.F.R. § 226.31(d)(2).
133. 15 U.S.C. § 1639(a); 12 C.F.R. § 226.32(c). A sample copy of a HOEPA disclosure may be found in 12 C.F.R. § 226 app. H-16.
134. 15 U.S.C. § 1601(a). HOEPA's provisions are also intended to discourage taking risky loans. Id.
135. Or perhaps bad luck, as other consumers may suffer the same impediments yet not have had the misfortune to be offered a loan on such high rate and fee terms.
136. 15 U.S.C. § 1639(c)-(f); 12 C.F.R. § 226.32(d).
is already being exacted. HOEPA thus recognizes that those consumers who have agreed to loans with high rates and fees may not fully take account of the price implications of prepayment penalty and default interest rate escalation provisions when making the loan decision. Because prepayment penalties and interest rate escalations are not otherwise reflected in the APR, the stated APR of a HOEPA loan is thus a more accurate reflection of true anticipated loan cost than of a loan not covered by HOEPA.

Finally, at closing, both TILA and RESPA require that the borrower be given final price disclosures. RESPA requires disclosure of all actual settlement costs, typically on the settlement sheet (the uniform settlement statement or "HUD-1"). The TILA disclosure provided at closing must also disclose actual as opposed to estimated figures. For refinance loans and second mortgages, this final TILA disclosure is the only one the borrower receives, as the three day estimated TILA is not required. Both estimated and final TILA disclosures are a single page document with a standardized format that includes:

(1) the annual percentage rate ("APR") of the loan;
(2) the finance charge;
(3) the amount financed;
(4) the total of all payments that will be made on the loan;
(5) the number and amount of monthly loan payments, exclusive of taxes and insurance, and the amount of any balloon;

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137. Thus far, HOEPA's prohibitions on adding particular terms to high-cost loans appear to be successful in stopping this specific practice, which is easy for a lender or court to identify. To enforce these provisions, HOEPA also leverages the power of the secondary market, which under HOEPA does not have the full protection of the holder in due course doctrine for loans that, on the face of the documents, violate HOEPA. 15 U.S.C. § 1641 (d)-(e).

138. 12 U.S.C. § 2603 (2000); 24 C.F.R. § 3500.10; 12 C.F.R. § 226.17(b). The consumer may be given these disclosures on the day before closing, if the consumer knows of the right to request the disclosures early and exercises that right. 12 U.S.C. § 2603(b); 24 C.F.R. § 3500.10. The borrower need not be informed of the right to see these prior to closing. 12 U.S.C. § 2603(b); 24 C.F.R. § 3500.10.

139. 12 U.S.C. § 2603; 24 C.F.R. § 3500.8. A copy of HUD's Uniform Settlement Statement, or HUD-1, may be found in 24 C.F.R. § 3500 app. A.


142. The total loan principal amount, including both net proceeds and any financed charges and fees, whether imposed by the lender or third parties. 12 C.F.R. § 226.18(b).

(6) the amount of any late charge;
(7) whether credit insurance is required and at what price; and
(8) whether a borrower "may" or "will not" have to pay a prepayment penalty if she pays the loan off early.

The first four of these must appear in the familiar TILA box at the top of the disclosure. For a nonpurchase money home loan, the borrower has three days from the date of receiving accurate final disclosures to rescind the contract.144

The federal statutes governing home lending embrace the thicker conception of rational choice theory, but with a recognition of some boundedness in borrower decisionmaking.145 On the price side, the legal model recognizes that, due to a lack of financial literacy and an unwillingness to incur the necessary search costs, consumers may fail to accurately extract price information from a stack of loan documents in arcane and nonstandardized legal vocabulary. The disclosures are intended to put the crucial price information on a few sheets of paper and for the disclosures under TILA and HOEPA, in a somewhat standardized way, such that consumers can, in theory, understand the price of the loan and comparison price shop. The disclosure of APR is aimed at helping consumers compare the total cost of credit as between loans with different interest rates and up-front costs.

While the model admits people are not unboundedly rational, and thus need the assistance of disclosures, it also assumes that they will, once given the information in the disclosures, use it to choose whether and which loan to take based on a rational calculus of their financial self-interest (or the self-interest of their families). Even for consumers who are satisficing rather than optimizing in their price shopping, the price disclosures are intended to allow consumers to accurately determine whether the loan price meets their personal maximum price satisficing requirements. The law assumes that once consumers receive the correct information through disclosures, their home loan decisions will reflect their own price-minimizing or price-satisficing, self-interested choices. People's choices, when informed by the disclosures, are seen as the touchstone of their well-being.

144. Id. § 1635; 12 C.F.R. § 226.23.
145. This is not to say that any legislator had this vision of decisionmaking explicitly in mind. See generally Edward L. Rubin, Legislative Methodology: Some Lessons from the Truth-in-Lending Act, 80 GEO. L.J. 233 (1991). Rather, such a model was implicit in the design of the statute.
C. Even a Rational Actor Could Not Use the Federal Disclosures to Price Shop in Today's Marketplace

Even if all borrowers met the mildly bounded decisionmaker model envisioned by the law, price shopping for home loans would be extremely difficult in the subprime marketplace because the timing of the disclosures is late, the information given is incomplete, and borrowers lack the financial literacy needed to use the information provided.

1. Logistical Problems of Timing and Expense.—The law recognizes that consumers need written price disclosures to make a decision, yet it fails to give them the disclosures until a point in time when, as a practical matter, many consumers will not be able to price shop. For a refinance loan or second mortgage, the GFE is the only document provided early enough to potentially use to price shop, but it discloses only settlement costs, not the interest rate or other loan terms. Even for settlement costs, the GFE is a poor tool for shopping because the figures are not firm and can be expressed as a range of potential settlement costs. One study reveals that 83% of borrowers end up with higher closing costs than those estimated on their GFE. Moreover, it is given after the application fee is paid, and borrowers on a limited budget may lack sufficient cash to pay another lender another application fee in time to obtain a competing price offer quickly. Thus, if a borrower has an immediate need for cash and lacks funds to pay multiple application fees, she is virtually locked in to the first lender to which she applies, regardless of the settlement costs or terms of the loan.

The HOEPA disclosures are provided for high-cost loans three days before closing. With automated underwriting, the loan approval and pricing decision can be fairly quick in the prime market. How-


147. U.S. BD. OF GOVERNERS OF THE FED. RES. SYS. & U.S. DEP'T OF HOUS. & URB. DEV., REPORT TO THE CONGRESS CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT PROCEDURES ACT, at ii (1998) (reporting that loan applicants "frequently must pay a fee before receiving required disclosures). Although some lenders charge no application fees, a 2001 survey found that lenders quoted charges between $100 and $400, with an average of about $250. See Michael D. Larson, Closing Costs Compared, BANKRATE, June 21, 2001, http://www.bankrate.com/brm/news/mtg/20010621b.asp. High application fees, particularly where the lender or broker does not need to do much work to submit the loan and obtain a quote, may reflect an attempt to inflate the transaction costs for the purpose of trapping the borrower.
ever, in the subprime market, more information must be collected and analyzed before a lender will make a pricing decision. This means that three days is not enough time to obtain competing loan price offers. For refinancings and second mortgages that fall below the HOEPA triggers, the only required written disclosure of the APR and finance charge is usually given at closing on the TILA disclosure, after which the borrower has only the three day rescission period for price shopping, again too short a period to obtain competing offers.

2. Incomplete Information.—The information in the disclosures is also insufficient for price shopping. Each lender uses its own terminology on the GFE, making it difficult for borrowers to comparison price shop for settlement costs. Although the TILA disclosure is standardized to disclose the APR, finance charge, amount financed, and total payments, these figures do not expose all potential price features of the loan, such as late fees and prepayment penalties. Even ignoring these potential costs, the APR does not allow for accurate comparisons between loans because it is only accurate if the borrower holds the loan to term or if the entire price is charged through interest, both unlikely scenarios. APR also excludes the price of title insurance and application, appraisal, and document preparation fees, all of which are part of the true cost of credit.

The prepayment penalty statement on the TILA disclosure is particularly opaque, stating whether the loan “may” result in a prepayment penalty, but without any explanation that refinancing the loan is the equivalent of prepaying it, nor any indication of how much such a penalty will cost the borrower. The failure to require a more trans-
parent prepayment penalty disclosure reflects an underlying substantive issue—these penalties are structured in so many ways today that no uniform short statement can convey all the information needed to make a fully informed price decision.152

3. Financial Illiteracy.—Current legal rules recognize consumers’ inability to comprehend underlying loan documents, but fail to recognize that the same problem infects the responses of some borrowers to the disclosures themselves. Understanding all of the types of home loans available and the terms offered requires a working knowledge of hundreds of specialized terms—e.g., “amortization,” “balloon,”153 “points,”154—that many borrowers do not have and that the required settlement cost and variable rate loan booklets will not give them. For

penalty notice is buried in the middle of several paragraphs of other contractual information. It is preposterous to put forth that the borrowers have ample opportunity, much less the knowledge, to search through a stack of documents looking for this “disclosure,” during a hurried and controlled document signing meeting. Just as preposterous is HFC’s repeated explanation... that the borrowers could have found the prepayment penalty in the documents and rescinded the transaction within three days following closing... [E]ven if the loan officer has simply remained silent about the existence of the prepayment penalty, there is no reason for the borrower to undertake a search of documents looking for... unsaid terms of the loan.

HOUSEHOLD EXAMINATION, supra note 72, at 42-43.

152. For example, prepayment penalties can be structured as a constant dollar amount, as a percentage of the remaining principal, or as a proportion of the as-yet-unpaid interest payment stream the lender had been hoping to receive, and can vary over time or expire after a set period. Engel & McCoy, supra note 37, at 734 n.30. For such a loan, the disclosure of the prepayment penalty would have to contain quite a lot of information, none of which is well-understood by people with low financial literacy.

153. Balloons can be particularly difficult for borrowers to understand when their loans are partially amortizing. One lender that routinely originated home loans with balloons of approximately 80% of the loan amount denied allegations that it had “misled” borrowers. However, when sued by the federal government, the lender agreed to refinance into fully amortizing loans any borrowers with balloon loans who certified that “[a]t the time I got my loan, I believed or was told my loan did not have a balloon payment.” See Stipulated Final Judgment and Order at 12 & app. B, United States v. Mercantile Mortgage Co., Inc., Civil Action No. 02-CV-5078 (N.D. Ill. July 18, 2002). The lender explained that “it agreed to the settlement to help approximately 1,500 borrowers who... 'may not have fully understood the 15-year balloon term’” stated in their loan disclosures. Mercantile Settles Deception Lawsuit, NAT’L MORTGAGE NEWS, July 22, 2002, at 3, 3.

154. One misunderstanding frequently occurs in borrower comprehension of “points,” traditionally used to buydown the interest rate, but today often just another form of origination fee. A borrower may see that she is paying points and think that she is receiving a lower note rate, but because she has no way of knowing what her rate would be without the points, she cannot know whether her rate has been lowered. In the subprime market generally, a large number of borrowers are paying “points” yet still receiving high interest loans. One study found twice as many subprime versus prime borrowers paid between two and four points, and 5% of subprime borrowers paid over six points, versus virtually no prime borrowers paying such high points. Courchane et al., supra note 88, at 376.
example, regarding loan price disclosures, only about 10% of respondents in a survey of consumers who had applied for or obtained home loans in the previous five years understood the concept of APR well enough to accurately answer whether the APR is higher, the same, or lower than the note or contract interest rate, fewer than would have correctly guessed the answer by chance. The disclosures are not presented in simple enough lay terms and many borrowers ignore the disclosures as incomprehensible legally mandated gobbledygook.

Most people also lack the financial literacy they would need to make sense of the entire transaction, even if they were given all relevant information and a dictionary explaining all relevant terms. To assess the full potential price of the loan, the loan applicant borrower must understand explicit price terms (reflected in the monthly payment, interest rate, APR, various origination and settlement fees, and points) and must forecast the likelihood, timing, and amount of potential additional costs such as late fees, interest rate changes, and prepayment penalties.

One of the largest subprime lenders in the United States, Household, was found to have routinely charged 7.25% in "points" on many of its subprime home loans, without lowering borrower interest rates. Household Examination, supra note 72, at 6. Household is not alone: Citigroup’s subprime unit, CitFinancial, routinely charges "points" on its home loans as a form of origination fee. Riva D. Atlas, Citigroup Makes Changes at Lending Division, N.Y. Times, Sept. 16, 2002, at C2 ("CitFinancial will also lower a form of up-front fee on real estate loans, known as points, from 5 percentage points to 3 points, beginning in the fourth quarter . . . ").

155. Lee & Hogarth, supra note 58, at 70. About half the respondents said they were equal, about a third said the APR was lower, and the rest admitted they did not know. Id. Even if those respondents who said that the APR and the interest rate are equal have a good enough understanding to effectively use the APR to price shop, the remaining consumers do not. HUD and the Federal Reserve Board have recommended that the TILA disclosure be changed to disclose the note interest rate in addition to APR. HUD-Treasury Report, supra note 46, at 69. However, adding another item to an already cluttered and poorly understood document is unlikely to be of assistance to borrowers who are vulnerable to predatory lending.

156. One loan seller testified that as part of his sales pitch he would ask potential borrowers—all of whom had pre-existing mortgages on their homes—whether anyone had ever explained to them how mortgages work and the time value of money, and most of them said "no." Transcript of Record, Day 1-Vol. II, at 85-86, Official Joint Borrowers Comm. v. Lehman Commercial Paper, Inc., No. SACV 01-0971-DOC (C.D. Cal. Feb. 18, 2003) (testimony of Terence J. LaFrankie) [hereinafter LaFrankie Testimony Day 1-Vol. II]. The broader point has been made in greater detail by Alan M. White & Cathy Lesser Mansfield, Literacy and Contract, 13 Stan. L. & Pol’y Rev. 253 (2002). Earlier, Eskridge made this point in the context of home purchase loans. Eskridge, supra note 9; see also Creola Johnson, Maxed Out College Students: A Call to Limit Credit Card Solicitations on College Campuses, 8 N.Y.U. J. Legis. & Pub. Pol’y 191, 266-67 (2004) (showing that even college-educated consumers have difficulty understanding credit).
Although nearly half of U.S. households have home loan debt,\textsuperscript{157} the National Adult Literacy Survey found that only 4\% could perform multiple arithmetic calculations sequentially, when the features of the problem had to be discerned from the text or when background knowledge was required to determine quantities or operations.\textsuperscript{158} The remaining 96\% of adults could not calculate the total interest charges on a $10,000 home equity loan from the information given in an advertisement.\textsuperscript{159} The advertisement listed, among other things, the length of the loan in months, and the monthly payment amount for a $10,000 loan, yet most respondents did not know to multiply the monthly payment given for a $10,000 loan by the number of months of the loan term stated in the advertisement minus the $10,000 principal.\textsuperscript{160} This does not mean that 96\% of consumers could not shop between loans based on total interest, points, and fees charged, once given a TILA disclosure stating the finance charge—one purpose of the TILA disclosure is to perform this calculation for consumers. But most borrowers would probably not be able to compare prices of loans when some costs are contingent on future events requiring the consumer to do her own calculations, such as prepayment fees, late fees, and interest rate changes, unless the loans were identical as to all terms governing these events.

Yet the majority of Americans are unaware of their lack of financial literacy. Most described themselves as functioning "well," including those in the lower half of the population by language and financial literacy levels, well below those tiers who can calculate home loan interest.\textsuperscript{161} Less than a quarter of those in the lower half report receiving a lot of help from family members or friends in reading printed information, filling out forms, or performing arithmetic.\textsuperscript{162} Even a rational price shopper, if she is unaware that she lacks the knowledge and information needed to price shop, will fail to accurately price shop.

The Federal Reserve Board's 1997 Surveys of Consumers confirms these problems with the current federal disclosures: over 80\% of


\textsuperscript{159} \textit{Id.} at 17 fig.1.1, 178.

\textsuperscript{160} \textit{Id.} at 178.

\textsuperscript{161} \textit{Id.} at 20-21.

\textsuperscript{162} \textit{Id.} at 21 tbl.1.3.
respondents found TILA disclosures "complicated,"163 about 65% found some of the information in them unhelpful,164 and only 2% of recent home equity second mortgage borrowers said that the TILA disclosures affected their loan decision.165 But fully understanding why that is so requires moving beyond the law's model of borrower decisionmaking.

III. HOW THE SUBPRIME HOME LOAN INDUSTRY MAKES USE OF CONSUMER PSYCHOLOGY IN TODAY'S MARKETPLACE TO SELL OVERPRICED HOME LOANS

A. Heterogeneous Behavioralism Meets the Home Loan Market

Recent psychology and behavioral economics research does not merely expand upon the insight that human rationality is bounded, but rather supports an alternative theory of human decisionmaking. I set forth this theory here broadly, along with a critique of attempts to apply it without a nuanced understanding of the effects of context and experience on the decisionmaking of different segments of the population. I then show how specific decisionmaking heuristics, biases, and emotional coping mechanisms are triggered for some consumers in the home loan shopping process, resulting in overpriced home loans.

1. A New Schematic of Internal Decision Processes: Recognizing the Influence of Intangible Transaction Costs.—Amos Tversky, Daniel Kahneman, and others show that decisions frequently are arrived at not through the application of expected utility functions, but rather through the application of biases and heuristics—mental rules of thumb to "reduce the complex tasks of assessing probabilities and predicting values to simpler judgmental operations."166 Their alternative to rational choice theory, dubbed prospect theory, posits that people: (1) make decisions based on evaluations of potential gains and losses from a context-dependent current reference point; (2) weight losses more heavily than gains and certain losses and gains more heavily


164. Id. That these borrowers found the disclosure helpful might be viewed with some skepticism given Lee and Hogarth's findings that so few borrowers know what APR means. See supra text accompanying note 155.


than probabilistic ones; and (3) display diminishing sensitivity to increasing marginal losses and gains. Complementary work by Loewenstein, Baumeister, and others have focused on the influence of emotion, or “affect” on decisionmaking. These researchers have found, for example, that people suffering from threats to self-esteem or other forms of emotional distress tend to make decisions based on short-term concerns, without thinking through long-term consequences.

Nonrational cognitive and emotional processes no doubt produce excellent results in many situations. However, heuristics, biases, and emotional coping mechanisms can also produce bad outcomes, such as agreeing to overpriced home loans. People’s informed choices are not necessarily the touchstone of their well-being; instead, whether and when “people make choices that serve their best interests . . . is a question to be answered based on evidence.”

I offer a new general picture of decisionmaking that integrates the heuristics, biases, and emotional coping literature: the intangible transaction costs schematic. During decisionmaking, two typically
strong but subconscious tendencies exist that are not congruent with the rational choice model: to minimize the cognitive effort and resources spent on decisionmaking and to minimize "the experience of negative emotions during decision making." These are not the only tendencies that influence the pursuit of substantive decision-making goals—people also frequently seek justification for their decisions, a tendency that is sometimes incongruent with substantive goals. Moreover, people can be motivated by situation or personality to engage in deep cognitive and emotional effort and processing. But the tendencies to minimize cognitive and emotional resource use are particularly likely to lead to poor substantive decision outcomes.

The minimizing effort tendency means relying on heuristics rather than more difficult deep cognitive processing. The minimizing negative emotions tendency can be met by avoiding or denying any ego threats presented by the decision process. Where these decision process tendencies conflict with meeting substantive decision goals, these tendencies can prevent people from reaching the substantive results they truly want.

174. While others have called these "goals," I call them tendencies due to their unconscious and nonteleological nature.

175. James R. Bettman et al., Constructive Consumer Choice Processes, 25 J. CONSUMER RES. 187, 192 (1998). Rationally calculated, a decisionmaker might want to use the least cognitive effort or experience the least amount of negative emotion necessary to reach the desired outcome, but a less rational form occurs as well, in the unconscious use of cognitive shortcuts and emotional coping mechanisms. These unconscious tendencies are not rational in the local, decision-specific sense implied by rational choice theory.

176. Bettman et al., supra note 175, at 192 (calling this the goal to maximize "the ease with which a decision can be justified"); Dan Horsky et al., Stating Preference for the Ethereal but Choosing the Concrete: How the Tangibility of Attributes Affects Attribute Weighting in Value Elicitation and Choice, 14 J. CONSUMER PSYCHOL. 132, 133 (2004); Eldar Shafir et al., Reason-Based Choice, in CVF, supra note 112, at 597, 600.

177. Cognitive motivation refers to both a situational variable and a personality dimension. As a decision calls for increased accuracy, such as when stakes are high, people will have a situational motivation to perform more complex cognitive processing. On the other hand, if time constraints or stressful situational variables are present, motivation to engage in cognition decreases. John A. Bargh, Losing Consciousness: Automatic Influences on Consumer Judgment, Behavior, and Motivation, 29 J. CONSUMER RES. 280, 280-81 (2002). As a personality trait, cognitive motivation is the degree to which people tend "to engage in and enjoy effortful cognitive activity." John T. Cacioppo et al., Dispositional Differences in Cognitive Motivation: The Life and Times of Individuals Varying in Need for Cognition, 119 PSYCHOL. BULL. 197, 197 (1996).

178. Kahneman has described this as the conflict between deriving "decision utility" and obtaining "experienced utility." Daniel Kahneman, New Challenges to the Rationality Assumption, in CVF, supra note 112, at 758, 760-62.

179. While this is a schematic rather than a model, because it is admittedly at too high a level of generality to predict decisions, it responds to claims by the critics of behavioral economics that the field lacks a unified theory of decisionmaking. E.g., Richard A. Posner, Rational Choice, Behavioral Economics, and the Law, 50 STAN. L. REV. 1551, 1558-61 (1998).
Because people are continuously seeking to conserve intangible resources, including time, decisionmaking does not linearly proceed from perception to attention to evaluation to decision. Rather, that which is salient, and therefore perceived with less effort, is immediately put to evaluative use. A decisionmaker perceives and appraises the choice situation in a cognitive and emotional context that will affect what features of alternatives are salient and begins to assess tradeoffs inherent in the decision based on those initial perceptions. If the reasoning process is not truncated by lack of time or stress, the decisionmaker will recursively focus increased and decreased attention on different aspects of the choice as she seeks to resolve, through deeper understanding or through simplification, the tradeoffs inherent in the decision. When one alternative in the perceived choice set dominates, or after the decision is made, frequently the individual will unconsciously reappraise the choice set so as to reconceive the tradeoffs as more heavily weighing in favor of the dominating or chosen choice, thereby justifying the decision. The looping process of decisionmaking means that it is not always possible to distinguish between when the reasoning process leads to the decision and when the decision leads to the reasoning process.180

Cognitive effort and negative emotions experienced during decisionmaking are intangible forms of what economists call transaction costs, although neoclassical economics does not traditionally recognize them as such.181 “Cognitive” here refers to the conscious process of decisionmaking, including more than mere mathematical calculation. “Emotional” here refers to often subconscious and automatic affective states, including both immediate visceral reactions and emotions more heavily mediated by cognition, such as anticipation of one’s experience of future costs and rewards and assessment of pro-

Moreover, I would argue that the rational actor model is no more predictive than the transaction costs schematic: a nuanced understanding of context, both socioeconomic and idiosyncratic to the individual, is crucial to understanding how the transaction costs schematic maps onto decisions, but so too a nuanced understanding of an individual’s utility function is necessary to use the rational actor model to predict decisions. If an individual’s utility function assigns disutility to not only the tangible transaction costs recognized by standard economic theory, but also to the intangible costs of cognitive and emotional resources, the theories begin to merge.


gress towards or threats to important values.\textsuperscript{182} Although decision-making is often conceived of as purely cognitive, psychological and neurological theories have recently converged on an understanding that cognition alone is insufficient for even simple rational decision-making—present bodily experience of emotions based on the mental anticipation of future experience appears to be necessary for decision-making involving future costs and benefits.\textsuperscript{183} It is useful to divide these conceptually, although cognitive and emotional processes are, in action, fully intertwined.\textsuperscript{184}

Sellers of predatory loans frequently instead benefit from cognitive and emotional transaction costs because they can exploit the heuristics, biases, and coping mechanisms consumers use to minimize these costs.\textsuperscript{185} Cognitive difficulty can lead consumers to use heuristics and biases, which in turn lead to decisions that fail to achieve the goal of obtaining a loan at the lowest possible price and a reasonable level of risk. Emotions can both short-circuit consumers’ cognitive processes, increasing the use of heuristics and biases, and can also di-

\textsuperscript{182} George F. Loewenstein et al., \textit{Risk as Feelings}, 127 PSYCHOL. BULL. 267, 267-68 (2001); see also LUCE ET AL., supra note 180, at 3 (developing a theory of consumer choice difficulty and adding to cognitive difficulty and emotional difficulty the concept of “trade-off” difficulty). The cognitive versus emotional divide is slightly askew to “dual processing theory,” the notion that people use both analytical, conscious, deliberate thinking and affective, unconscious, automatic responding to process the world. Seymour Epstein, \textit{Integration of the Cognitive and the Psychodynamic Unconscious}, 49 AM. PSYCHOLOGIST 709, 710 (1994).

\textsuperscript{183} Antonio R. Damasio explains:

[E]motions and feelings can cause havoc in the processes of reasoning under certain circumstances . . . [but] the absence of emotion and feeling is no less damaging, no less capable of compromising the rationality that makes us distinctively human and allows us to decide in consonance with a sense of personal future, social convention, and moral principle.

. . . Emotion and feeling, along with the covert physiological machinery underlying them, assist us with the daunting task of predicting an uncertain future and planning our actions accordingly.

ANTONIO R. DAMASIO, \textit{DESCARTES’ ERROR: Emotion, Reason, and the Human Brain}, at xii-xiii (1994); see also THOMAS J. COTTLE & STEPHEN L. KLINEBERG, \textit{THE PRESENT OF THINGS FUTURE} 13-35 (1974) (discussing the need to form an image of and emotionally experience a future event for the future to influence present behavior); DAMASIO, supra, 201 & n.25 (citing congruent psychological and philosophical work); Loewenstein et al., supra note 182, at 267-74 (discussing evidence that feelings are not only helpful, but necessary to decisionmaking).

\textsuperscript{184} Emotion or affect can influence what information is attended to and cognated, can be a form of information, and can be a result of cognition. \textit{See generally} Joseph P. Forgas, \textit{Mood and Judgment: The Affect Infusion Model (AIM)}, 117 PSYCHOL. BULL. 39 (1995); Loewenstein et al., supra note 182.

rectly form competing emotional goals that consumers may meet at the price of not meeting price or risk goals. These emotional goals may be quite legitimate, but the magnitude of the home loan decision's effect on a person's life is such that the negative consequences of a poor cost or risk decision may overshadow the positive effects of meeting these emotional goals. The process by which predatory loans impose these price and risk injuries on the borrower is socially and psychologically pernicious, in that the borrower participates in her own injury. Regret over having agreed to these loans is widespread.

Although predatory home lending reflects a failure to meet both price and risk goals, the heuristics, biases, and coping mechanisms that influence decisionmaking about price differ from those that influence decisionmaking about risk. Therefore, to develop appropriate policy solutions, price and risk should be considered independently. As previously explained, this Article focuses on price.

2. The Importance of Socioeconomic Context on Decisionmaking Outputs.—To understand individual decisionmaking, a distinction must be made between inward psychological (cognitive and emotional) processes and outward behavior. At the psychological level, it appears that the same cognitive and emotional processes shape all human decisionmaking and that, generally speaking, these processes can "bias"—or affect in nonrational ways—their resultant decisions. Cognitive processes are, as Tversky and Kahneman famously asserted, "neither rational, nor capricious."186 "[J]udgment and choice—like perception and memory—are prone to distortion and error . . . [and] errors are common and systematic rather than idiosyncratic or random."187 Heuristic, biased, and emotion-laden decisionmaking processes are not departures from the norm, they are the norm.188 However, the real-world triggers for various psychological responses are not the same for all segments of society, with the result that people's decisionmaking behaviors are not homogeneously modelable and predictable.189 This is perhaps particularly true of the

188. Tversky & Kahneman, supra note 166, at 18; Camerer et al., supra note 169, at 25.
home loan decisionmaking process, given the range of literacy and numeracy levels consumers bring to what is a complex and difficult decision for even the most financially savvy and consumers' different historical experiences of inclusion or exclusion from the credit and homeownership markets. Different borrowers, to some extent falling along socioeconomic lines, make the home loan decision in different contexts, contexts that influence which cognitive and emotional processes will come into play.⁹⁰

There is a tendency in some legal scholarship, in an attempt to match the parsimoniousness of rational choice theory, to collapse the distinction between psychological processes and behavior. These scholars fail to appreciate sufficiently the degree to which context mediates between internal processes and resultant behavior. Focused on the commonness of nonrational decisionmaking mechanisms, they miss how the heterogeneity of contexts in which people find themselves leads to heterogeneous behaviors.⁹¹ The seminal Christine Jolls, Cass Sunstein, and Richard Thaler article exhorting the use of economic behavioralism in legal analysis asserts that "behavioral economics allows us to model and predict behavior relevant to law,"⁹² and subsequent articles have attempted "to provide a decisionmaker model that is relevant to a broader and more realistic range of behavioral contexts than the traditional economic actor."⁹³ They have rejected a *homo economicus* model in favor of a more realistic model of *homo behavioralus*, one who is altruistic, lacking in perfect willpower, and subject to some cognitive errors, in short a model of the person we intellectuals have come to recognize as ourselves at the dawn of the twenty-first century.

But in a monolithic *homo behavioralus* model, the influence of sociological factors such as race, gender, class, and age are ignored.

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⁹⁰ Cf. Marianne Bertrand et al., *A Behavioral-Economics View of Poverty*, Am. Econ. Rev. 419, 419 (May 2004) ("[T]he poor may exhibit the same basic weaknesses and biases as do people from other walks of life, except that in poverty, with its narrow margins for error, the same behaviors often manifest themselves in more pronounced ways and can lead to worse outcomes.").


⁹² Jolls et al., *supra* note 172, at 1474.

Most of the experimental research on decisionmaking has been performed on a socioeconomically and educationally privileged members of society—captive college students enrolled in Psych 101 and other members of the academic communities at which the experimenters work. But uniformity of behavior in the laboratory does not imply uniform behavior throughout the population in the real world. Basic tenets of prospect theory include the reference-dependent nature of choice and the extent to which choice is influenced by framing effects. Because people come to decisions from different frames of reference, and because immediate real life contexts are too complex and idiosyncratic to be replicated in the lab, experimental observations do not permit predictions of homogeneous real-world behavior. Just as law based on a monolithic \textit{homo economicus} model fails to reflect the realities of some consumer segments, so too does law based on a monolithic \textit{homo behavioralus} model. Recognizing the heterogeneity of behavioral responses decreases the elegance of behavioral decision theory, but inheres in the diversity of human experience and the existence of framing effects.

The effect of context does not render decisionmaking utterly unpredictable; context is shaped by socioeconomic and situational influences that, while heterogeneous, are neither thoroughly idiosyncratic nor immune from manipulation. Because the application of heuristics, biases, and coping mechanisms, unlike the application of rational self-interested decisionmaking, can result in different decisions depending on the psychological mechanism involved, the seller who can

194. At the other end of the spectrum, the neurological research described above is primarily performed on patients with neurological disorders, they being the most available to the lab, and providing, through evidence of nonfunctioning during impairment, suggestive evidence regarding the manner of functioning in normals. \textit{E.g.}, \textsc{Damasio}, \textit{supra} note 183, at xii.

195. \textit{Cf.} \textsc{Howard Latin}, \textit{"Good" Warnings, Bad Products, and Cognitive Limitations}, 41 UCLA L. Rev. 1193, 1227 (1994) (noting that people's ability to understand and make decisions based on product warnings "is influenced by educational backgrounds, personality traits, and motivation levels, by socioeconomic status and group affiliations, and by idiosyncratic personal experiences and prejudices").

196. \textit{See} \textsc{Korobkin \\& Ulen}, \textit{supra} note 112, at 1058 (noting that tangible evidence of behavior in real-life settings, not just controlled research, is needed to ground legal policy).

197. As Tversky and Kahneman admit:

Theories of choice are at best approximate and incomplete. One reason for this pessimistic assessment is that choice is a constructive and contingent process. . . .

The heuristics of choice do not readily lend themselves to formal analysis because their application depends on the formulation of the problem, the method of elicitation, and the context of choice."

\textsc{Amos Tversky \\& Daniel Kahneman}, \textit{Advances in Prospect Theory: Cumulative Representation of Uncertainty}, in CVF, \textit{supra} note 112, at 44, 65.
invoke a decisionmaking mechanism can manipulate consumer choice. Consumers usefully, heuristically if you will, can be divided into different segments by reference to the likelihood that their socio-economic context will render them susceptible to marketing and sales techniques that will increase seller profits.

Vulnerable segments are not necessarily stable, nor need they be for that vulnerability to be exploited. The asymmetry between the reversibility of the decision not to borrow versus the decision to take the loan means that a consumer need only be caught by a seller when in a vulnerable state that lasts long enough for the borrower to engage in the loan transaction and, for nonpurchase money loans, through the three day rescission period.

3. Segmenting the Market by Vulnerability Rather Than Risk and Cost.—Within the home loan borrowing public, rough lines can be drawn between those for whom price shopping is more difficult and those more likely to obtain competitively priced home loans.

First, the reasons that even a rational actor could not use the federal disclosures to price shop affect some borrowers more than others. The logistical problems of timing and expense are more problematic for subprime than prime borrowers because, as noted above, in the subprime market, more information must be collected and analyzed before a lender will make a pricing decision, meaning that three days is not enough time to obtain competing loan price offers. Additionally, subprime borrowers are more likely to lack the resources necessary to pay multiple application fees.

The federal disclosures are also less informative for subprime loans. The figures disclosed on the TILA and HOEPA disclosures—APR, financed charge, amount financed, and total payments—come closer to disclosing the true cost of credit for prime than subprime loans. The APR is also more accurate for comparing price of prime loans because prime loans carry only small origination fees and costs—as noted above, typically 0.5% of the loan amount—whereas

198. For the classic work in this regard, see generally LEFF, supra note 7. Sellers need not understand the cognitive psychology underlying consumer manipulability for competitive market forces to lead sellers evolutionarily towards marketing and sales techniques that exploit consumer psychology. Hanson & Kysar, supra note 189, at 724. On the other hand, as described infra, evidence has leaked out from the industry indicating a sophisticated understanding and purposeful exploitation of consumer cognitive and emotional vulnerabilities.

199. Although a borrower can refinance, origination fees and prepayment penalties can make refinancing into a lower interest rate loan a money-losing proposition. See infra Part IV.A.3.
subprime up-front fees can be a much larger share of the loan price.\footnote{200} Late fees\footnote{201} and prepayment penalties not reflected in the disclosed figures are more frequently charged to subprime borrowers. Estimates are that between 64% and 98% of subprime loans, but only 2% of prime home loans, have prepayment penalties.\footnote{202} The opacity of the prepayment penalty disclosure on the federal forms is of no consequence to most prime borrowers, but can impede accurate price shopping for subprime borrowers whose loans are more likely to carry these penalties.

Financial illiteracy that impedes price shopping for even rational actor borrowers is a bigger problem for subprime than prime borrowers. Financial experience and knowledge is possessed disproportionately by the well-educated, middle and upper classes, who have more familiarity with financial matters from personal experience, work experience, and education and have networks of family and friends with similar experience and knowledge. Those borrowers who do understand what an APR is, for example, and are able to translate it into a dollar amount, tend to be in higher socioeconomic groups, with both higher levels of income and of education; these are prime loan borrowers, not subprime borrowers.\footnote{203} Lower income and African-American and Latino consumers on average possess less financial and document literacy as a result of less financial education and experience.\footnote{204} A 2003 study of recent African-American and Latino homebuyers found that they “had a limited understanding going into

\footnote{200} See GAO Report, supra note 45, at 4 (noting that predatory practices “offer lenders that originate predatory loans potentially high returns even if borrowers default, since many of these loans require excessive up-front fees”). Recall that the APR is an accurate statement of price only if the loan is held to term or the price is charged as interest rather than upfront fees.


\footnote{202} Engel & McCoy, supra note 37, at 734 n.30; Elizabeth Renuart, An Overview of the Predatory Mortgage Lending Process, 15 Hous. Pol'y Debate 467, 475 & n.17 (2004). It was previously thought that subprime loans prepay faster than prime loans, thus justifying the greater use of prepayment penalties in the subprime market. E.g., OCC Working Paper, supra note 43, at 11. However, recent literature casts some doubt on this conclusion; because subprime loans prepay even when interest rates are rising, lenders and investors may benefit from subprime prepayments even when no penalty is charged. See infra Part IV.A.3.

\footnote{203} Lee & Hogarth, supra note 58, at 67-68; see also Paul S. Calem et al., Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities, 15 Hous. Pol'y Debate 603, 618 (2004) (finding a strong negative relationship between neighborhood educational levels and quantity of subprime loans); Rubin, supra note 145, 236 & n.15 (citing empirical sources for the proposition that price shopping for consumer credit is limited to “upscale consumers who would manage perfectly well without benefit of legislation”).

\footnote{204} KIRSCH ET AL., supra note 158, at 32-37, 60-65.
the mortgage application process" and specifically expressed concerns about "[u]nderstanding the terminology of the [home loan] process." Those with lower incomes, less education, and lower English fluency also reported that they lacked friends or relatives with expertise to help them through the process. On average, older adults also demonstrate more limited document and financial literacy skills than do adults under fifty-five years of age. This is in part due to fewer years of schooling and in part due to degraded cognitive abilities caused by the aging process.

Beyond the rational actor model, some segments may encounter larger intangible transaction costs in obtaining a home loan than others, leading to greater use of heuristics, biases, and emotional coping mechanisms in decisionmaking and greater vulnerability to poor price decisions. As elaborated in the next Section, we know that all people tend to reduce decision situations to a handful of attributes. The next question is: which small set of attributes will the decisionmaker select as the ones on which to base the home loan decision?

For prime borrowers, low-risk borrowers who receive low-cost loans, who on the whole are better educated and more financially savvy, more loan price characteristics are understood and evaluable and therefore salient. These borrowers are less likely to be under as much stress, and thus can consider more loan attributes when making their decision. As previously explained, prime loan products are sig-

206. Id. at 6.
207. KIRSCH ET AL., supra note 158, at 30, 31 fig.1.5.
208. Older borrowers may suffer from "[r]educed capacity for maintaining information active in memory" and "[d]ecreased ability to process complicated text," including "difficulty making appropriate inferences from texts." Gabriel K. Rousseau et al., Designing Warnings to Compensate for Age-Related Changes in Perceptual and Cognitive Abilities, 15 PSYCHOL. & MARKETING 643, 647 tbl.1, 653 (1998); see also GAO REPORT, supra note 45, at 100-01 ("Age-related . . . mental impairments can limit the capacity of some older persons to comprehend and make informed judgments on financial issues . . . [and] can make older persons more vulnerable to financial abuse and exploitation."); Catherine A. Cole & Siva K. Balasubramanian, Age Differences in Consumers' Search for Information: Public Policy Implications, 20 J. CONSUMER RES. 157, 158, 166 (1993) (noting that older adults on average search less for information about consumer choices and are more likely to use satisfactory strategies); Melissa Finucane et al., Task Complexity and Older Adults' Decision-Making Competence, 20 PSYCHOL. & AGING 71, 79-80 (2005) (finding lower decisionmaking quality in older adults due to, e.g., decreased comprehension and less consistency in valuation of choice attributes); Gary J. Gaeth & Timothy B. Heath, The Cognitive Processing of Misleading Advertising in Young and Old Adults: Assessment and Training, 14 J. CONSUMER RES. 43, 52 (1987) (concluding that older adults are more susceptible to misleading advertising than younger adults when both groups are given more time to scrutinize the advertisements).
nificantly more standardized in their structure, such that fewer terms
must be analyzed to assess price to meaningfully compare prices of
various loans.\footnote{209} For example, because prime loans rarely have pre-
payment penalties, prime borrowers do not have to find the price of a
prepayment penalty and weight it by the likelihood of prepayment in
determining loan price. Prime loans are more likely than subprime
loans to have a fixed rate rather than an adjustable rate,\footnote{210} such that
prime borrowers are less likely to need to forecast future monthly pay-
ment changes to determine loan price. Prime loans also are more
standardized in collateral and credit history requirements, such that
prime rates do not significantly vary.\footnote{211} Advertising of prime rates
gives prime borrowers the ability to shop without going through the
application process.\footnote{212} Prime loans are not very risky, so risk of fore-
closure is not a concern. These borrowers are rarely rejected for
loans,\footnote{213} so rejection is not a salient concern for them. Therefore,
although prime borrowers generally do reduce the home loan deci-
sion to a few attributes, the characteristics they consider are, on aver-
age, the more important ones for determining prime loan price.

By contrast, subprime borrowers have many more decision attrib-
utes to worry about during the home loan borrowing process. Under-
standing these in detail is the subject of the next Part of this Article,
but I present a summary here. People who have bad credit, who erro-
neously think they have bad credit, or who fear lending discrimina-
tion—all groups into which minorities disproportionately fall—may
fear rejection and choose lenders advertising guaranteed approvals
rather than lowest APR or price. Less financially savvy borrowers may
ignore attributes of a loan they do not understand because lack of
understanding leads to lack of salience. The legal requirement that
borrowers be given a form that lists, among a great number of loan

\footnote{209} See supra Part I.A.2.
\footnote{210} See HUD-TREASURY REPORT, supra note 46, at 31 (reporting that for the last quarter
of 1999, that 30\% of mortgages in existence overall at that time were ARMs, but
about 40\% of subprime mortgages were ARMs); Courchane et al., supra note 88, at 382
tbl.A1 (finding that in 1999-2000, a period of interest rate lows which might cut in favor of
fixed rates generally, only 9\% of the prime borrowers in the survey who obtained loans
received an ARM, whereas 30\% of subprime borrowers received ARMs).
\footnote{211} As noted above, however, standardization of terms and pricing in the prime sector
appears to be decreasing of late. See supra note 50.
\footnote{212} For further discussion, see infra Part IV.A.2.
\footnote{213} According to 1998 data, the denial rate for prime purchase loans was 13\%, 13\% for
refinance loans, and 33\% for home improvement loans; the comparable figures for sub-
prime loan application denials were 45\%, 57\%, and 68\%. See 2000 HOUSE Hrg., supra note
3, at 666 (statement of Laura J. Borrelli on behalf of National Home Equity Mortgage
Association, an industry group).
attributes, whether the loan has a balloon and what the APR is, may have no effect on these borrowers if they do not understand these aspects of the decision. Because subprime loan structures are more complicated than prime loan structures, subprime borrowers must attend to even more loan features than prime borrowers to assess loan price, and thus they are more likely to become overloaded when attempting the task. Most subprime borrowers do pay attention to the monthly payment amount, both as an indicator of price and an indicator of risk. But often they will take the first loan offer that comes in below their maximum monthly payment limit. Lender sales manuals have come to light telling loan officers to obtain that figure and structure the loan to have initial monthly payments of that amount. But the loan may extend many years or may have monthly payments that increase at intervals automatically, not necessarily tied to any indexed rate. Because people consider long-term future events abstractly, they assess feasibility by looking at the near-term monthly payments only. Finally, many borrowers think they do not have to price shop because they are paying a broker or loan officer to do that for them. The next Section elaborates on each of these factors and how they are used by brokers and lenders to sell overpriced home loans.

B. Heuristics, Biases, and Coping Mechanisms That Shape Borrower Decisionmaking

1. Reducing the Decision to a Few Salient Attributes.—

The majority of customers are looking at one thing . . . .

—1998 Senate Hearing Testimony of former finance company employee, testifying anonymously.  

As shown above, the federal disclosures are intended to assist borrowers by deluging them with every piece of information they need to fully assess the price of the loan transaction. But do consumers use all this information in making a loan decision? The cognitive problem of information overload indicates that few if any consumers consider this many factors in making any decision. The emotional phenomenon of stress-truncated reasoning means that consumers under stress consider even fewer choice attributes. From the long list of loan attributes disclosed, different attributes are considered by different consumers, segmenting borrowers into those who can more easily price shop and those for whom price shopping is more difficult.

a. Cognitive Responses to Information Overload.—Even when people have all pertinent information about a decision, they frequently fail to use it, not only due to comprehension difficulties explained above, but also due to the second bound on rationality Simon identified, information overload. Too much information may be as harmful as too little. Information overload has been grossly used to describe a number of different phenomena. First, the quantity of information presented or for which the consumer must search can be daunting. Because the costs of complete information search and processing seem too high, the consumer may not even try. Second, processing too much information can cause the consumer to lose track of some of that information or to fail to encode all of the information, when memory and attention become overloaded. Once the finite limits on assimilating and processing information in any given unit of time are surpassed, cognitive performance becomes confused, less accurate, and less effective. Third, too much information can lead a consumer to conserve effort by examining only a few aspects of a decision, and these may turn out to be the wrong aspects for good decisionmaking: “In a world where attention is a major scarce resource, information may be an expensive luxury, for it may turn our attention from what is important to what is unimportant.”

As a result of information overload, all people reduce most decisions to a small number of salient characteristics. In laboratory experiments—ideal conditions not present in real-world home loan decisionmaking in that (1) subjects are given information about all relevant attributes (and thus subjects have no search costs); and (2) information is presented in a format that is easily understood and encoded (and thus subjects have low information processing costs)—subjects typically consider a maximum of five attributes (including price and quantity terms) of a product. Within this bound, differ-

219. Herbert A. Simon, Rationality as Process and as Product of Thought, 68 AM. ECON. REV. 1, 13 (1978); see generally JAMES R. BETTMAN, AN INFORMATION PROCESSING THEORY OF CONSUMER CHOICE (1979); DAVID SHENK, DATA SMOG (1997).
220. Denis A. Lussier & Richard W. Olshavsky, Task Complexity and Contingent Processing in Brand Choice, 6 J. CONSUMER RES. 154, 155 (1979) (noting that past research indicates that consumers consider only three brands and five attributes when making purchase decisions); id. at 162 (in product choice experiment, subjects usually reduced the number of
ent subjects consider different attributes and different numbers of attributes and use different choice strategies.\textsuperscript{221} In marketing studies designed to determine which attributes consumers consider in making real-world product purchasing decisions, under more realistic search and information processing cost conditions, consumers consider even fewer attributes.\textsuperscript{222} Studies of more complex decisions demonstrate that as complexity increases, people rely more heavily on suboptimal simplifying strategies.\textsuperscript{223} One study of recent mortgage loan shoppers found that giving shoppers more information about the subcomponents of the loan price led to worse price shopping decisions; consumers were significantly more likely to choose a more expensive but otherwise identical loan over a cheaper loan when price subcomponents and total price were revealed for the cheaper loan but only the total price was listed for the more expensive loan.\textsuperscript{224}

The federal disclosures contain too many items for most consumers to consider them all. The amount of information on the federal disclosures, however, reflects a deeper problem: home loan products today can be structured in such complicated ways that a true assessment of the loan price requires all of the information disclosed and more. The existing disclosures made sense in a world of fairly uniform loan products, containing a standardized package of features for the borrower to compare. Prepayment penalties and ARMs, for example, were virtually nonexistent in 1968 when TILA was passed.\textsuperscript{225} But in today's marketplace of loans with multifarious complex structures, the disclosures have become encrusted with layer upon layer of additions to meet each new complexity in the product.


\textsuperscript{222} See David M. Grether et al., \textit{The Irrelevance of Information Overload: An Analysis of Search and Disclosure}, 59 S. CAL. L. REV. 277, 302 app. (1986) (listing studies showing that, in addition to price, consumers consider anywhere from a single attribute to three attributes in making purchase decisions); \textit{id.} at 300 ("[T]he number of salient or determinant product attributes . . . does not exceed five, and often is less.").


\textsuperscript{225} See \textit{supra} Part I.A.1.
b. Abbreviated Reasoning: A Response to Emotional Distress.—On the emotional side, people who are suffering emotional distress, including anger, fear, embarrassment, annoyance, or frustration, frequently make poor decisions. People experiencing such stress tend to truncate their cognitive processing when they make decisions.

Truncated reasoning under stress occurs through two mechanisms. The first is that the person is devoting part of her limited conscious attentional capacity to the stressor and has insufficient capacity remaining to cope with the decision task, in a response similar to information overload. To an even greater extent than when unstressed, she does not assimilate all available information and instead focuses on a very few dimensions of the problem. Even more than when unstressed, she will satisfice, choosing the first option she encounters that seems minimally acceptable along these dimensions. Stress also increases reliance on highly salient and tangible dimensions in decisionmaking.

The second mechanism by which stress causes truncated reasoning is as a motivation to terminate and escape from the stressful situation as quickly as possible. The escape mechanism is both a form of prioritizing short- over long-term consequences and increases use of short-term-focused decision strategies. People under stress tend to make choices impulsively, based on a consideration of short-term consequences only. For example, when given an ongoing choice between playing an enjoyable game or studying for an upcoming test, subjects who were put in a bad mood through watching an upsetting film played the game longer, prioritizing improving their mood in the short term at the long-term expense of preparing for the test. In the real world, when "bad moods" can run significantly deeper than those caused by a brief film, emotional distress can result in behavior that is out of control, even "in situations characterized by substantial deliberation."

226. E.g., Luce et al., supra note 180, at 97-100.
228. Id. at 642.
230. See Keinan, supra note 227, at 642.
231. See, e.g., Loewenstein, supra note 168, at 275 (explaining that visceral factors generally can cause people to act impulsively in that they experience "a good-specific collapsing of one's time-perspective toward the present").
233. Loewenstein, supra note 168, at 289.
Subprime home lender marketing strategies attempt to reach potential borrowers at times of stress, when the borrowers are more likely to truncate their reasoning. One method is to target marketing efforts to consumers whom sellers know to be in some financial crisis. Lenders and brokers search courthouse records for home loan owners facing foreclosure or tax liens and buy lists of home loan owners with overdue balances on their credit cards or medical debt.\footnote{234}{See, e.g., Robert W. Seifert, The Demand Side of Financial Exploitation: The Case of Medical Debt, 15 Hous. Pol’y Debate 785 (2004) (discussing the link between medical debt and predatory home loans). One predatory lender explained how his company could convince borrowers to accept loans with fees and costs often equaling half the money they borrowed: “When you’re broke, you’ll borrow money at any price. It’s like buying tomatoes. Everybody’s got a price.” Mike Hudson, Little Relief for Consumers, Roanoke Times, Dec. 12, 1994, at A1 (quoting owner of Landbank).}

Second, predatory lenders mail homeowners “live checks,” instant loans with high interest rates disclosed in the mailing. The homeowner who cashes the check is the ultimate “prequalified lead” for an overpriced home loan. She has demonstrated that she will take an immediate gain, even at an exorbitant later price, possibly because she is under stress and focuses only on the short-term benefits.\footnote{235}{She may also misunderstand the price disclosure for the live check and will therefore be likely to misunderstand a home loan price disclosure.}

The lender will contact her within days, hoping to catch her in the same state of mind, and the lender will offer to refinance the check loan at a lower rate on a home loan.\footnote{236}{Although the higher check loan rate appears more favorable to the lender, the lender can get large origination fees and the security of collateral out of a borrower flipped into a home-secured loan, even at a lower rate. Major lenders, such as Wells Fargo and Household, send live checks to targeted consumers. E.g., Promoting Homeownership by Ensuring Liquidity in the Subprime Market: Joint Hearing Before the S. Subcomm. on Financial Institutions & Consumer Credit & the House Subcomm. on Housing & Community Opportunity, 108th Cong. 110 (2004) (statement of Assistant Attorney General Pamela Kogut, Office of the Attorney General of Mass.) (noting that practices of Household Bank included “luring” mortgage customers through live checks); E. Scott Reckard, State Sues to Void “Instant Loans” by Wells Fargo Unit: Regulators Accuse Finance Arm of Knowing It Was Overcharging Interest on Unsolicited Check Sent in the Mail, L.A. Times, Jan. 10, 2003, at Cl.}

Once she has taken the check loan, motivated reasoning may kick in, assuring her that the lender is trustworthy, a company she wisely chose to do business with on the check loan, and could safely do business with again on a home loan.

Third, lenders target borrowers who need, or have been led to believe they need, home repairs. Lenders pair with real or fraudulent home repair companies that go door-to-door in neighborhoods with older housing stock (and often older and minority homeowners). The repair people tell homeowners that their homes need crucial repairs and that these repairs can be financed with a home loan that the

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235. She may also misunderstand the price disclosure for the live check and will therefore be likely to misunderstand a home loan price disclosure.

236. Although the higher check loan rate appears more favorable to the lender, the lender can get large origination fees and the security of collateral out of a borrower flipped into a home-secured loan, even at a lower rate. Major lenders, such as Wells Fargo and Household, send live checks to targeted consumers. E.g., Promoting Homeownership by Ensuring Liquidity in the Subprime Market: Joint Hearing Before the S. Subcomm. on Financial Institutions & Consumer Credit & the House Subcomm. on Housing & Community Opportunity, 108th Cong. 110 (2004) (statement of Assistant Attorney General Pamela Kogut, Office of the Attorney General of Mass.) (noting that practices of Household Bank included “luring” mortgage customers through live checks); E. Scott Reckard, State Sues to Void “Instant Loans” by Wells Fargo Unit: Regulators Accuse Finance Arm of Knowing It Was Overcharging Interest on Unsolicited Check Sent in the Mail, L.A. Times, Jan. 10, 2003, at Cl.
company will arrange. Under the stress of fear that their homes may be at risk of damage, homeowners may focus on the immediate repairs rather than the long-term costs of the repairs and associated home loan.  

Finally, the very stakes of the home loan decision may induce stress in all borrowers, prime and subprime. The home loan decision typically involves a large amount of money and a large proportion of household net worth, which would motivate a consumer to engage in systematic rather than heuristic processing—that is, to increase cognitive effort rather than accepting decreased accuracy. That so many black, Latino, and low- and moderate-income homeowners have nearly all of their savings for retirement tied up in their home equity, and that the home loan decision would typically involve a greater proportion of their net worth than the home loan decision does for higher wealth and income segments, might motivate these groups to engage in particularly careful home loan decisionmaking. That the elderly are more likely to have lived longer in their homes and be more adverse to losing the home, might provide a similar impetus. On the other hand, the added stress from the higher stakes may push in the opposite direction, putting these homeowners at greater risk of truncated reasoning.


238. A former loan officer explains: “Be ready for an emotional roller coaster. It really is true that your mortgage will probably be the most expensive transaction of your lifetime, so don’t be surprised if it’s an emotionally draining [experience].” Brunner, supra note 146.

239. But see Paul A. Klaczynski & Gayathri Narasimham, Development of Scientific Reasoning Biases: Cognitive Versus Ego-Protective Explanations, 34 DEVELOPMENTAL PSYCHOL. 175, 185 (1998) (finding that increased accuracy goals led to superior justifications, but no decrease in cognitive biases).

240. While about 30% of net worth of white households was held in home equity, over 60% and over 50% of net worth was held in home equity for black and Hispanic households, respectively. U.S. CENSUS BUREAU, supra note 92, at 15 tbl.I. This is not due to minority households having greater home equity, but rather due to having virtually no net worth other than home equity: in 2000, black and Hispanic households had less than $2000 of median net worth excluding home equity, whereas white households had over $22,000 of median net worth excluding home equity. Id. at 13 fig.6. The elderly also disproportionately hold equity in their homes. See U.S. CENSUS BUREAU, U.S. DEP’T OF COMMERCE & OFFICE OF POLICY DEV. & RESEARCH, U.S. DEP’T OF HOUS. & URBAN DEV., AMERICAN HOUSING SURVEY FOR THE UNITED STATES 2003, at 148 tbl.3-15 (2004) (noting that 72% of homeowners age sixty-five and over own homes free and clear of any mortgage, versus only 35% of all homeowners); Kurt Eggert, Lashed to the Mast and Crying for Help: How Self-Limitation of Autonomy Can Protect Elders from Predatory Lending, 36 LOY. L.A. L. REV. 693, 704-05 (2003).

241. High stakes have a mixed effect on decisionmaking, at times increasing departures from the rationality assumption and at times reducing biases, although never fully elimi-
2. Ignoring the Price: Focusing on the "Yes" and the "Now."—The Power of Yes.

—Washington Mutual

Marketing pitches of subprime lenders emphasize that applicants will be approved for credit, that they will get the "Yes!" with ease. Why is this their marketing strategy? First, it exploits the ego threats experienced by borrowers who believe they have poor credit or fear discrimination. Second, it stresses the immediate tangible reward to be had, thus taking advantage of cognitive tendencies to discount over time and certainty.

a. Avoidance: Response to Ego Threats.—Someone who fears a denial of credit may experience the loan application process as ego-threatening. Ego threats are situations that challenge, undermine, or dispute favorable self-appraisal, and thereby can evoke negative emotions such as anxiety, depression, and anger. The most ego-threatening situations are those in which people perceive that others may judge them negatively. Although home loan credit denials today are based on cold, calculating financial modeling, creditworthiness is seen as a reflection on such moral traits as industry, frugality, and integrity. "Character" has even been called the fourth "C" of consumer loan underwriting. Offering someone credit is perceived as a statement of trust, an implicit statement from the lender that the borrower is trusted to pay back the loan. At the same time, failing to pay back a loan is seen as reflecting poor character—being a "deadbeat," a per-


243. See Baumeister, supra note 168, at 145.

244. Id. at 146.

245. See Lendol Calder, Financing the American Dream: A Cultural History of Consumer Credit 87-88 (1999) ("Character earned the confidence of the community, and confidence established credit."); id. at 258 (recounting J.P. Morgan's congressional testimony where he said that "the first thing' in getting credit was not money or property or connections but 'character'").

246. Getting "trusted" was formerly popular slang for obtaining a loan. Id. at 93. "Get the credit you deserve" is a popular tag line in consumer loan advertising today.
son who lacks control of her finances and is not trustworthy.\textsuperscript{247} Being
denied a home loan sends a negative message apart from the money
itself, and thus any perceived possibility of rejection in the home loan
application process presents an ego threat.

Fear of race or gender discrimination in the home loan process is
also ego-threatening. Cultural stereotypes paint minorities, women,
low-income persons, and the elderly as unable to manage their own
financial affairs.\textsuperscript{248} Despite laws prohibiting discrimination, in the
2002 \textit{Fannie Mae National Housing Survey}, African Americans continued
to report fear of discrimination in home lending; although over 40% reported
that obtaining approval for a home mortgage loan has im-
proved, half said it is the same as before or harder for African Ameri-
cans to get financing from banks or mortgage companies than ten
years ago.\textsuperscript{249} About a quarter of Latinos report that it is harder for
them than for other groups to obtain home mortgage financing, and
of these, 45% of non-English speakers believe Hispanics experience
more discrimination in home buying and lending.\textsuperscript{250}

Further, race and fear of lack of creditworthiness are intertwined;
a substantial segment of the population misperceives their own credit
history as being poor,\textsuperscript{251} and that segment is disproportionately non-
white. A 1999 Freddie Mac study shows that blacks who have good
credit are significantly more likely than whites to believe they have

\textsuperscript{247} \textit{Id.} at 8 (observing the association of good values with consumerism); \textsc{Viviana A.
Zelizer, The Social Meaning of Money} 148 (1994); cf. \textsc{Teresa A. Sullivan et al., As We
Forgive Our Debtors: Bankruptcy and Consumer Credit in America} 8-9 (1989) ("People
see bankruptcy through a lens of fault.").

\textsuperscript{248} See \textit{Calder}, supra note 245, at 180-83, 218-21 (tracing cultural belief in the "psycho-
pathology of the female credit user"); \textit{Zelizer, supra note 247, at 36-70, 119-98 (chroni-
cling history of cultural belief that women and lower socioeconomic classes cannot be
trusted with cash, evidenced by husbands' control over their wives' spending and the provi-
sion of in-kind rather than cash relief for the poor).

\textsuperscript{249} \textit{Fannie Mae, The Growing Demand for Housing: 2002 Fannie Mae National
Melvin P. Sikes, Contending with Everyday Discrimination: Effects and Strategies, in Self and
Society} 332, 345 (Ann Branaman, ed., 2001) (describing African Americans' experience of
being defensively on guard for fear of discrimination).

\textsuperscript{250} 2002 \textit{Nat'l Hous. Survey}, supra note 249, at 12.

\textsuperscript{251} Loan sellers may contribute to this misperception. One sales technique for an
overpriced loan is to take the borrower's credit report and, if the borrower does not al-
ready believe she has bad credit, "show [her] that [she] wasn't in as good a shape as [she]
thought [she] was." \textit{LaFrankie Testimony Day 1-Vol. II, supra note 156, at 64-65. Even
when the consumer's credit history was good, "[f]or the most part, there is always some-
thing on the credit report that can be identified as a weak link." \textit{Id.} As explained in the
lender's training materials: "Not many people today can say they've never had a 30-day late
on a credit card or a mortgage." Affidavit of Greg Walling, Minnesota v. First Alliance
Walling Aff.].
bad credit; among those survey respondents who had good credit records, about a quarter of white respondents, but almost half of black respondents, mistakenly believed they lacked good credit.\textsuperscript{252}

This may be due to a history of discrimination and cultural stereotypes, but it may also be due to disparate treatment received by minority home loan applicants as compared to white home loan applicants. In a study of six major metropolitan areas in the United States from 2004 to 2006, white, black, and Latino testers posing as loan applicants approached the same mortgage brokerage firms looking for similar loans. The minority testers had slightly higher incomes, better credit scores, and longer employment histories, making them better credit-qualified than the white testers. However, nearly 40% of the minority testers were "pressed for details on possible credit problems, late payments, outstanding debts or prior foreclosures" whereas only 9% of the white testers were asked about this sort of derogatory credit information.\textsuperscript{253} With experiences like these, it would be surprising if minority home loan applicants did not fear that lenders would not extend credit to them.

As a report jointly issued by the Department of Housing and Urban Development (HUD) and the Department of the Treasury explains: "Many subprime borrowers who have had difficulty obtaining credit in the past may underestimate their ability to obtain new sources of credit, which may make them more likely to accept the first offer of credit they receive, rather than shop for a loan with the best possible terms."\textsuperscript{254} Borrowers who think they have bad credit also assume they do not qualify for lower rates. A Washington Post story explains: "In fact, that's what their subprime lenders keep telling them: With your credit rating, you don't qualify for anything much lower than what you've got. So stick with us."\textsuperscript{255}

\begin{itemize}
\item \textsuperscript{252} Sheila D. Ards & Samuel L. Myers, Jr., \textit{The Color of Money: Bad Credit, Wealth, and Race}, 45 Am. Behav. Scientist 223, 229 (2001) (citing Freddie Mac News Release (Sept. 2, 1999)). About a third of Latinos surveyed were so mistaken. \textit{Id.}
\item \textsuperscript{253} See Kenneth R. Harney, \textit{Study Finds Bias in Mortgage Process}, WASH. POST, June 17, 2006, at F1.
\item \textsuperscript{254} HUD-TREASURY REPORT, supra note 46, at 18; see also 1998 Sen. Hrg., supra note 1 (statement of Jodie Bernstein, Director of Bureau of Consumer Protection, Fed. Trade Comm’n) (reporting that consumers who live in low-income and minority neighborhoods, which are underserved by traditional banks, tend to turn to subprime lenders regardless of their credit history).
\item \textsuperscript{255} Kenneth R. Harney, \textit{Past Credit Woes Don’t Have to Haunt High-Rate Borrowers}, WASH. POST, Apr. 27, 2002, at H1; see also Marsh Testimony, supra note 84, at 93-96 (discussing how predatory lender training manuals instructed loan officers to "make it sound as though we are here to help you because no other people will help you."); Walling Aff., \textit{supra} note 251, ¶ 15 (lender impressed upon consumers that “unlike ‘banks,’” this lender wanted “to help the consumer get the best possible loan”).
\end{itemize}
Similar to the effect of stress on decisionmaking, the ego threat presented to borrowers who have or think that they have bad credit or who fear discrimination can affect the loan decisionmaking process in two ways. First, it can cause emotional stress, and impair reasoning by diverting limited attentional capacity to the threat, rather than to the decision at hand. Second, to achieve an immediate escape from the negative emotion created by ego threat, people may engage in the coping mechanism of avoidance. Rather than be subjected to an ego threat, such as the possibility of discrimination, they may restrict their activities in an attempt to shield themselves from discrimination. The result may be a near-term, certain, intangible benefit to self-esteem, but the price can be a decision outcome with high tangible costs.

Borrowers who believe their credit is impaired are more likely than prime borrowers to choose a lender based on likelihood of being approved for the loan. As one loan broker explained it to me, these borrowers experience the home loan application process—having their credit history pored over, their past financial decisions scrutinized, and the bona fides of their current desire for credit second-guessed—to be a “financial strip search.” Subprime lenders engage in a variety of marketing practices designed to appeal to such borrowers, reassuring them with slogans such as “Bad Credit? No Problem,” “Guaranteed Approval,” and “We Believe in You.” To spare borrowers the financial strip search, lenders offer “low doc” or “no doc” loans—meaning loans which require little or no documentation of the borrower’s financial condition, but which rely on high prices and equity in the home to cover the risk of default. Loan sellers comb credit reports for homeowners who have recently been turned down for

256. Luce et al., supra note 180, at 31, 107-08.
257. Daphna Oyserman & Janet K. Swim, Stigma: An Insider’s View, 57 J. Soc. Issues 1, 5 (2001); see also Elizabeth C. Pinel, Stigma Consciousness: The Psychological Legacy of Social Stereotypes, 76 J. Personality & Soc. Psychol. 114, 126 (1999) (finding evidence that people avoid domains in which negative stereotyping may occur); Feagin & Sikes, supra note 249, at 334 (“One way to deal with discrimination is to try to avoid situations where it might occur, even at some personal cost.”).
258. 2001 Nat’l Hous. Survey, supra note 53, at 14. Fifteen percent of credit-impaired borrowers admitted this reason for choosing their lender, versus only 4% of all borrowers giving this reason. Id.
259. There are legitimate uses of low or no documentation requirements, as when a borrower is self-employed, but warnings from the loan industry indicate that loan salespeople also eliminate full documentation requirements in cases where this is unwarranted, leading to serious default and foreclosure risk. See Shenn, supra note 20, at 1 (citing as a factor in increasing home loan risk “the large number of loans where . . . lenders do not ask for, or thoroughly verify, a borrower’s income”).
credit, and then barrage them with "Yes!" advertising. By assuring the borrower that she will be approved, the borrower is relieved of the concern that she will be handed an ego-threatening rejection that impugns her character for creditworthiness.

Moreover, if loan approval is guaranteed, consumers are unlikely to fear discrimination because in the legitimate credit market, discrimination has traditionally involved denials, not disadvantageous pricing. More than twice as many borrowers who have subprime home loans than borrowers overall reported that they picked their lender based on the fact that the lender did not discriminate. The unsurprising result is that blacks and Latinos are over-represented in the subprime market, even after controlling for credit histories.

b. Myopia and Certainty Effects: Discounting over Time and Probability.—As explained above, people must mentally visualize and emotionally experience a future contingency to give it weight in the decision process. Contingencies that are farther out in the future, or more uncertain, influence decisions less strongly than those that are immediate and certain.

There are two ways to conceptualize this effect; either time and uncertainty decrease the weight put on such an outcome by making the current imaginings of the outcome murkier, and/or immediacy and certainty increases the weight put on an outcome by making the current imaginings more vivid. The effect of time has correspondingly been termed either time discounting or time preference. The

260. Credit-impaired borrowers who had previously been rejected for a home loan are more likely to turn to a lender they learned about through solicitation or advertising than credit-impaired borrowers who had not previously been rejected. Id. at 15.

261. Although the often illegal loan-shark market has always involved price gouging, loan sharks traditionally operated surreptitiously. Predatory lenders present themselves as legitimate professional lenders, and much of their business may be nonpredatory subprime lending.

262. Which is not to say that denials today are race-neutral. In 2000, black applicants were about twice as likely and Latino applicants were about 1.5 times as likely as white applicants to be denied home loan credit. Ross & Yinger, supra note 17, at 6 & fig.1.2, 7 & fig.1.3.

263. 2001 Nat’l Hous. Survey, supra note 53, at 14. The percentage that said nondiscrimination was the reason they chose their lender overall was fairly small—6% for subprime borrowers and 3% for all borrowers. Id.

264. See supra Part I.A.3.

265. See supra note 183 and accompanying text.

266. Cf. Adam Gifford, Jr., Emotion & Self-Control, 49 J. Econ. Behav. & Org. 113, 128-29 (2002) ("[P]urely abstract options tend to present the most difficult problems with self-control . . . .").

267. There is some debate in behavioral science as to whether and/or when this phenomenon reflects quasi-hyperbolic discounting, a present-biased, immediacy, or myopia
effect of uncertainty has been captured by prospect theory's "certainty effect," the finding that people tend to weight certain losses and gains more heavily than uncertain or probabilistic ones, so that the difference between probabilities of 0% and 5% and the difference between probabilities of 95% and 100% both carry more weight in the decision process than the difference between 45% and 50%. People overweight opportunity costs as opposed to out-of-pocket costs in part because the latter are nearer-term and more certain. The operation of time and uncertainty will differ both across people and across situations, depending on the vividness and detail with which a person internally visualizes the future uncertain event, such that no one discount rate or myopic preference rate can be applied.

As a consequence, decisions about near-term, certain events are judged by tangible aspects such as feasibility, whereas long-term or uncertain events are judged by the desirability of the broad-brush outcome. Even where future feasibility issues can be predicted with some accuracy, the vague visualization of the event does not call them to mind. Instead people often leave feasibility to be determined later in an attitude of "we'll think about that when we get there." Not all aspects of a future or uncertain choice are equally affected by this phenomenon; those aspects that are consistently construed at a high or abstract level are neither discounted nor enhanced, but lower-level details are weighted more strongly when made more concrete, immediate, and certain. So, for example, a loan applicant would place equal weight on the homeownership dimension—a more abstract feature of a home loan—regardless of time or uncertainty, whereas she is unlikely to attend as carefully to a concrete monthly loan payment when that payment is in the future or uncertain.

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269. Tversky & Kahneman, supra note 166, at 7-9.
272. For example, when subjects were asked to imagine and describe moving into a new apartment in the long-term future ("sometime next year"), they described starting a new life. Id. at 8-9. Yet when asked to imagine and describe moving into a new apartment tomorrow, they described the specific feasibility aspects of the life change, such as packing and carrying boxes. Id.
Components of loan price that are uncertain at the time of loan purchase, or that do not come into effect until sometime long after the first monthly payment, are almost certainly underweighted, if not ignored altogether, in borrower decisionmaking. The popularity of loans with "teaser rates," adjustable rates that will, with certainty, increase in six months or a year, is due to this bias. Consumers are even more likely to fail to appreciate the true future costs of a loan when these costs are not only in the future, but also uncertain, such as where the interest rate is tied to an index. Similarly, prepayment penalties and late fees, future expenses that are, from the borrower's perspective, quite uncertain at the time of loan purchase, probably do not register on most borrowers' conscious decisionmaking about entering into the loan contract. Yet these fees have associated probabilities—lenders can predict likely incidences of prepayment penalties and late fees over a pool of loan—and are part of the true cost of the loan to the borrower.

That the "Yes!" pitch is successful is a reflection not only of the premium placed by segments of borrowers on avoiding ego threats; it is also successful because the approval determination, and the upfront cash it brings are the most concrete and immediate, and therefore most salient, aspects of the loan. The "Cash Back Now," "Instant Cash," "Fast Cash," and "Easy Credit" advertising slogans that are ubiquitous throughout the subprime lending industry exploit the salience of meeting immediate goals, with little or no mention of the price to be paid in the future. The promise of credit approval holds out the

274. See, e.g., Bar-Gill, supra note 6, at 1405-07 (explaining how credit card teaser rates play on consumer discounting of future costs). Teaser rates are popular with lenders both because they can be used to convince borrowers to take loans at higher prices, and because lenders know that borrowers are unlikely to refinance when rates go up. See infra Part IV.A.3; cf. Bar-Gill, supra note 6, at 1392-93 (reporting profitability to lenders of teaser rates in credit card marketing).

275. See Jack Guttentag, Your Mortgage: Prepayment Penalty a Surprise, L.A. TIMES, Oct. 14, 2001, at K5 (reporting that many borrowers do not know they have a prepayment penalty until they attempt to refinance, either because they do not read or understand their TILA disclosures, or because when they took out the loan "the prepayment penalty did not register in [their] mind[s]."); John Hechinger, Home Bound: Nasty Surprise Haunts Some Folks' Mortgage: A Prepayment Penalty, WALL ST. J., Aug. 1, 2001, at A1 (reporting stories of borrowers who were surprised to find their mortgages carried prepayment penalties); Bar-Gill, supra note 6, at 1392-93 (late fees in credit card contracts are "largely invisible to consumers").

276. See supra text accompanying note 56.

277. Even when the price to be paid must be mentioned, for example when the borrower is receiving the federal disclosures, the lender can seek to focus the borrower's attention on what she will do with the loan proceeds rather than on what she will pay for the loan proceeds. See Transcript of Record, Day 2-Vol. III, at 48-49, Official Joint Borrowers Comm. v. Lehman Commercial Paper, Inc., No. SACV 01-0971-DOC (C.D. Cal. Feb. 19,
possibility of a certain gain, as opposed to the uncertain prospect of a lower-priced loan that might be produced by spending the time, money, and effort of applying to a prime lender. The subprime industry is well-aware that subprime borrowers are more concerned with the “Yes!” than the price; one lender listed loan origination fees and interest rates last in a list of areas of competition among subprime lenders, after “convenience in obtaining a loan, customer service, marketing and distribution channels, [and] amount and term of the loan.”

Consumer survey evidence likewise bears out the higher incidence of borrowers with subprime loans who shopped based on the “Yes!” or the “quick decision” rather than the APR. Subprime borrowers report less search for the best interest rate than prime borrowers; about a third of subprime borrowers yet half of prime borrowers report that they searched “a lot” for the best rate. No money down and a quick decision were more frequently cited by subprime borrowers than by borrowers overall as reasons for choosing a particular lender or broker. An industry study of recent African-American and Latino purchase money home loan borrowers fleshes out these findings, and sheds some light on why even upper-income minorities are disproportionately likely to end up with subprime loans: A majority reported that they were not provided with, and did not seek, a variety of mortgage options.

[They] did not actually comparison-shop for the best terms for their mortgage. Many did not think such comparisons were possible.

....

A substantial number . . . were just happy to get a “yes” to their mortgage application, so they did not even consider the possibility of getting better terms for their mortgage.

Fannie Mae similarly found that 10% of all homeowners and nearly a third of all credit-impaired borrowers “did not care whether they re-

2003) (testimony of Terence J. LaFrankie) [hereinafter LaFrankie Testimony Day 2-Vol. III] (describing lender practice of requiring, in the midst of receiving required federal disclosures and other documents, that borrowers complete a document stating why they want the loan).


279. Courchane et al., supra note 88, at 372. Almost a third of all homeowners report that they chose their lender based on the interest rate, whereas only 11% of subprime borrowers report that this was why they chose their lender. 2001 NAT’L HOUS. SURVEY, supra note 53, at 14.


281. RIHA, supra note 205, at 8-9.
ceived the lowest-cost loan for which they were qualified. They were just happy to be approved for a mortgage.”

3. Framing the Price: Capitalizing on the Evaluability of the Monthly Payment.—

Through more than fifty interviews with borrowers and inspection of loan documents, a pattern emerged.

All of the borrowers interviewed knew the amount of their monthly payments, but none understood all of the financial details in their loan such as adjustable interest rates, balloon payments and points.

Many borrowers said they were not even seeking a loan when the lenders contacted them via mail or telephone. —Philadelphia Daily News, Feb. 5, 2001

Time and again, borrowers and sellers of subprime loans report that borrowers do not attempt to sort out the complicated structuring of their loans and instead focus exclusively on one dimension of the loan in making their decision: the monthly payment. Why? Again, common decisionmaking patterns are to blame. Borrowers do not understand the other aspects of the home loan decision, and so they ignore them. They focus on the one attribute of the loan price that they can easily understand and evaluate, and that aspect is the monthly payment. Although this can be a successful strategy for dealing with risk, it can lead to accepting an overpriced loan because sellers are also aware that although the evaluability of the monthly payment is high, other attributes of the loan that determine price—e.g., interest rate, APR, loan length, origination fees, balloon features, late fees, credit insurance, and prepayment penalties—are less salient.

a. The Evaluability Bias: Oversimplifying to Cope with Incomprehensibility.—When presented with product attributes that they do not comprehend, some consumers will react by ignoring the incomprehensible attributes rather than seeking further information to allow them to comprehend all aspects of the decision. For some home

284. See, e.g., 1998 Sen. Hrg., supra note 1, at 38 (statement of “Jim Dough,” former finance company employee) (“The majority of customers are looking at one thing—that is monthly payment”); Henriques & Bergman, supra note 74, at A1 (quoting CEO of First Alliance Mortgage Corporation as saying: “Most borrowers are much more concerned about their monthly payment than the amount of any fees”).
loan borrowers, it is not merely the jargon used by sellers or the specific operation of a loan term that is incomprehensible; the incomprehensibility for some is at a meta level, such that the consumer does not even know where to begin searching for information that would be informative. The consumer needs not merely information per se, but the financial education to make that information meaningful. Without this education, the consumer has no way to know the depth of her own ignorance, nor the importance of the loan terms she does not understand. Without knowing whether the attributes of the loan that she does not understand are important, she is apt to ignore her own ignorance. Embarrassment about ignorance may further motivate the consumer to ignore the incomprehensible, rather than seeking more information.

b. Number Problems: Percentages, Large Numbers, and Truncation.—In addition to poor financial literacy, the way in which people process numbers may cause borrowers to misunderstand or ignore (1) percentages such as interest rates and APRs; (2) large numbers such as finance charge, total of all payments, and balloons; and (3) differences between numbers disclosed when the numbers are grossly similar.

People have an intuitive sense of whole positive integers, but must think longer and with more effort to process percentages. For example, information given to consumers about nutritional content was more likely to evoke relatively correct consumer comparisons of nutritional value, and to be better remembered later, when presented

consumers reported that they did not use nutritional labels because they did not understand nutrition or nutrition labels; Zuckerman & Chaiken, supra note 218, at 622 (noting that limited knowledge in the relevant subject area can lead to reduced systematic processing and increased heuristic processing). The general tendency to judge options by the attributes that are easy to evaluate has been dubbed the “evaluability hypothesis.” Christopher K. Hsee, The Evaluability Hypothesis: An Explanation for Preference Reversals Between Joint and Separate Evaluations of Alternatives, 67 ORG. BEHAV. & HUMAN DECISION PROCESSES 247, 255-56 (1996).

286. Cf. Craig R. Fox & Amos Tversky, Ambiguity Aversion and Comparative Ignorance, in CVF, supra note 112, at 528, 539-42 (finding that people are only concerned about their ignorance regarding aspects of a decision when they have some comparison reference point that draws their attention to the ignorance).

287. Thus, it is not surprising that few Americans at the lowest financial literacy levels seek assistance from others in performing tasks that require higher literacy levels to be performed well. See supra note 226 and accompanying text.

in adjective format, rather than in percentage format.\textsuperscript{289} Large effective differences in price when evaluated from the interest rate perspective may seem quite small—because people more easily and more strongly process numbers as whole integers rather than as percentages, the difference between 8\% and 10\% may seem small both in absolute terms, and when the borrower is using a mental scale that puts 100\% at the high end and 1\% at the low end, because both eight and ten seem low.\textsuperscript{290} Put in percentage terms, a small increase in the interest rate or APR, although equivalent to many thousands of dollars, will not register with some borrowers as a difference requiring consideration in the loan decision. This is not true of all borrowers; prime borrowers know to refinance when interest rates decline. But subprime borrowers, particularly black, Latino, and female borrowers with low credit scores, do not appear responsive to interest rate changes.\textsuperscript{291}

Survey data bears out a failure to attend to the interest rate. In a 2001 survey of homeowners, including both prime and subprime borrowers, about 10\% reported that they do not know what their home loan interest rate is, even within a percentage point or two.\textsuperscript{292} The 10\% figure probably understates the true number who do not know their interest rate because the researchers did not investigate whether the responses of borrowers who claimed to know their home loan’s interest rate within a percentage point or two were correct.

When recent home loan borrowers were surveyed, a large majority preferred receiving information about the fees and costs associated with the loan as a dollar amount such as TILA’s finance charge, rather than as a percentage such as the APR disclosure. A bare majority of respondents even preferred to receive the contract interest rate disclosed as a dollar amount, rather than as a percentage.\textsuperscript{293}

Although people state a preference for receiving price information as whole numbers rather than percentages, there are problems with relying on such large numbers as the finance charge or total pay-

\begin{enumerate}
\item[289.] Debra L. Scammon, "Information Load" and Consumers, 4 J. Consumer Res. 148, 153 (1986).
\item[290.] When people process quantities or numbers, they are subject to a distance effect, in that they can more easily (as defined by how quickly and accurately they do so) distinguish between quantities or numbers that are far apart (80 and 100) than those that are close together (81 and 82). Dehaene, supra note 288, at 71.
\item[291.] See infra Part IV.A.3.
\end{enumerate}
ments to convey loan price. People display a magnitude effect when trying to estimate numerosity or number size, in that they have more difficulty distinguishing between two quantities or numbers equally far apart when they are larger (1100 and 1200), than when they are smaller (100 and 200). This magnitude effect operates in a decreasing marginal ability to quickly and accurately distinguish between quantities and numbers as they become larger.\(^\text{294}\) It parallels prospect theory's axiom, noted above, that people display diminishing marginal sensitivity to increasing gains and losses, such that the difference between $100 and $200 is weighted more heavily than the difference between $1100 and $1200. As Dehaene has explained regarding the mental "number line":

The "mental ruler" with which we measure numbers is not graduated with regularly spaced marks. It tends to compress larger numbers into a smaller space. Our brain represents quantities in a fashion not unlike the logarithmic scale on a slide rule, where equal space is allocated to the interval between 1 and 2, 2 and 4, or between 4 and 8.\(^\text{295}\)

People display a bias towards small numbers, which occupy more mental space and are more concrete and mentally available or imaginable.\(^\text{296}\) They frequently fail to appreciate the magnitude of differences between large numbers because these numbers are compressed on their mental number line. Large dollar values are too big to comprehend in terms of daily experience and at some level can become nearly indistinguishable.\(^\text{297}\)

Some borrowers therefore fail to attend to the finance charge, total payments, or balloon payment figures reflected on the TILA disclosure because these numbers are too large, dollar figures far beyond their daily life experience. For some borrowers, a large finance charge—say $81,000—is not so different on the mental number line than an even larger finance charge—say $89,000. The degree to

\(^{294}\) Dehaene, supra note 288, at 108.

\(^{295}\) Id. at 76. This principle, called "Weber's law" or "scalar law," is that for each doubling of the quantities or numbers compared, we must double the distance between them to easily distinguish them; that is, our ability to distinguish ten from thirteen is matched by our ability to distinguish twenty from twenty-six. Id. at 72.

\(^{296}\) See Denes-Raj & Epstein, supra note 288, at 826 (explaining the ratio-bias phenomenon).

\(^{297}\) Cf. David Hume, A Treatise of Human Nature 22-23 (L.A. Selby-Bigge ed., Oxford Univ. Press 2d ed. 1978) (1888) ("I observe that when we mention any great number, such as a thousand, the mind has generally no adequate idea of it . . ."); Max Singer, The Vitality of Mythical Numbers, in JUU, supra note 166, at 408, 410-11 (explaining that people cannot estimate aggregate crime data because the quantity is beyond everyday experience).
which people display these number line effects will vary across the
population and across settings, with people who are more accustomed
to dealing with larger numbers or dollar amounts less likely to experi-
ence these effects, and people for whom large numbers are especially
unfamiliar likely to experience these effects most strongly.

Finally, people may fail to appreciate significant price differences
due to rounding, simplifying to reduce the amount of information
under consideration, in the context of multi-digit numbers having
more than two digits.298 People prefer round numbers because they
are simpler and more cognitively accessible than nonround numbers.
They do not, however, always follow the rule to round up when they
should. Instead, people sometimes simplify the information load of
the number when the number has more than two digits by truncating,
reading from left to right, so they more frequently round down than
round up.299 The popularity (with sellers) of nines at the ends of
price figures appears to result from consumer truncation of price in-
formation processing.300 Note that not all consumers need to trun-
cate for nine-ending prices to be profitable, only a significant segment
of consumers. This segment is likely to be the segment having the
least experience and familiarity dealing with numbers and financial
matters.

The effects of truncation will vary with the place-level to which
the buyer truncates: if a $2.19 product price is truncated to $2, the
effect is insensitivity to 19 cents; if a $21,999 loan amount is truncated
to $20,000, the effect is insensitivity to $1999. The rents extracted by
sellers per purchasing decision would vary accordingly. Truncation
can have particularly large effects when it is interest rate percentages
or APRs that are being truncated rather than finance charges or other
whole numbers. The difference between 10% and 10.8% might be
missed by the borrower entirely, if she is the type of shopper who trun-
cates. Unfortunately, this difference can have a large dollar effect
over the life of the loan.301

298. DEHAENE, supra note 288, at 75-76. We understand two digit numbers by processing
both digits simultaneously, rather than by reading from left to right. Id. When faced with
three or more digits, however, people at times truncate. Id. at 80.
299. Robert M. Schindler & Patrick N. Kirby, Patterns of Rightmost Digits Used in Advertised
300. Id. (dubbing this the “underestimation effect”).
301. For a thirty-year $100,000 loan, the difference in monthly payments for a 10% ver-
sus a 10.8% loan is about $60, but the difference in payments over the life of the loan is
about $21,000.
c. Framing Effects: The Invisibility of Financed Fees and Costs.—The most fundamental challenge to the rationality assumption made by decision behavior researchers is the recognition that the manner in which a decision problem and choice set is presented and perceived or "coded" affects the decision itself. Decisions cannot be perceived apart from some frame of reference, whether the integrated states of well-being reference point assumed by rational choice theory or a piecemeal isolated gain-loss calculus frame posited by prospect theory.  

This phenomenon has been dubbed "framing," although it is not so much a distinctive phenomenon as a reflection of a lack of definite preexisting preferences and the invocation of various heuristics, biases, and coping strategies that shape those preferences during the decisionmaking process.

While we need not accept a decision choice as it is framed by others or by happenstance, we frequently trade off accuracy for less effort and accept the decision choice formulation as it is presented to us. Framing effects are manipulated by those with a market incentive to do so because "alternative framings of the same options can give rise to different choices." The more familiar we are with a decision situation, and the stronger our preexisting preferences regarding the decision, the easier it is for us to reformulate the situation (edit the frame) as we make the decision, and the less susceptible we are to framing effects. Because the home loan decision process is an infrequent one for borrowers, it is one in which they are particularly susceptible to framing effects.

One type of framing, "choice bracketing," is framing the breadth of the decision itself, bundling or unbundling aspects of a choice over time and space. Bundling or unbundling various gains and losses and considering them part of a single or multiple choice bracket ex-
ploits prospect theory's observation of diminishing sensitivity to gains and losses. Because people place declining weight on marginal increases in gains and losses, when a number of losses are bundled together, they will register on one's mental account as a smaller total loss than each loss would register if incurred separately. In the loan context, even if a borrower thinks that shopping around might help her eliminate one $100 fee or another, she might be unwilling to spend this effort because the $100 seems negligible compared to the total loan price of thousands of dollars, even to a borrower who would comparison shop between grocery stores to save even $10.

In addition to the origination fee and single premium credit insurance, a product that is extremely profitable to lenders but rarely useful for borrowers, other "junk fees" are bundled into loan packages, and then interest is charged on these over the life of the loan. Fannie Mae found that these fees, costs that lenders can legally add to a settlement statement under names such as document preparation fee, underwriting analysis fee, tax escrow fee, or escrow fund analysis fee, are quite common. One subprime lender recently claimed that its fifteen different settlement fees and charges were standard, even where they could add up to 20% of the total loan. The prevalence of these fees at closing plainly appears to be a framing problem—once they are bundled in with total price, most consumers do not notice them at all, and if they do notice them, figure they are such a small proportion of the overall cost as to not be worth fighting about. Financing of all fees and costs can decrease the weight put on the fees

308. The classic example of this is when car salespeople sell consumers on a car at a particular price and then persuade the buyer to add numerous "options" that seem, in relation to the total price of the car, to be negligible. ROBERT B. CIALDINI, INFLUENCE: SCIENCE AND PRACTICE 16 (4th ed. 2001). Although Cialdini ascribes this to contrast effects (the option price in contrast to the car price seems negligible), it is only likely to work in conjunction with mental accounting—if the option purchase were not choice bracketed with the car purchase, but were instead an offer by a salesperson passing by the car lot to sell you an air conditioning unit for your home, it is unlikely that the small price of the air conditioning as compared to the price of the car would be of any consequence, decisionally speaking. See Thaler, supra note 302, at 186.


310. See supra note 56 and accompanying text.

311. 2001 NAT'L HOUS. SURVEY, supra note 53, at 6. Fannie Mae found that only just over half of borrowers surveyed were confident that they were not charged these fees. Id.

312. See Davies, supra note 283, at D3 (recounting story of borrower who received a $21,000 home equity loan, of which $4187 went to pay fifteen different fees and settlement charges).

in the loan decision or even make them virtually invisible to some borrowers so much so that The Washington Post found it necessary to explain to borrowers that "zero cost" loans are not really zero cost.\textsuperscript{314}

This relates to one reason subprime lenders try to sell borrowers cash-out refinancing loans rather than second mortgages: in addition to being able to collect interest on the entire amount,\textsuperscript{315} the larger the loan, the smaller a large origination fee will appear to many borrowers.\textsuperscript{316} Many subprime borrowers do not have the financial literacy to determine that a refinanced first mortgage loan at a couple of points higher interest rate is much more expensive than keeping a first mortgage with a low interest rate and adding a small second mortgage at a higher rate. As one borrower who paid points and fees totaling $8105 to do a cash-out refinancing of an existing $74,000, 7.5\% mortgage with a $100,750, 12.85\% mortgage explained:

I did not understand the full cost of the additional money I received until several weeks later when I finally discussed the situation with one of my sons. Based on my son's calculations, American Equity Mortgage\textsuperscript{317} and their loan officer thought it was in my best interest:

To pay $8,105 in points and fees to receive $18,645 in additional funds; to pay an effective interest rate of 44 percent on the . . . additional funds . . . ; and to pay an additional $201,608 in interest over the life of the loan for the $18,645 in additional funds.\textsuperscript{318}

Although $8000 in various points and fees for a $100,000 loan did not appear to warrant shopping for a better price, reframing the components of the transaction allowed the borrower to see just how high the price of the loan was. But this was long after her three-day right of

\textsuperscript{314} Kenneth R. Harney, Acute Cases of Refi Fever, WASH. POST, Aug. 24, 2002, at H1 (explaining that transaction fees are paid by borrowers on "zero cost" loans in the form of settlement costs rolled up into a higher interest rate or added to the principal of the loan).

\textsuperscript{315} Further, a refinancing is in first-lien position rather than second, which puts the lender in a more favorable position at any foreclosure.

\textsuperscript{316} See Transcript of Record, Day 4-Vol. I, at 91, Official Joint Borrowers Comm. v. Lehman Commercial Paper, Inc., No. SACV 01-0971-DOC (C.D. Cal. Mar. 2, 2003) (testimony of Terence J. LaFrankie) (loan officers were trained to refinance first mortgages into a new, larger mortgage rather than selling smaller second mortgages because "[y]ou would never be able to get the size fees you could get by lending that small of an amount"). Lenders try to convince borrowers to borrow more money than they need to borrow, so that the origination fee does not "look so bad." LaFrankie Testimony Day 1-Vol. II, supra note 79, at 99-100.


\textsuperscript{318} 2001 Sen. Hrg., supra note 77, at 12-13 (statement of Carol Mackey).
rescission had expired; to refinance elsewhere, she will have to pay another set of origination fees and costs, plus a prepayment penalty to the first lender.\footnote{319}

d. \textit{Exploiting Borrower Reliance on the Monthly Payment}.—A simplifying heuristic used by subprime borrowers for deciding whether to take the loan is using the monthly payment as the single price-related attribute upon which to base the loan decision. The monthly payment amount, even if higher than prior mortgage payments, is still close in size to dollar amounts with which most borrowers have familiarity. It is a figure that can be assessed by simple addition and subtraction in calculating monthly budget amounts, rather than requiring more difficult calculations such as multiplication or working with percentages. The salience of the monthly payment is high for all segments, but perhaps even higher for lower income segments, frequently the elderly and minorities, because people on a more restricted budget tend to perform household accounting on a weekly or monthly basis, rather than over longer time intervals.\footnote{320}

If one is going to reduce the loan decision to a single attribute, the monthly payment is probably the best choice because the affordability of payments is a good way to assess risk of foreclosure. If you had to pick a single oversimplifying heuristic, this would be it. However, the monthly payment conveys little information about the price of the loan. Price shopping based on monthly payment might have worked when all home loans were comparable thirty-year fully amortizing products. Today, however, sellers of loans can take advantage of this simplifying heuristic to extract a larger profit from the borrowers relying solely on the monthly payment, either through charging a higher interest rate or through packing the loan with more fees and lucrative but useless credit insurance products.

\footnote{319. See id. at 13. A similar story is told by Judge Posner in \textit{Emery v. American General Finance}, wherein a lender, in the course of extending a borrower a $200 personal loan, refinanced a $2000 personal loan she had taken six months earlier, calculating the finance charge on the total new loan amount: By our calculation, the implicit interest rate that she paid for the $200 loan exceeded 110 percent per annum. This was not disclosed on the Truth in Lending Act form that Emery received because the Act treats the transaction as a reborrowing of the original amount of the loan plus $200. So much for the Truth in Lending Act as a protection for borrowers. 71 F.3d 1343, 1346 (7th Cir. 1995).

320. Thaler, supra note 302, at 193. Due to different financial constraints, different consumer segments display systematic differences in their mental accounting: “Poorer families . . . tend to have budgets defined over shorter periods (a week or a month), whereas wealthier families may use annual budgets.” Id. at 193-94; accord Richard H. Thaler, \textit{Anomalies: Saving, Fungibility, and Mental Accounts}, 4 \textit{J. Econ. Persp.} 193, 194 (1990).}
Lenders and brokers are well aware that in evaluating the monthly payment, many borrowers are satisficing, not optimizing. That is, borrowers are looking for a loan with a monthly payment amount that will be equal to or less than the maximum monthly payment amount they think they can afford. Brokers and loan officers will obtain that figure and then quote a loan price (including interest and packed-in products and fees) that will bring the monthly payment to that level, regardless of the borrower's desire or appropriateness for packed-in credit products, regardless of what the lender or broker has done to earn the origination fees, and regardless of the monthly interest rate for which the borrower would qualify based on risk.

Studies confirm that borrowers who rely on monthly payments as a simplifying heuristic are vulnerable to price gouging. Using a multivariate regression analysis of the home loan search methods of prime and subprime borrowers, one study found that "borrowers whose search emphasized affordable monthly payments" were more likely to end up with a higher interest rate, subprime loan rather than a prime loan, even controlling for underwriting (risk) factors. An AARP study of older borrowers who had recently obtained refinance loans found: "Low monthly payments, getting approved, and a quick turnaround were the loan characteristics more important to subprime than prime borrowers, while interest rate and mortgage terms were more important to prime than subprime borrowers."

4. Disclosures, the Loan Seller's Sword and Shield.—

When my wife and I went in for the closing, they went through all the paperwork so fast, it was like a Barker in a circus—they just keep talking; you put your money down... It was over in less than a half hour.

....

The basic problem is that when you sit down at that closing table, the lender knows more than you do. You expect honest dealings, like you have had on past loans.

—2001 Senate Hearing Testimony of borrower Paul Satriano

The disclosures currently required by federal and state law do not help significant numbers of borrowers to price shop and can even affirmatively harm borrowers. First, the quantity of disclosures can cre-

321. Courchane et al., supra note 88, at 373.
ate an information overload. Second, they are given at a time when the borrower is no longer in a decisionmaking frame, but is already psychologically committed to the loan and likely to ignore red flags under the influence of motivated reasoning. Finally, the disclosures reinforce a false sense of security about the home borrowing process, in part through the representativeness heuristic.

a. Information Overload and Stress-Truncated Reasoning, Again.—As explained above, the disclosures required by federal law were designed to reduce the problem of information overload, by placing key pieces of information on a few sheets of paper. But predatory lenders mock disclosure statutes, frequently giving borrowers more "disclosures" or other paperwork about the home loan than required by law, with little time to read them. As the HUD-Treasury Report explains: "The Federal disclosures under RESPA and TILA comprise only 3-5 forms out of what can involve up to 50 documents . . . ."\footnote{HUD-TREASURY REPORT, supra note 46, at 63; see also LaFrankie Testimony Day 2-Vol. III, supra note 309, at 25-26, 40 (explaining that loan officers were trained to present borrower with fifteen to twenty documents to sign, interspersing the three or four "hot" federal disclosure documents with mundane documents not required by law); at 45-46 (explaining that in presenting the GFE, a single document containing an itemization of settlement costs, loan officers were trained to "hit hard on the little insignificant [fees]" so that by the time the loan officer came to the place on the GFE disclosing the lender's origination fee, "hopefully the [borrower's] attention span had wandered, and their trust factor was way up").}

Although some of these disclosures are required by state law, the excess "disclosures" are part of sales tactics designed to "overload, overwhelm, distract, and . . . fatigue" borrowers.\footnote{Deposition Testimony of Jay M. Finkelman at 65-66, Pagter v. First Alliance Mortgage Co., No. CV766996 (Cal. Super. Ct. Dec. 15, 1999) [hereinafter Finkelman Testimony]; see also Marsh Testimony, supra note 84, at 69, 71 (describing lender strategy to "distract[ ] . . . borrowers, from the fundamental credit disclosures . . . to distract borrowers from the consumer disclosures that matter most"); Henriques & Bergman, supra note 74, at A1 ("The [lender's] script, regulators say, is designed to deflect questions about rates and fees, swamp borrowers under masses of needless detail and foster a trusting atmosphere that would encourage customers to lower their guard.").} Settlement officers typically schedule home loan closings every thirty minutes, an unrealistic amount of time for even highly literate borrowers to read through all the fine print.\footnote{Engel & McCoy, supra note 109, at 1309; Renuart, supra note 202, at 490.} By moving through the papers quickly, the lender sends the message that the borrower is not expected to read or understand the documents, or, contrariwise, is expected to understand them easily, but in either case is not expected to ask questions. Borrowers have frequently reported that this tactic is successful—they feel too rushed at closing and do not feel they have
the time to read and ask questions about all the documents. The feeling of being rushed may create a sense of stress, leading to truncated reasoning rather than careful cognition, and consideration of even fewer loan attributes than might otherwise be considered. The result is that almost 70% of consumers disagree with the statement that “[m]ost people read their Truth-in-Lending Statements carefully.”

b. Motivated Reasoning, Decision Process Framing, and the Endowment Effect.—In addition to the disclosures coming too late as a practical matter to use to shop, as a psychological matter they are apt not to be used well in decisionmaking. The first impediment to using the disclosures well is “motivated reasoning,” the tendency to selectively search and interpret information to justify a desired conclusion. Although the decisionmaker perceives herself as engaging in an unbiased reasoning process, all the information and logic used are biased toward the result she wants to arrive at. This form of reasoning has also been called “elastic justification.”

Reasoning is not infinitely elastic, but it is particularly elastic when assessing outcomes that are not definite—where there is uncertainty. As discussed above, the GFE can disclose a range of estimated settlement figures, and the TILA disclosures need only to state whether the loan “may” have a prepayment penalty. Lenders therefore low-ball borrowers in the early price estimates. Where a range of values is given, or only uncertain information, the potential elasticity of justification will be high, as the borrower who already wants to take the loan may engage in motivated reasoning and focus on the

327. E.g., Henriques & Bergman, supra note 74, at A1. One mortgage seller’s loan officer manual instructs: “Now don’t stop, hesitate or look [the consumer] in the eye. Keep your momentum going,” and “Don’t gear the customer for a slow, relaxed decision.” Marsh Testimony, supra note 84, at 78, 98, 128. By not making eye contact and not pausing, the loan officer creates “a discomfort zone for a potential borrower who then does not want to challenge the loan officer and say wait a minute, hold it, slow down, I don’t understand this . . . .” Finkelman Testimony, supra note 325, at 62-63.

328. See, e.g., Bettman et al., supra note 175, at 200 (surveying evidence that time pressure decreases complex thinking and increases reliance on shortcut decision strategies).

329. Durkin & Elliehausen, supra note 163, at 129 tbl.6.


332. See Household Examination, supra note 72, at 6-7 (explaining one lender’s practice of disclosing a broad range of potential settlement costs and origination fees on the GFE and then repeatedly charging at the high end of that range at closing); cf. Cialdini, supra note 308, at 84-87 (noting that car salespeople use the same tactic).
bright side—the low end of the dollar range of settlement costs and the possibility that a prepayment penalty might not be imposed.

Second, the disclosures are too late because of another framing effect, the decision stage frame. A decision is a point between two stages: a predecisional deliberation stage of weighing alternatives, and an implementation stage of implementing a decision that one has made. A decision is often subjectively experienced as a commitment. Once someone has committed to something, she may be reluctant to change and will not pause to reconsider her decision even when new information comes about during implementation that would cause her, if she were in the predecisional phase, to weigh options differently. Instead, motivated reasoning may lead her to misinterpret ambiguous evidence as providing further support, and forget, discount, or reject new evidence that does not support her prior judgment. The sunk costs fallacy can also come into play once she has spent effort, time, and tangible costs in making the decision. Rather than appear wasteful and incurring a certain loss by admitting having made a bad and costly decision and changing course, the decisionmaker may, at least up to a point, mentally inflate the probability of success and continue with the commitment.

Most home loan disclosures are given to the borrower at a point in time when the borrower has already moved to an implementation mindset and is no longer in a predecisional frame. The GFE is given three days after the borrower has gathered paperwork, filled out an application form, and paid an application and/or appraisal fee, and may be feeling mental commitment stemming from these sunk costs. A broker may also have convinced the borrower prior to receipt of the GFE to sign a form promising to pay the broker even if the loan is never originated. The HOEPA and TILA disclosures come three

333. See Liberman & Trope, supra note 271, at 7-8 (calling decision framing "temporal construal theory"); Renuart, supra note 202, at 487-91 (describing the process by which lenders rush the two stages).

334. This bias has a host of names: e.g., belief perseverance, confirmatory bias, and the entity effect. Lee Ross & Craig A. Anderson, Shortcomings in the Attribution Process: On the Origins and Maintenance of Erroneous Social Assessments, in JUU, supra note 166, at 129, 144-52.


336. Renuart, supra note 202, at 488. More subtly, a lender might require potential borrowers to place their signature next to a description of their loan at the application stage because although no loan contract is yet being presented, the act of signing creates a feeling of commitment, that the potential borrowers are "putting in full faith and word that they want to continue the process" of obtaining the loan. LaFrankie Testimony Day 2-Vol. III, supra note 309, at 18; see also Walling Aff., supra note 251, ¶ 13 (describing methods used by loan officers to "get the consumer emotionally committed to the loan").
days before and at closing, when the borrower is even more likely to have moved to a psychologically committed implementation mindset.

HOEPA recognizes something close to this phenomenon for high-cost loan borrowers and gives them a disclosure explaining that they are not obligated to accept a loan once they have signed the application. But even high-cost borrowers will usually know that they are not obligated to accept the loan until they sign the papers at closing; decision framing, sunk costs, motivated reasoning, and financial resource limits all operate despite the absence of a legal commitment to the loan. In the words of one borrower who was quoted a fixed APR of 8% from Wells Fargo, but found herself at closing signing papers for a loan with an adjustable APR of over 9%, “At the point we were sitting at the table, we were just so desperate.”

Finally, the three-day right of rescission is very unlikely to be resorted to due to the endowment effect. Once people perceive themselves as being endowed with or having ownership over something they value it more highly—and will demand more to give it up than something they do not perceive themselves as possessing. It is thus unsurprising that the three-day right of rescission is virtually never exercised within three days of the loan closing.

c. Representativeness and the Veneer of Legality.—People often take one event or thing to be representative of others that are only somewhat similar. This “representativeness heuristic” leads to the fallacy of the “law of small numbers,” by which people confidently predict based on a small sample of experience that the entire population will behave in the same manner as the sample even when the sample is


339. Federal Reserve Board Governor Donald Kohn has testified: “With regard to [the] right of rescission, let me say that virtually every outreach meeting that we’ve had bankers stand up and say, ‘I’ve been in the banking business for 35 years, I’ve been lending money that entire time. No one has ever asked to exercise their right of rescission.’” Financial Services Regulatory Relief: The Regulators’ View: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services, 109th Cong. 26 (2005) (statement of Donald L. Kohn, Governor, Board of Governors of the Federal Reserve System).

340. Tversky & Kahneman, supra note 166, at 4-7.
not representative of the population along the relevant dimension.\textsuperscript{341} In the consumer setting, the representativeness heuristic can lead consumers with prior knowledge of a type of product to assume that a new similar product will mirror their prior experience if the new product does not have sufficient cues that it is different from past products.\textsuperscript{342}

Sellers invoke the representativeness heuristic to calm borrower feelings of overload and worry about signing a raft of documents they have not read and/or do not understand. One lender training manual directed its loan officers, when they placed a stack of paperwork in front of the borrowers to sign, to announce: "Okay, folks, we have about fifteen papers to okay. Now, most of these papers are the same ones you signed when you took out your last mortgage."\textsuperscript{343} Because predatory loans are refinancings or second mortgages, not purchase money loans, the borrowers are already familiar with the process. Even if the format of the note or deed is different from the last loan, the federally required disclosures will have a familiar, reassuring look. Although ordinarily, the stakes of the home loan decision would motivate borrowers to examine the documents carefully, the reassurance that this loan is no different than the last gives borrowers a reason to let down their guard.

Compounding the problem is that the disclosures give the veneer of legality and authority to the loan process, both to borrowers at the time they take the loan and to regulatory agencies and courts who may review the transaction down the line. By seeing the many government-required disclosures, some borrowers may be led to believe that the government regulates the home loan process to a greater degree than it does. This "lulling effect" of the disclosures can result in borrowers failing to be as self-protective during the process as they should be. Loan sellers like to point out to borrowers that these are "disclosure forms from the federal government" because it "sounds real official . . . . It sounds comfy, cozy . . . . Gives somebody confidence."\textsuperscript{344}

\textsuperscript{341} Id. at 7-8; accord Richard E. Nisbett et al., \textit{Popular Induction: Information Is Not Necessarily Informative}, in JUU, supra note 166, at 109-10.


\textsuperscript{343} Marsh Testimony, supra note 84, at 113-14; see also Walling Aff., supra note 251, at Ex. 2, Part II, p. 29 (quoting same from loan officer training manual); LaFrankie Testimony Day 2-Vol. III, supra note 309, at 35 (explaining that by describing documents this way, the loan officer put the borrowers "at ease").

\textsuperscript{344} LaFrankie Testimony Day 2-Vol. II, supra note 309, at 79; see also LaFrankie Testimony Day 2-Vol. III, supra note 277, at 36 (noting that in conjunction with disclosures, "[y]ou always want to use the word 'federal' because this made the people feel safe").
As one borrower stated in describing the settlement of his home loan, at which he signed the papers quickly, without taking the time to read them: "I was under the impression that the settlement officer is a neutral party and the D.C. government had some oversight over all settlements." Over the years since TILA was passed, about 70% of consumers surveyed have agreed with the statement that TILA "makes people more confident when dealing with creditors." This is a positive outcome when that confidence leads to decisions in the consumer's best interests. However, it is a negative one where it leads to acceptance of terms that are not in the borrower's best interests.

The unwarranted comfort that some borrowers take from their prior borrowing experience and from the federal disclosure forms is exacerbated by a surprisingly prevalent myth. According to the 2003 National Housing Survey, just over 40% of all American adults think that "[h]ousing lenders are required by law to give you the best possible rates." This erroneous belief is even more widespread among minority communities targeted by predatory lenders. Two-thirds of all blacks and over half of all English-language-dominant Latinos and three-quarters of all Spanish-language-dominant Latinos responding to the survey agreed with the statement.

The source of this myth is unclear—perhaps overoptimism about the extent of government protection or motivated reasoning on the part of borrowers who have obtained loans at high rates but want to convince themselves that the rate they received was a good one. It may partly be an artifact of consumer familiarity with both Biblical prohibitions and formerly existing legal usury caps on home loans.

The higher incidence of this misperception among minorities is not surprising, given that they are rarely given any information from lending professionals that would alert them to the fact that loan prices

345. Quarles Declaration ¶ 17, FTC Capital City Mortgage Corp., Civ. A. No. 98CV-237 (GK/AK) (D.D.C. 2004) (on file with author). Other borrowers think the settlement agent works for the borrower, an unsurprising belief given that the borrower usually pays the closing agent's fee. However, the settlement agent works for the lender. Renuart, supra note 202, at 471 & n.7.

346. Durkin & Elliehausen, supra note 163, at 129 tbl.6.


348. Many U.S. employees hold a similar myth about the extent of government protection in the workplace. Pauline T. Kim, Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protections in an At-Will World, 83 CORNELL L. REV. 105, 134-47 (1997) (relating that most at-will employees believe they are protected from many arbitrary firings that are perfectly legal and think that something closer to a for-cause standard applies).
can vary. In the recent testing of mortgage loan brokers described above, white applicants were told that they could qualify elsewhere for better, prime loan rates, but the more-creditworthy African-American and Latino applicants were offered only higher rate subprime loans. Similarly, real estate agents have been found to more frequently offer to white than minority homebuyers “reduced closing costs or lower mortgage rates through affiliated lending and service companies,” thus suggesting that rates are not required by the government to be as low as possible and are instead negotiable.  

**d. Disclosures Blame the Borrower.**—Predatory lenders have an added reason to be meticulous in giving the required disclosures, as borrowers who receive overpriced and overly risky loans are more likely to challenge the loans in litigation or foreclosure proceedings. Borrowers who claim that they did not understand the cost and terms of their loans when they agreed to them will face a lender brandishing the disclosures as a shield from any liability. When one borrower thought she was borrowing about $51,000 at 8.5%, but discovered some time after closing that a 26% loan origination fee had been added to the principal, bringing it to over $64,000, her lender’s response emphasized that she was responsible for her own undoing: “Well, Ms. Durney, the contract is signed. You signed a contract, and I thought seniors honored their contracts.” The borrower responded as the lender intended: “I felt so stupid... I couldn’t tell

350. See Kenneth R. Harney, *Agents Steer Home Buyers Based on Race, Study Says*, L.A. TIMES (April 16, 2006); cf. Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 856 (1991) (finding that car salespeople were more likely to invite price negotiations with white customers than black customers, and citing nationwide survey results that 61% of black consumers and 31% of white consumers did not realize that car sticker prices are negotiable).
352. Federal Reserve Board Governor Edward M. Gramlich has been quoted as saying: “When you hear these predatory lending stories, my initial reaction is ‘Gee, why couldn’t the borrower get someone to review the papers before they signed them?’” Paul D. Davies, *Fighting the Predators*, PHILADELPHIA DAILY NEWS, Feb. 7, 2001, at 10.
353. Transcript of Record at Day 4, Vol. 1, p. 43, Official Joint Borrowers Comm. v. Lehman Commercial Paper, Inc., No. SACV 01-0971-DOC (C.D. Cal. Mar. 2, 2003) (testimony of Velda Durney) [hereinafter Durney Testimony]. Her lender later explained to the *New York Times*: “All borrowers are given two separate three-day periods to reject the terms of the loan. She decided not to.” Henriques & Bergman, *supra* note 74, at A1 (referring to the three-day period after receiving the HOEPA disclosure, because it was a high-cost loan, and TILA’s three-day right of rescission).
anybody." Courts and regulators have been sympathetic to the argument that borrowers who are given disclosures are responsible for their own predation. The United States Court of Appeals for the District of Columbia Circuit recently agreed with the district court that no reasonable jury could find that a borrower did not understand that credit insurance was optional when the borrower had signed a form disclosing that fact. This despite the court's description of the borrower as follows:

Williams testified that he had only a sixth-grade education from the segregated schools of Savannah, Georgia, that he could read no more than 40 percent of a newspaper, ... that he thought an interest rate of 13.90 percent exceeded 13.9 percent, and that when he bought his house in 1970, he "depended on [his wife] basically to do most of [his] reading [at the closing] 'cause she had an 11th grade education." Williams also testified that during his 20-minute meeting with [the lender] to settle the loan, the loan officers neither explained the papers he signed nor gave him time to review the papers or any papers to take home.

Courts have rejected any argument that borrowers have the right to a federal mortgage price disclosure they can understand; lenders are free to provide non-English speakers with disclosures exclusively in English. Employing reasoning that could effectively prohibit the majority of home loan borrowers, particularly subprime borrowers, from collecting actual damages for violations of TILA, more than one court has held that borrowers who could not read their lender's English-language TILA disclosures could not collect damages: "Because Plaintiffs cannot demonstrate that they either read the disclosure statement or that they understood the charges being disclosed, they cannot show that they relied on the inaccurate disclosure."

354. Durney Testimony, supra note 353, at 45.
356. Id. at 744-45 (internal citations omitted). The court did, however, remand for further review by the trial court of the entire loan transaction for unconscionability. Id. at 752; see also Harrison v. Commercial Credit Corp., No. Civ.A.4:01CV151LN, 2003 WL 1844464, at *4-*5 (S.D. Miss. 2003) (unpublished decision) (holding that where borrowers did not read their loan documents, but could have done so or found someone with good eyesight to do so, they could not claim lack of knowledge that the credit insurance obtained with their loans was optional).
The Washington State Department of Financial Institutions has admitted that when it first received complaints from borrowers about one large subprime lender, Household, a lender it ultimately found to have been engaging in widespread predatory practices, it relied on Household’s claims that “borrowers were mistaken and had not availed themselves of the . . . disclosures provided during the transaction process.” The HUD-Treasury Report is uncharacteristically blunt on this point: “The fact is that written disclosure requirements, without other protections, can have the unintended effect of insulating predatory lenders where fraud or deception may have occurred.”

5. The Ultimate Escape from Decision Difficulty: Overreliance on Intermediaries . . . Who Can Manipulate More Framing Effects?

According to the brokers, [a] major determinant of profit per loan is the sophistication of the borrower relative to the sales skills of the loan officer.

—Jack Guttentag, a.k.a. The Mortgage Professor

When faced with a difficult decision involving specialized knowledge, a normally quite appropriate response is to seek the advice of an expert such as a mortgage broker or loan officer. But even without engaging in actual fraud or misrepresentation of loan terms, loan salespeople are able to frame the choices available to potential borrowers so as to exploit borrowers’ cognitive and emotional responses through individualized sales techniques. Sellers can shape borrower decisionmaking through a range of means, from taking advantage of the affect heuristic or befriending the borrower, to portraying

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359. HOUSEHOLD EXAMINATION, supra note 72, at 39.
362. Cf. GIALDINI, supra note 308, at 9 n.5 (“When feeling overwhelmed by a complicated and consequential choice, we still want a fully considered, point-by-point analysis of it—an analysis we may not be able to achieve except, ironically enough, through a shortcut: reliance on an expert.”); Latin, supra note 195, at 1299 & nn.55-57 (cataloguing situations in which people ignore written information and instead rely on explanations provided by doctors, supervisors, and salespeople). In some situations, the use of a third party for advice can decrease or eliminate framing effects. James N. Druckman, Using Credible Advice to Overcome Framing Effects, 17 J. L. ECON. & ORG. 62, 77 (2001); Jeffrey J. Rachlinski, The Uncertain Psychological Case for Paternalism, 97 Nw. U. L. REV. 1165, 1216-17 (2003) (suggesting that reliance on intermediaries such as attorneys to reframe decision problems will protect people from the harms that might otherwise flow from heuristics and biases).
loan pricing as an objective or expert matter, to engaging in pressure sales tactics.

The seller is limited to using goals that the potential borrower has or accepts during the process, but the one-on-one interaction facilitates the seller's ability to find and influence those goals and exploit them.\textsuperscript{364} For example, the lender could help a borrower meet her decision process goal of minimizing internal transaction costs by directing the borrower's attention away from unpleasant thoughts about the burden of repaying the loan. Loan seller behavior need not be consciously manipulative, but the role of the broker as currently structured is not merely to assist the borrower, but also to shape demand.\textsuperscript{365} The problem is particularly acute because loan salespeople have financial incentives to convince borrowers to agree to loans that are overpriced.

At the mild end of the spectrum, loan salespeople take advantage of automatic and often subconscious influences of the "affect heuristic" and the "reciprocity effect." The affect heuristic is a frequently subconscious tendency to confuse an emotional response felt during decisionmaking with a cognitive appraisal of the choice presented.\textsuperscript{366} Most advertising, including the "Yes!" marketing described above, aims for a positive affective consumer response. Salespeople frequently attempt to invoke the affect heuristic. A former loan broker explains the first minutes of a consumer's interaction with a loan salesperson:

[W]hile the opening conversation may seem to be idle chit-chat, rest assured—it's not. Your unguarded comments will be used to the salesperson's advantage . . . . For example, you tell the loan salesperson you want the loan to upgrade a room. He or she will ask you why, and you innocently will say that you want your daughter to have a nice new room. "Oh really, what color?" asks the loan arranger. Purple, you say.

\textsuperscript{364} Consumers are only responsive to priming (exposing consumers to a mood or behavior message so as to influence consumers' purchase decisions) when it is congruent with their current goals and needs. John A. Bargh, Losing Consciousness: Automatic Influences on Consumer Judgment, Behavior, and Motivation, 29 J. CONSUMER RES. 280, 282-83 (2002).

\textsuperscript{365} Cf. Langevoort, supra note 351, at 634 (noting stockbrokers' role in shaping demand).

Rest assured, as the process moves along, the salesperson will keep you focused and will continuously remind you that your goal is to "paint a nice new purple room." The salesman seems to understand your deepest needs, to truly care that the room is done professionally to ensure your daughter's complete happiness.

It's easy to forget that your goal is not a purple room, it's a loan at the best price and terms possible.\(^\text{367}\)

The reciprocity effect is invoked when the seller "befriends" the borrower, who then reciprocates for the seller's "kindness" with her trust and her business.\(^\text{368}\) Conventional social mores will inhibit the customer from challenging the credibility of this new "friend."\(^\text{369}\) Linguistic conventions play into the lender's hands; we say that the lender "gives" and the borrower "receives" the loan, as if the loan were a gift, rather than being clear that the lender "sells" and the borrower "buys" the loan product. Moreover, the borrower who perceives the seller as a friend will be more likely to reveal personal information, thus giving the seller additional opportunities to manipulate framing effects.\(^\text{370}\) As a former loan officer explains: "It's a dog-eat-dog world out there, and you do what you have to, to get loans . . . You don't lie to your client, but you make them feel like you're their best friend and can be trusted."\(^\text{371}\) Not all borrowers will be open to receiving the "friendship" of a broker and thus susceptible to this type of influence,

\(\text{367. }\) Brunner, supra note 146. One predatory lender trained its loan officers to engage in ancillary discussions about the borrower's family, her positive feelings about being able to pay off other debts with this loan, and her plans for what she would do with the cash she was taking out of the transaction, rather than the terms of the loan: "Build on love of family, show concern for their future. This gives you emotional leverage." Marsh Testimony, supra note 84, at 70 (quoting from lender training manual).

\(\text{368. }\) Cialdini, supra note 308, at 20-50.

\(\text{369. }\) Finkelman Testimony, supra note 325, at 63 ("[I]t's difficult to imagine that this new found friend is acting in bad faith or is trying to deceive you into doing something that is not in your best interests."); Cialdini, supra note 308, at 22-26; Langevoort, supra note 351, at 654.

\(\text{370. }\) Lenders may ask potential borrowers for detailed personal information irrelevant to the loan origination decision, precisely to use that information to create a sense of rapport and to discover the sales pitches to which the borrowers are most likely to respond. See LaFrankie Testimony Day 1-Vol. II, supra note 156, at 59-60; Walling Aff., supra note 251, ¶ 13.

\(\text{371. }\) Michael Moss, Erase Debt Now. (Lose Your House Later.), N.Y. TIMES, Oct 10, 2004, at C1 (quoting former loan officer for Aames Financial, a mid-sized lender); see also LaFrankie Testimony Day 1-Vol. II, supra note 156, at 72-73 (explaining that first steps of loan sales process are "feel good, relationship building, trust steps," followed by encouraging the borrower to "bare their soul" as to "where the pain was, " i.e., why they needed a loan).
but some segments are, particularly elderly isolated borrowers or borrowers who fear discrimination.\textsuperscript{372}

Loan salespeople can also exploit borrower deference to their expertise and the common belief that the salesperson has no discretion in the loan process. Borrowers will defer to the expertise of the broker or loan officer, in part due to a desire not to expose their own inexperience and lack of understanding.\textsuperscript{373} Although the reality is that sellers can set an individualized price for each loan to each borrower, the process is shrouded in an aura of mysterious objectivity, rather than as an open auction, so borrowers do not receive the message that they should shop for the best rate.\textsuperscript{374} By viewing the loan offer as scientifically determined, the borrower is less likely to question the price of a loan, or shop with other lenders.\textsuperscript{375} If loan prices are objective, then there is little variation in the marketplace, so why

\begin{itemize}
\item \textsuperscript{372} About 40\% of U.S. adults, and about half of all blacks and Latinos surveyed, erroneously believe that "[n]eighborhood mortgage brokers will give you a better deal than large banks and housing lenders." 2002 NAT'L HOUS. SURVEY, supra note 249, at 9.
\item \textsuperscript{373} Cf. Langevoort, supra note 351, at 653-54 (explaining that investors are unwilling to expose their inferior knowledge and avoid this by agreeing with the broker rather than challenging him).
\item \textsuperscript{374} Loan sellers encourage the idea that loan prices are objectively determined. One seller's sales script includes:

Well, let me explain to you how they go ahead and determine . . . the amount of interest that you're going to pay. It's based on what we call the three C's. The three C's are: One "C" is for credit. And your credit is pretty much what it is when you arrived at my office. It's your credit report.

The second "C" is your capability to repay. And what that is is your job, how is your income coming in; or if you're retired, your investments.

Your third "C" is your collateral—your house, your castle. What they do is they put all these things together and they come up, based on the three C's with a rate . . .

[T]he lending institution has a right, depending on the three C's to gain some type of interest.

LaFrankie Testimony Day 1-Vol. II, supra note 156, at 93, 95. While this is how loan pricing would work in a price-competitive market, it is not how predatory loan pricing actually works.
\item \textsuperscript{375} When people perceive the offers as coming from a computer rather than from another person, Sally Blount, When Social Outcomes Aren't Fair: The Effect of Causal Attribution on Preferences, 63 ORG. BEHAV. & HUM. DECISION PROCESSES 131, 134-35 (1995), or even from another person who is playing the role of an expert student loan officer, Jared R. Curhan et al., Dynamic Valuation: Preference Changes in the Context of Face-to-Face Negotiation, 40 J. EXPERIMENTAL SOC. PSYCHOL. 142, 148 (2004), they are less likely to demand that the offer be fair. Similarly, people tend to accept higher prices when they are described as being offered by a monopoly seller. See Camerer et al., supra note 169, at 18. To the extent that borrowers believe that the seller they have found is the only one who will sell to them, perhaps due to poor credit history unacceptable to other lenders, they may accept loan terms as being monopolistically set.
incur the costs of shopping? Similarly, if the loan officer or broker is the expert, how would the borrower find a better loan?

Loan sellers play on this belief; about a third of all borrowers in an industry study said their lender did not give them loan options or discuss the pros and cons of various options. Again, salespeople frequently disadvantage minority loan applicants on this score; in the 2004-2006 study testing mortgage broker treatment of white and minority home loan shoppers, “[w]hite applicants were presented twice the number of loan options—different rates, fees and structures—than were presented to African-American and Hispanic shoppers, who were often steered toward high-cost subprime mortgages.” In previous studies as well, borrowers who reported that they did not have choices in mortgage options when they obtained their loan had a significantly greater likelihood of ending up with a high rate subprime loan, rather than a prime loan, ceteris paribus.

Further, once she has chosen a seller with whom to deal, a borrower may tend to believe that her chosen third party will act fairly so as to maintain a sense of herself as having chosen the third party well. Again, linguistic conventions contribute to role confusion; although consumers do not usually refer to the sellers they frequent as “my department store” or “my restaurant,” they do say “my broker,” “my lender,” and “my loan officer.”

For a significant number of borrowers, a single broker or lender has control over the entire choice set of loan options presented to the borrower. In the 1997 Survey of Consumer Finances, only about half of the consumers surveyed who had recently obtained home equity loans reported that they had searched for information about other creditors or other credit terms before obtaining credit. Even this figure probably overstates the proportion of borrowers who engaged in meaningful price shopping—not all of those who reported that they had searched said that they did so by contacting other lenders or reviewing published information to discover competing rates; some reported that they consulted friends, relatives, or financial advisers, i.e.,

376. Howard Beales et al., Consumer Search and Public Policy, 8 J. Consumer Res. 11, 12 (1981).
378. Harney, supra note 55, at Fl.
379. Courchane et al., supra note 88, at 372.
380. Cf. Daniel Kahneman et al., Fairness as a Constraint on Profit Seeking: Entitlements in the Market, 76 AM. ECON. REV. 728, 737 & n.2 (1986) (illustrating the often unwarranted degree of trust consumers have in their own auto mechanics).
381. Canner et al., supra note 165, at 245.
brokers. For recent refinance loan borrowers, about 15% said they contacted only one lender and did not seek any other sources of information. While the failure to shop is partly caused by borrower beliefs that shopping is unnecessary and rude to do to the first seller contacted, and partly due to an unwillingness to incur the costs of shopping, it is also caused by loan seller enforcement of an unwritten industry code forbidding price shopping. When a borrower actually attempts to shop for the best price, brokers and lenders will often retaliate with anger, or even by terminating their relationship with the borrower.

Finally, a loan salesperson can try to create and take advantage of consumer “hot” states to convince the consumer to take the loan without price shopping. Under the influence of “projection bias,” related to the myopia or present-biased preferences discussed above, people overpredict the extent to which their future preferences will be the same as their current preferences. They can therefore be convinced to buy something when induced by present circumstances to highly value it, because they believe they will continue to value it in the future.

Because the loan sale transaction is typically face-to-face, sellers can try different approaches—perhaps at first emphasizing the immediate benefit that the loan will provide, trying to trade in on myopia or

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382. Id.
384. As Guttentag explains, the borrower who submits applications to multiple lenders and then takes the best offer is viewed by lenders and mortgage brokers as “the lowest form of animal life, because receipt of an application initiates a set of costly tasks on their part for which they will not be compensated if they lose the loan. If they discover what is going on, they may simply terminate their relationship with the borrower.” Guttentag, supra note 51, at 20. A friend of mine recently defied this norm by shopping with several brokers for a mortgage. The first broker she had gone to, when he discovered she had gone to other brokers, began yelling at her: “You’re shopping me! You’re shopping me! I can’t believe you’re shopping me!” as if she had done something nefarious. When she replied that if he could offer her better terms than the package she had been offered elsewhere, she would do business with him, he tried to manipulate her into agreeing to trust him and stop price shopping by saying: “I can get you a better price. But I don’t know if we can work together. I can’t really trust you if you’re shopping me.”
385. Loan officers may use the “Hearse Close” to sell loans: “Put a scare into the customer. Look what might happen to you if you don’t act.” Marsh Testimony, supra note 84, at 124 (quoting from lender training manual).
387. On-line sellers such as LendingTree sell loans to prime borrowers only, and in any case, many borrowers who are likely to end up with predatory loans are on the other side of the digital divide.
time discounting, but then if the consumer does not seem responsive, instead stressing the invasive loan application process and possible discrimination a borrower might experience from another lender, trading in on ego threats. As one loan officer testified: "It was my job to find out where [the potential customer's] hot buttons were. Was he interest-rate conscious? Or was he pain conscious about wanting the money out badly and he will pay anything, a get-me-down, so to speak. It was a matter of where his mindset was."388

A consumer who does know that prices vary might reasonably believe that she is paying her broker to price shop for her, and may even think that a loan officer plays a similar role.389 Unfortunately, the compensation scheme for loan officers and brokers can reward behavior that is not always in the borrower's best interests.390 Some loan officers earn only commissions, which may be explicitly tied to the size of the loan origination fees the officer can pack into the loan.391 Others may receive a base salary but also bonuses when they sell ancillary products that are particularly profitable for lenders, such as single-premium credit insurance.392

Brokers—used today in over 60% of all mortgage transactions393—have compensation schemes even more obviously bound to overpricing. "Yield spread premiums" (YSPs) are a payment to the broker from the lender for upselling the consumer to a higher interest rate than the lowest rate at which the lender would be willing to

388. LaFrankie Testimony Day 2-Vol. II, supra note 309, at 32. One lender even had a response planned for any borrower who did not want to decide whether to take the loan until she prayed about it: "Do you think you were sent here by accident?" Marsh Testimony, supra note 84, at 124 (quoting from loan officer training manual).

389. Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, 67 Fed. Reg. 49,134, 49,141 (proposed July 29, 2002) (codified at 24 C.F.R. pt. 3500) [hereinafter, Simplifying RESPA] (borrowers believe their broker is price shopping for them). Even a loan officer working for a single lender may portray himself as looking out for the borrower’s best interests in the loan origination process. See Marsh Testimony, supra note 84, at 81 (quoting loan officer training manual: "Identifying the real purpose [for the loan] and problem [the borrower seeks to solve with the loan] puts us in partnership with the customer. We are all working together to solve the problem . . . . We’re not sales people. We’re problem solvers.").

390. Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums Before the S. Comm. on Banking, Housing, and Urban Affairs, 107th Cong. 55-56 (2002) (statement of Howell E. Jackson, Professor of Law and Associate Dean for Research and Special Programs, Harvard University School of Law) [hereinafter Jackson Statement].

391. Walling Aff., supra note 251, ¶ 10 (explaining that loan officer salary was calculated primarily based on selling loans with origination fees exceeding fifteen points for small loans and eleven points for larger loans).

392. 2001 Sen. Hrg., supra note 77, at 265-66 (statement of Mike Shea, executive director, ACORN Housing) (explaining that lenders have incentive to profit from add-ons).

393. Simplifying RESPA, supra note 389, at 49,140.
extend the loan.\textsuperscript{394} YSPs give brokers an incentive to sell the borrower loans at the highest interest rate possible, rather than helping the borrower shop for the lowest interest rate.\textsuperscript{395} No nationwide data on YSPs is available, although several sources indicate that they are common.\textsuperscript{396} One study found that, for the lenders analyzed, YSPs occurred in about 85\% of the loans, averaged about 1.5\% of the loan amount or just over $1800, and were by far the largest component of broker compensation, larger than the combined total of average origination fees and average loan processing fees collected by brokers.\textsuperscript{397} Moreover, for the loans analyzed, African-American and Latino borrowers paid about five to six hundred dollars more in YSPs than all borrowers on average.\textsuperscript{398}

That brokers and lenders charge borrowers through YSPs rather than through up-front fees—in effect, re-framing the loan price through the loan structure—shows that they are aware of and seek to exploit the behavior of borrowers to attend to interest costs over time. Myopic loss aversion, time discounting, the evaluability bias, and a poor facility with percentages result in some borrowers weighting an up-front broker fee more heavily than a larger price increase extracted through the interest rate. Such a borrower might find, for example, a $1000 up-front broker fee on a thirty-year, $100,000 mortgage at 7\% more salient than the extra $1000 due every year on a

\textsuperscript{394} The lowest rate at which the lender would be willing to originate the loan, called the "par rate," is the rate that the lender's modeling of the borrower's risk and cost levels indicates is necessary for the loan to generate the lender's expected return. Sometimes the "par" rate already includes a YSP, but the broker can sell up or down from that rate and receive a smaller or larger YSP.

\textsuperscript{395} These are frequently "disclosed" to the borrower on the HUD-1, among dozens of lines of items, through a notation "POC" followed by "YSP" and a dollar amount. The borrower would have few ways of knowing what any of these mean—the settlement costs booklet that RESPA requires borrowers be given and the commonly used on-line glossaries for mortgage terms at fanniemae.com, freddiemac.com, or hud.gov do not explain them—and if she asks about them, the settlement agent can truthfully explain that they are not listed as items on the seller's side of the ledger sheet, not coming out of the borrower's pocket. See Jackson Statement, supra note 390, at 74 \& n.112 (recounting how difficult it is to locate YSPs on HUD-1 Settlement Statements, where they are disclosed at all).

\textsuperscript{396} Guttentag, based on data collected from brokers who were willing to share records from about 800 loans they originated in December 2000 and January 2001, found that about 60\% of these loans carried YSPs. Guttentag, supra note 51, at 7 \& 16 n.13. (Note that he calls YSPs "rebates" and the rate increases formulated based on YSPs "rebate pricing.")

\textsuperscript{397} Jackson Statement, supra note 390, at 73-80 (analyzing comprehensively a number of lenders' files obtained through litigation). Jackson does find, on average, some offsetting compensation to these borrowers in the form of about $0.25 in reduced costs for every dollar paid in YSPs, such that the actual average additional cost to a borrower with a loan with a YSP in the sample was closer to $1000 to $1100. Id. at 127.

\textsuperscript{398} Id. at 125 fig.23, 128.
thirty-year $100,000 mortgage at 8.22%. YSPs are some indication that borrowers do pay some attention to origination fees and costs, even when these are financed directly, and thus a broker may use the interest rate to hide what might otherwise be an objectionable fee.

But brokers might also prefer to receive a YSP over a financed fee not because borrowers would price shop over the fee amount per se, but because a disclosed fee would undermine the fiction that the broker is the borrower’s friend, acting to help the borrower rather than for his own financial gain. A borrower who realizes that the broker has financial motives not aligned with the borrower’s best interests might look the purported gift horse in the mouth and realize she should shop not only for a lower broker fee, but for the total price of the loan.

IV. SOLVING THE PRICE PROBLEM

A. Why the Market Will Not Solve the Price Problem

1. Exploiting Information Asymmetries: The Profitability of Price Discrimination.—In some market transactions, only a minority of consumers need to act in accordance with the postulates of rational choice theory for the entire market to function close to efficiently, with most transaction surplus going to consumers. Where the cost to the seller of engaging in price discrimination between customers is higher than the benefits to be gained from that discrimination, the result will be goods and services of uniform price and quality, set by the choices

399. A $100,000, thirty-year fully amortizing loan at a fixed rate of 7% requires monthly payments of about $665, whereas the same loan at 8.22% requires monthly payments of about $750 for an annual difference of about $1000. A similar phenomenon has been observed in credit card pricing; lenders charge high interest rates rather than up-front annual fees or per-transaction fees to consumers, even though lenders incur up-front and per-transaction costs, because borrowers are sensitive to these fees, but insensitive to interest rates. Bar-Gill, supra note 6, at 1392-93.

400. A recent FTC study supports the wisdom for the broker of hiding his fee in the interest rate through a YSP. The study found that when consumers were faced with one loan disclosure in which the broker fee was disclosed as a dollar figure and another in which it was hidden by a YSP, consumers were more likely to choose the latter loan, and to state that it had a lower price, even when the price of the latter loan was higher! In effect, disclosing the broker’s compensation as a dollar figure caused borrowers to make price decision errors and choose the loan with the higher APR. Lacko & Pappalardo, supra note 224, at 49. If loans with YSPs in the real world have higher prices, then this “error” could lead to good loan decisions. However, if brokered loans have lower prices, then the disclosure would hurt borrowers.

of a few rational price shoppers. When the products are reasonably homogeneous in their pricing and terms, consumers who have not engaged in rational decisionmaking can shop in the wake of those consumers who have, and can benefit from the prices and terms that the minority of shoppers have set. To the extent that the wake-riding consumers share the same utility functions as the price shoppers, the wake-riding consumers will also engage in efficient transactions and keep any transaction surplus, plus the costs they have saved by not engaging in comparative shopping. The prime home loan market appears to have traditionally functioned this way.402

In the subprime home loan context today, however, the benefits to the loan sellers of engaging in price discrimination based not only on cost factors such as the default and prepayment risk presented by the borrower, but also on borrower vulnerability to taking overpriced loans, outweigh the costs of price discrimination.403 A lender who can sell a borrower an overpriced loan has no financial incentive to sell that borrower a competitively priced loan. The “informed minority” of rational price shopping borrowers has no effect on any of the terms a vulnerable borrower receives because the benefit to the lender of setting individualized contract terms outweighs the costs. Therefore, lenders and brokers carefully differentiate among borrowers.404

Lenders today are able to discriminate between vulnerable borrowers and price shoppers in part due to the same technological advances in data mining and information processing that make objective risk-based pricing possible and that help to widen the availability of competitively priced credit to previously excluded groups.405 Lenders

402. HUD-Treasury Report, supra note 46, at 17. It is thus unsurprising that prime rates are highly competitive, even though there is nowhere near universal price shopping by prime borrowers. Of those consumers who had recently obtained second mortgage loans in the 1997 Survey of Consumer Finance, only about half reported trying to do any price or term shopping. Only about half of those claimed to have “shopped other institutions” and less than half said they consulted “media or printed sources.” Durkin & Eliehausen, supra note 163, at 131, 132 tbl.7. Note, however, that the prime market may be becoming more like the subprime market. See supra note 50.

403. Cf. R. Ted Cruz & Jeffrey J. Hinck, Not My Brother’s Keeper: The Inability of an Informed Minority to Correct for Imperfect Information, 47 Hastings L.J. 635, 672-74 (1996) (explaining how even in the market for less profitable items, sellers are often able to differentiate among buyers and provide them with different terms, such that the “informed minority” of savvy shoppers does not set the terms that will be offered to the more vulnerable buyers).

404. Cf. Ayres, supra note 350, at 845 (“If a [car] dealership can infer that a black or a woman is less likely to search at other dealerships, it may rationally attempt to charge him or her more. If a consumer’s cost of searching at more than one dealership is prohibitively expensive, the dealership may realize that, as far as that consumer is concerned, it has a virtual monopoly.”); Cruz & Hinck, supra note 403, at 672-74.

405. For a fuller description of these technological advances, see supra Part I.A.2.
now have the capability to know more than most borrowers about the price that a borrower is likely to pay for any given loan over time, the costs the lender is likely to incur, and the borrower's risk of default and prepayment. That individual borrowers frequently know less about their own risk of default than lenders do in part due to the heuristics, biases, and emotional coping mechanisms, explained above. But it is also due to the frailty of subjective human forecasts of risk and future performance generally and the more accurate assessments made by data-driven regression analyses. As described above, such analyses are used by lenders in their objective credit scoring models for assessing risk. In every test that pits subjective human judgment of manual loan underwriters against automated objective credit scoring models, the objective models win.\(^{406}\)

While the law now requires that consumers be given access to their credit reports,\(^{407}\) and consumers today can buy their credit scores,\(^{408}\) borrowers, unlike lenders, have no way of translating their score into a determination of future risk and costs for any particular loan. The models that transform credit score and other borrower, loan, and collateral information into a prediction of loan performance are proprietary to the lenders.\(^{409}\)

Thus, asymmetric information and adverse selection assumptions have begun to run in the opposite direction from the Stiglitz-Weiss credit rationing model explained above. With access to greater information, originating lenders now have the ability to do the "selecting" by hunting for borrowers who are particularly vulnerable to taking loans that are profitable to the lender but not necessarily in the borrowers' best interests.\(^{410}\) Lenders search for borrowers who have good credit histories but have taken loans from high-cost lenders in the past,\(^{411}\) who are under stress due to past due credit card, property tax, and so on.

\(^{406}\) Straka, supra note 20, at 219-21; see also Robyn M. Dawes & Bernard Corrigan, Linear Models in Decision Making, 81 PSYCHOL. BULL. 95 (1974) (finding that objective modeling consistently produces better predictions of performance than subjective human judgment).

\(^{407}\) This is required by the Fair Credit Reporting Act (FCRA), 15 U.S.C. § 1681g (2000).


\(^{409}\) See Ross & Yinger, supra note 17, at 23 (calling prediction of loan performance an "origination score").

\(^{410}\) That risk in the home loan market is better understood by lenders than by borrowers parallels Kunreuther's insight that risk in the flood insurance market is better understood by insurers than by insureds, such that adverse selection on the part of insureds is unlikely to occur. See Mark J. Browne & Robert E. Hoyt, The Demand for Flood Insurance: Empirical Evidence, 20 J. RISK & UNCERTAINTY 291, 296 (2000) (explaining Kunreuther's insight).

\(^{411}\) See supra Part III.B.2.b.
and medical bills, or who are members of vulnerable groups. In the process of deciding to provide financial backing to a lender, Lehman Brothers described that lender's marketing practices as follows:

The true value of this firm . . . is its ability to find its customer. [The firm] is absolutely amazing at ferreting through large databases in order to find its target customer . . . .

Using information purchased from tax assessors, municipalities, recordation offices, Data Quick, and Multiple Listing Service ("MLS") they identify the subset of borrowers who have been in their home greater than five or ten years and have an inferred value of between $85,000 and $350,000. The value can be inferred through prior sales or through extrapolation of the property tax rate.

Next using information from the major credit repositories (Trans Union, Equifax, Experian) the subset above is screened for high consumer debt and the existence of a competitor's loan.

At the end of this process [the firm] has a list of potential borrowers with high consumer debt and significant equity in their properties.

Based on the algorithm presented above, . . . [t]he average age of the borrowers . . . is fifty-eight years old.

By discriminating between rational price shoppers and vulnerable borrowers, lenders can sell more expensive loans to the latter. Therefore, a significant portion of the home loan borrowing market cannot shop in the wake of price terms set by other shoppers. Each of these consumers must engage in comparative price shopping on their own to be assured of obtaining a loan that is not overpriced.

2. Lack of Price Advertising.—Prime borrowers are assisted in the price shopping process by the advertising of prime lender rates, but

412. See supra Part III.B.1.b.
413. As researchers at the Federal Reserve Board have opined:

Technological advances have . . . increased the capacity for targeted marketing to consumers, with robust databases of consumer information making it possible to match household characteristics and preferences with product offerings. This application of technology can promote competition and improve customer service. However, its misuse can increase consumer vulnerability to unscrupulous lenders. Questionable marketing and sales tactics may induce consumers to acquire products that they do not need or that are inappropriate for their circumstances.

Braunstein & Welch, supra note 108, at 446; see also Paul D. Davies, Anything for a Deal, PHILADELPHIA DAILY NEWS, Feb. 6, 2001, at 8 ("Rather than cold calls, brokers can buy customized lists of potential borrowers . . . by ZIP code, age, race and income.").

there is little price advertising in the subprime market. This is be-
cause, as explained in Part I above, subprime loan pricing, even if it
were price competitive, would still be too complicated to convey in an
advertisement. A subprime borrower, or someone who thinks she is a
subprime borrower, is left without good price reference points to use
for price shopping.\footnote{415} Although a subprime borrower can discover
prime rates in the newspaper, she has no idea how much more than
prime she should have to pay. When people do not have the means to
directly evaluate alternatives, a common decisionmaking strategy is to
appraise their own relative location in the population's distribution
and then choose an alternative that corresponds to that same relative
location.\footnote{416} The only reference point subprime borrowers have is
prime rates, not a menu of subprime rates. Even within social groups
of subprime borrowers, many people do not discuss finances, and
even when they do, their own understanding of their loans may be so
faulty that the information is not useful for another borrower.

Advertising that touts "low rates," "low fees," "guaranteed lowest
price," or even "we'll beat any price," rather than particular APRs, can-
not generate price competition because lenders cannot be held to
these promises. For a subprime loan applicant to prove that she had
been offered a loan that was not the lowest priced, she must reach the
point in the transaction when all components of the price are dis-
closed in a legally binding document. For refinance loans not cov-
ered by HOEPA, this does not occur until the borrower reaches the
settlement table; for high-cost HOEPA loans or purchase money
loans, it happens only three days earlier.\footnote{417} Our borrower would also
have to reach or nearly reach the settlement table with another seller
at the same time, because prices change rapidly. All the reasons bor-
rrowers do not currently apply to multiple lenders to price shop pre-
vent this from occurring. No lender will find it in its interest to assist
our borrower shopping by giving her complete and binding price in-
formation about the loan early in the process because that would only
open up the possibility that the borrower will find a cheaper loan
elsewhere.

\footnote{415. Cf. Dan Ariely et al., "Coherent Arbitrariness": Stable Demand Curves Without Stable Pref-
erences, 118 Q.J. ECON. 73, 100 (2003) (explaining parallel situation for wage earners, who
have little internal valuation of their time, little idea what competing wage rates are availa-
ble, and so must judge their wages primarily in relationship to their own past wages).

\footnote{416. See, e.g., Drazen Prelec et al., The Role of Inference in Context Effects: Inferring What You
Want from What Is Available, 24 J. CONSUMER RES. 118, 118 (1997); Birger Wernerfeld, A
Rational Reconstruction of the Compromise Effect: Using Market Data to Infer Utilities, 21 J. CON-

\footnote{417. See supra Part II.B.}
Sellers know that price is not a top concern for significant market segments. More importantly, sellers benefit from keeping borrowers in the dark about subprime loan prices. Without reference points for what loan price to expect, subprime borrowers generally must rely on the loan prices offered to them by lenders, who know much more about what prices are available in the marketplace for each borrower’s risk and cost profile. In a sense, adverse selection is turned on its head—the lenders are doing the adverse selection here, picking buyers who will generate the highest surplus to the lenders. No lender or broker will find it in its interest to advertise and then offer low prices to vulnerable borrowers, because these borrowers will accept higher prices. Further, because broker and loan officer compensation is tied to selling overpriced loans, they have an incentive to sell borrowers a larger loan than the borrower needs, at a higher price than otherwise available on the market.

3. Competitive Pricing Unnecessary to Keep Customer.—In theory, lender anticipation that borrowers with overpriced loans will refinance elsewhere could lead to interest rate competition. In practice, however, up-front fees, prepayment penalties, and borrower nonresponsiveness to interest rate changes all prevent refinancing from taming the overpricing problem.

First, fear of refinancing will not lead to competition over prices for up-front fees, because fees are not refunded if the borrower refinances. As explained above, such fees can be a large share of the price of the loan in the subprime market.

Second, large prepayment penalties—a certain loss that can be conveyed by the lender to the borrower in an easily understood whole dollar amount—can deter refinancing. This particularly has been used as a tool to trap borrowers in high-interest rate loans in the subprime market, where, as explained above, prepayment penalties are dramatically more common.

Third, subprime refinancings are not very responsive to interest rates. Although prime refinancings mirror market rate changes, subprime refinancing activity is fairly flat, driven by cash-out refinancings

418. Recall that in a list of areas of competition among subprime lenders, one lender listed loan price components last, after, e.g., “convenience in obtaining the loan” and “marketing and distribution channels.” New Century Fin. Corp., supra note 278, at 18.
419. See supra Part III.B.5.
420. See Guttentag, supra note 275, at K5 (“[L]enders never refund fees to borrowers.”).
421. See supra text accompanying note 202.
rather than by rate refinancings.\textsuperscript{422} This is also true of low-income, black and Latino borrowers generally—they are less likely to prepay and refinance when it is in the money to do so \textsuperscript{423} than white or higher-income borrowers.\textsuperscript{424} Blacks are only one-fifth as likely as whites to prepay when prepayment is in the money or one-half as likely after controlling for, e.g., credit history and LTV ratios.\textsuperscript{425} Borrowers with lower credit scores are both less likely to prepay when interest rates decrease and more likely to prepay even when facing a higher interest rate environment than borrowers with higher scores.\textsuperscript{426}

The dearth of rate refinancing may in part be due to the predatory servicing practices of some subprime lenders, who refuse to give borrowers payoff statements or to report borrowers' positive credit histories to the credit reporting agencies to prevent refinancing. More mundane switching costs may also play a role. But it is also no doubt due to the same reasons that lead some of these borrowers to take overpriced loans in the first place—e.g., an unwillingness to be subjected to another financial strip search in applying to a new lender, a low level of knowledge about available interest rates, and lack of an appreciation of the effect of small changes in interest rates.

4. Financial Education Is a "Public Good."—Finally, no lender has an incentive to provide consumers with the financial education needed to enable price shopping. Any seller that educates a potential borrower who would otherwise agree to an overpriced loan will find itself with one less opportunity to extract rents in the form of a higher price from that borrower. Consumers' dearth of financial education


\textsuperscript{423} Meaning interest rates have fallen sufficiently that the borrower will save more money on interest after refinancing than she will spend on the costs of refinancing.

\textsuperscript{424} See Robert Van Order & Peter Zorn, \textit{Performance of Low-Income and Minority Mortgages, in LOW INCOME HOMEOWNERSHIP} 322, 323-24 (Nicolas P. Retsinas & Eric S. Belsky eds., 2002) [hereinafter LIHO] (discussing the financial importance to the lender or loan investor of prepayment risk in addition to default risk).

\textsuperscript{425} Id. at 330 & tbl.11-1, 336-37 & tbl.11-5.

adds to the seller’s temptation to price gouge. People can be strongly influenced in how they judge and decide when they are in learning situations, and so the potential for both helping and manipulating people in such situations is enormous.427 Lack of pre-existing knowledge means the loan shopping process is a learning situation in which consumers are particularly vulnerable to influence by the way in which the seller of the loan presents information and advice.

Financial education is also a “public good” in the economic sense. If one lender were to provide financial education to consumers, those consumers would not be required to give the teaching lender their business. Instead, those consumers could—and with their newfound education presumably would—go to a rival lender that, not having spent its resources on consumer education, would have lower costs of production and could therefore undercut the loan price being offered by the teaching lender.

Yet any entity other than the loan seller, such as the government or consumer groups, will have difficulty reaching the borrower at the “teachable moment” when financial education could have any effect.428 Financial education is notoriously difficult to do effectively in the abstract. Studies repeatedly show little long-term positive effect of financial education on consumer behaviors.429 Small positive effects in the home loan education area have only been shown for in-person pre-loan counseling—even telephone counseling was ineffective.430 The amount of resources that the government or nonprofits would have to provide to achieve this education would be enormous. Providing a personal loan shopper to assist every borrower in the market might work to assure price shopping, but we lack the resources to pub-

427. See Hillel J. Einhorn, Learning from Experience and Suboptimal Rules in Decision Making, in JUU, supra note 166, at 268, 269.

428. Although requiring home loan applicants to receive pre-loan financial counseling at the time of loan decisionmaking would help some borrowers, it would be a waste of resources for other borrowers. Voluntary counseling from community groups is already available in many communities, but many of those for whom it might be most helpful are likely to opt out so as to use that time for, e.g., working more hours to meet loan payment requirements. See Hilgert et al., supra note 93, at 319 (finding that financial learning through courses or seminars was less popular with consumers with lower financial knowledge than with those with more knowledge).

429. For an overview of recent research, see Braunstein & Welch, supra note 108, at 450-53.

430. Abdighani Hirad & Peter Zorn, Prepurchase Homeownership Counseling: A Little Knowledge Is a Good Thing, in LIHO, supra note 424, at 146, 146-47. Note that although this study kept all observable borrower characteristics constant, it could not keep the most important variable constant—borrower motivation and time to devote to having a successful loan experience—because borrowers self-selected as to whether they wished to receive the pre-loan counseling.
licly fund such services, and the provision of this service in the private market—brokers—has thus far proven to be unreliable.

Borrowers are unlikely to learn price shopping skills on their own. Consumers know that high financial and personal stakes are involved, thus motivating them to exercise a high degree of care in the decision. But learning requires more than high stakes and motivation; it requires accurate information at a level of specificity such that the decisionmaker will recognize how to apply the lesson to the loan price shopping situation. The home loan borrowing process is not a frequently repeated game for most. Lessons learned even a few years ago may no longer be useful—or could even be counterproductive—to consumers facing a new loan market today. With few opportunities to learn decision strategies from the process, consumers are unlikely to reach an equilibrium maximizing decision strategy.\footnote{431}

The single most important source of learning is a difficult financial experience.\footnote{432} But even a borrower who is “flipped” from predatory loan to predatory loan may not learn. Because the ultimate bad outcome is delayed by refinancing, it is difficult for the borrower to attribute the problem to any particular aspect of the loan choice, and the lender will give misleading feedback to the borrower to indicate that the borrower has not made a bad decision.\footnote{433}

A 2003 focus group study of African-American and Latino high- and middle-income households that had recently applied for a home mortgage found that “[t]hose [borrowers] who thought that something was not fair about their mortgages had a hard time identifying particular elements that were not fair, since [these borrowers] tended to be those with the least expertise and general knowledge about the [home loan] process.”\footnote{434} Without being able to pinpoint what was unfair, these borrowers will have difficulty learning how to modify

\begin{footnotes}
\item[431] See Colin F. Camerer & George Loewenstein, \textit{Introduction to Advances in Behavioral Economics} 3, 8 (Colin F. Camerer et al. eds., 2003) (noting that important aspects of economic life are often more like the first few rounds of an experiment rather than the last).
\item[432] See id. at 8-9.
\item[433] See Tversky & Kahneman, \textit{supra} note 112, at 221-22 (listing factors that prevent the learning needed to counteract biases and over-reliance on heuristics); Rabin, \textit{supra} note 167, at 31-32 (discussing evidence that people do not easily or quickly overcome biases through learning); see also Jason J. Kilborn, \textit{Behavioral Economics, Overindebtedness, and Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions}, 22 \textit{Bank. Dev. J.} 13, 23-24 (2005) (arguing that consumer education is not a useful policy device to prevent borrowers from entering into credit transactions that result in more indebtedness than is in the consumers' best interests).
\item[434] RIHA, \textit{supra} note 205, at 9.
\end{footnotes}
their home loan decisionmaking in the future to avoid whatever the problem was with their prior loans.

B. Why Should We Care About Overpriced Home Loans?

One story that could be told about overpriced home loans is that they may not be competitively priced, but they are still welfare-enhancing transactions for the borrowers. The hypothesis would be that the issue on the price side is just a question of who gets the transaction surplus—the lender would sell the loan at 8%, the buyer would buy at 20%, so if the loan is originated at 12% the borrower is capturing most of the surplus. But to say that the borrower's reservation price is 20% is difficult to do. As explained above, we have reason to think that the borrower does not understand the price of the loan, so we cannot use her assent to the loan as a measure of her preferences. So we must suspect that some borrowers are paying more than their reservation prices, resulting in an inefficient allocation of resources.\textsuperscript{435}

Moreover, to the extent that the issue is a question of distribution of the transaction surplus, giving the surplus to lenders results in regressive income redistribution. As explained above, victims of predatory lending are disproportionately African-American, Latino, and low- to moderate-income households that already have fewer financial resources to spare and lower homeownership rates. It is distributionally unfair across borrowers to say that prime borrowers get to keep transaction surplus and subprime borrowers do not. While we might not care who gets the surplus on a box of breakfast cereal or a tube of toothpaste—other overpriced products that come in an infinite and dizzying array of choices—home equity is too important a component of wealth for us not to care distributionally that the lender gets it. As cited above, the median wealth of an African-American family in the 2000 Census was $7500, with over 60% held in home equity. Predatory loan overpricing is estimated to cost households annually $3800, enough to reduce that wealth to zero in two years.\textsuperscript{436}

Finally, we have the same socially inefficient costs as we find in monopoly pricing: the deadweight loss of consumers who borrow less than they efficiently should because they see inflated prices in their

\textsuperscript{435} This could be true in theory for a competitively priced loan too, but there is even more reason to suspect it for a high priced loan.

\textsuperscript{436} See supra Part I.A.3.
communities, and the costs of rent-seeking, expensive ploys to grab market share despite rather than because of loan prices.

The rent-seeking costs in this market are particularly absurd. All of the methods described above that lenders use to find vulnerable borrowers are expensive. The archetypal predatory lending marketing plan is to buy a truck and supplies and go around neighborhoods of older housing stock selling home repairs—and home loans to cover those repairs—to little old ladies. Other "search costs" include live check gimmicks, befriending socially isolated potential borrowers such as the elderly, searching courthouse records for homeowners who are in foreclosure or behind on paying taxes, and buying lists of homeowners who owe medical debt or who recently have been turned down for credit. "Push marketing" like this is expensive, and not only to the sellers; the targeted consumers who do not take the bait are put to the annoyance of a high volume of telemarketing calls, junk mail advertising, and even door-to-door sales calls. The extensive one-on-one interactions with potential borrowers that loan salespeople use to manipulate borrower decisionmaking require significant time, and therefore money. A sales training manual for one predatory lender explains: "These loans are sold, not bought."

C. Why Not...

1. Why Not Price Controls?—Price controls, whether the old usury caps or a more modern floating cap that moves with an index, are

437. Cf. Ayres, supra note 350, at 850-51 (explaining one effect of the fact that car dealers fail to offer black consumers prices that are competitive with the prices they offer white consumers: "[I]f sellers refuse to bargain seriously with blacks because they believe that blacks generally are too poor to purchase cars, then in equilibrium blacks will continue to fail to purchase cars—because of inflated, nonbargained prices. That failure will only reaffirm the sellers' original mistaken belief.").


439. See supra Part III.B.1.b, Part III.B.2.a; see also Renuart, supra note 202, at 480.

440. One homeowner targeted for subprime loans relates her experience:

After the second home equity loan, I kept getting things in the mail from this company, as well as phone calls. It seemed like every time I opened the mailbox, there was something from them. They sent me these checks, telling me I was cleared for $3,000 in credit or $1,500 in credit, and all I had to do was cash the check. They were always telling me that I was a good customer and my credit was good with them.


441. See supra Part III.B.5.

problematic for a number of reasons. First, substantive limits on interest rates are not an appropriate remedy for the problem of overpriced loans because loan instruments are so malleable that any limit on one aspect of price can be evaded through restructuring the loan. Second, the price of home loan money will vary with many macroeconomic factors over time, such that an absolute limit could constrain appropriately priced lending when interest rates rise. Third, even if an indexed rate were chosen as a price limit, some loans at high prices in comparison to indexed rates can be appropriately priced, depending on the specific situation; for example, a small loan would, due to the cost of making and servicing the loan, be appropriately priced at a rate higher than a large loan. That is, some high-priced home loans are not overpriced, are not predatory, and serve a valuable role for consumers who would otherwise be forced to use even higher-priced credit sources such as credit cards or payday loans.\footnote{A fairly high indexed price limit—for example, 10% over the comparable Treasury bill rate—would stop the grossest overpriced loans without preventing appropriate loans from being made, because there are probably few if any home loans at this high a rate that are predatory.\footnote{But this cap would not protect borrowers from overpricing below the worst cases.}}

Any attempt by the government to create a pricing cap matrix tailored to different loan, collateral, and borrower characteristics is doomed to create bizarre marketplace distortions. The conditions supporting each element in the matrix and the marketplace's knowledge about those conditions will vary from the government's assumptions, particularly over time. The government, with its cumbersome notice and comment process for every rulemaking, is simply incapable of acting with the swiftness and agility of today's consumer credit markets. It also lacks the necessary data and political incentives to do so well.

2. Why Not Suitability Standards, Unconscionability, Fraud, or Broker Fiduciary Duties?—Obvious possible solutions for the problem of pred-

\footnote{Cf. Collins et al., \textit{supra} note 36, at 5 (listing the benefits of home mortgage loans versus other types of financing).}

\footnote{A small home loan might be competitively priced this high, because many of the costs of lending are fixed. Such a small home loan is unlikely to be appropriate, however, because the high fixed costs of home loans means it makes more financial sense to obtain that amount of credit through unsecured short-term credit card or payday loans. If the truly competitive market rate for a reasonably sized home loan is this high, then my sense is that the risk of default is also very high, making this too risky a loan. The problem of overly risky loans will be more fully addressed in a future article.}
atory overpricing would include unconscionability doctrines, suitability standards, or broker or lender fiduciary duties. Even if a defendant could not defeat any of these claims by presenting the federally required loan disclosures, they all suffer from similar flaws. First, they are all enforceable only through the back end, after the borrower has taken the loan. Second, none gives the secondary market any reason to discipline lender behavior. Third, all are indeterminate subjective standards that are often prohibitively expensive to pursue legally.

Some predatory home loans have been found unconscionable, but based on being overly risky rather than being overpriced. Weighing against a finding of procedural unconscionability will be the fact that most of these borrowers have been through the home loan transaction at least once before when they purchased their homes and are thus not utterly unsophisticated parties. Weighing against substantive unconscionability will be the fact that high prices are widespread, rather than outside the norm in the market. But even where unconscionability or even fraud is found, they are only remedies at the back end, thus only available to borrowers who have the fortitude to pursue them after the loan transaction has been completed and typically when the borrower is being threatened with foreclosure. Further, the investors fueling this lending are given no stake in the matter—no "skin in the game"—because the holder in due course doctrine will protect most from any unconscionability claims.

With the modern home loan having so many of the attributes of an investment in a security—complicated and difficult-to-assess risks and costs, yet also capable of growing savings for retirement or other needs in the form of a gradual increase in equity—an elegant fix would be to borrow from the suitability standards applicable to securi-
ties brokers, as suggested by a number of commentators. A suitability violation occurs when an investment made by a broker is inconsistent with the investor's objectives, and the broker knows or should know the investment is inappropriate. Know-your-customer rules are implicit in the suitability doctrine, in that the broker must know the investor's experience level, risk-preferences, and capacity for risk in selecting appropriate investments to make for the investor. Parallel to the securities context, Patricia Engel and Kathleen McCoy have suggested that a suitability doctrine be developed for home lending using an administrative body. This body would establish guidelines for what price levels are suitable for different borrowers, and to what lengths brokers and lenders must go in getting to know their borrowers before advising them on which home loan, if any, to select. Decisions would be better made at the administrative level rather than through price caps enacted by legislation, because an agency can be more flexible and responsive to changes in the market.

But a suitability standard would pose numerous hurdles: (1) the borrower must realize the loan was overpriced and initiate enforcement; (2) enforcing the standard would consume significant judicial or administrative resources in determining the "correct" price for the loan; and (3) a standard, rather than ex ante disclosure rules, is more difficult to use in passing liability on to the secondary market. Further, the political will to form what might plausibly be described as an SEC for vulnerable, disproportionately low- and moderate-income and nonwhite borrowers, seems lacking. Even if HUD, for example, were to create a sub-agency to perform this function, there is the risk that suitability would, like unconscionability, remain too undefined a term for tractability.

Placing a fiduciary duty on brokers or originating lenders—a step that has been taken in some jurisdictions already—suffers from many of the same problems as a suitability standard. Imposing the duty on the brokers and originating lenders alone will not work, be-

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449. E.g., Engel & McCoy, supra note 67, at 1337-39; Daniel S. Ehrenberg, If the Loan Doesn't Fit, Don't Take It: Applying the Suitability Doctrine to the Mortgage Industry Eliminate Predatory Lending, 10 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 117 (2001).

450. Susan Wachter, Price Revelation and Efficient Mortgage Markets, 82 TEX. L. REV. 413, 416 (2003) ("The solution is not to create an ill-defined national legal standard that, in its uncertainty, may chill the willingness of lenders to lend to any but the most creditworthy of subprime borrowers.").

cause they can set up shop and move at will. But passing liability on to the secondary market will be barred by the holder in due course doctrine. It would be difficult legally to abrogate the doctrine with a fiduciary duty, because investors have little means to discover whether the duty has been met. Even if liability were passed on, imposition of fiduciary duties will not take us all the way home—courts must then ask what price a fiduciary can charge. While fees far out of the norm for the area might be found a violation of the duty, judges abhor such line-drawing. Finally, it is difficult to imagine how a borrower would know that the fiduciary duty had been violated and bring suit, prior to some kind of crisis with the loan.

D. A Proposal to Facilitate Price Shopping

The success of stores like Kmart and Wal-Mart is ample evidence that consumers in the United States, even those with low incomes and little education, will price shop, if enabled and encouraged to do so. To do this, the practical, cognitive, and emotional transaction costs of price shopping must be radically reduced.

Home loans need to be simplified and standardized, and disclosures need to be provided earlier in the process, such that the vast majority of home loan borrowers would price shop. We need to move to simpler and more standardized loan products because only easily understood pricing, in conjunction with disclosures that make that pricing easily observable early in the process, can lead to effective price shopping.

My proposal, for home loans other than purchase money loans and in-the-money refinancings, is to:

1. provide a simplified price shopping disclosure to the borrower early in the shopping process;
2. substantively limit the structure of these loans such that the simplified disclosure would provide all the information needed to price shop; and

452. See Deborah A. DeMott, Beyond Metaphor: An Analysis of Fiduciary Obligation, 1988 Duke L.J. 879, 923-24 (explaining that imposition of a fiduciary duty means nothing without further substantive rules about actions the fiduciary should and should not take).
453. Because more creative financing may be reasonable to get someone into a home purchase, and because creative loan structuring tends to be predatory only in the nonpurchase money market, my price proposal would not apply to purchase money loans. In-the-money refinancings—refinancings where the total finance charge remaining to be paid on the old loan exceeds the total finance charge to be paid on the new loan plus any prepayment penalty on the old loan—are also unlikely to be predatory. Further, such refinancings might legitimately need to be engaged in more quickly than my proposal would allow, to take quick advantage of a change in market rates.
(3) bring the market to the buyer to facilitate price shopping through a centralized process through which lenders could submit competing loan offers to borrowers.

Through these steps, the marketplace would be transformed into one in which consumers could make good price decisions despite heuristics, biases, and emotional coping mechanisms.454

1. Radical Transparency: Simplification of Loan Products to Achieve Meaningful Transparency Through Simple, Timely Disclosures.—The disclosure would contain only four loan terms, few enough attributes that most borrowers could effectively use them in decisionmaking. These attributes would be:

(1) total loan proceeds;
(2) total up-front fees, points, and costs (whether financed or not financed);
(3) maximum monthly payment,455 and
(4) loan length in years.456

A sample “Loan Price Tag” may be found in the Appendix. To ensure that loan applicants direct their attention to the Loan Price Tag, lenders would be required to give it to applicants before and apart from any other disclosures or other distracting papers.

For the Loan Price Tag to be widely used for price shopping, all of the figures would have to be in a format that most borrowers understand well and can compare easily. The first three figures would be expressed as a dollar amount, because, as previously explained, consumers generally understand whole dollar figures better than percentages. Admittedly, the total proceeds and total costs would be large numbers beyond the facility of many borrowers, but these could be directly compared to another loan’s price shopping disclosure. Comparing figures on two Loan Price Tags would highlight the relevance of digits beyond the first few, even to a consumer who ordinarily truncates.

The Loan Price Tag would in effect transmit a locked price offer, just as loans currently can be offered with locked rates. Tolerances for estimates on the Loan Price Tags would be very narrow. The aim

454. I thus take up Alan Schwartz’s suggestion to “ask whether the market is ameliorating cognitive error or could be helped to do so.” Schwartz, supra note 363, at 8.
455. Alongside the maximum monthly payment figure should be a statement “plus taxes and insurance” because the borrower must budget for that total, a concern on the risk side of the predatory lending problem.
456. People are more familiar with and have better facility with an expression of long time periods in years, rather than TILA’s disclosure of the loan period in months (e.g., people understand what is meant by a “20 year” loan better than a “240 month” loan).
would be to prevent lenders from exploiting motivated reasoning, decision process framing, and the endowment effect by hooking borrowers through an initially disclosed broad range of possible prices or a low-balled price.

The up-front cost figure would include every kind of fee and cost, including single premium credit insurance and similar products bundled into loan packages, such that the total up-front fee figure added to the total loan proceeds figure would sum to the total loan amount. The figure would thereby be a more complete cost measure than the GFE and TILA disclosures currently provide. Further, the Loan Price Tag should inform the applicant that this is the component of the price that is nonrefundable, even if the borrower refinances.457

By disclosing only the maximum monthly payment, and not the initial monthly payment, hidden interest rate and monthly payment increases would no longer be advantageous.458 A borrower engaging in myopic discounting over time and probability would not be hooked by an initial monthly payment figure, but instead would be price shopping using the maximum monthly payment.

Why four features? Why not make it five, and include the APR? Every additional price attribute disclosed adds to the likelihood that the consumer will fail to focus on another price component, and the APR disclosure does not add any information to these. As previously described, only 10% of recent home loan borrowers understand APR well enough to know that it is higher than the note interest rate, despite the ubiquitous use of this term since TILA's passage in 1968. The APR is a failed instrument of social policy. The four attributes given here are few enough, comparable enough, and concrete enough for most borrowers to use in comparison price shopping among loans. By structuring loans in simpler and fairly standardized ways, loans could be meaningfully compared through examination of these few features.459

457. My proposed language is: “You must pay this nonrefundable amount even if you pay off or refinance the loan.”

458. Prohibiting monthly payment escalations other than those tied to an indexed rate (a traditional ARM) might be required to prevent lenders from sidestepping this regime by orally contradicting the disclosure. In the case of an indexed rate, the maximum monthly payment would have to be disclosed as the “maximum foreseeable monthly payment.” The “maximum foreseeable monthly payment” would be the maximum monthly payment given the highest interest rate prevailing for the applicable index for any quarter in the number of years prior to the loan origination equal to the loan term (e.g., for a thirty-year loan, the thirty years prior to origination).

459. The National Consumer Law Center has proposed nearly the reverse of this proposal, but for many of the same reasons. They have proposed disallowing up-front fees and limiting prepayment penalties such that most of the price of the loan is bound up in the
For the simplified disclosure to enable price shopping, the four attributes disclosed must fully reflect the price of the loan. Therefore, balloons and negative amortization would be prohibited because these would not be reflected in the above figures. While it would be possible to craft an exception for balloons and negative amortization in situations where the borrower has a reasonably certain reason for expecting to be able to pay the balloon when it comes due, and from sources other than another mortgage (e.g., maturing trust fund, plans to sell house), any exception creates opportunities for deception by unscrupulous lenders. Similarly, prepayment penalties would not be permitted because these would not be reflected in the above disclosure. The ban on prepayment penalties would create, in effect, a modified cooling off period for the life of the loan, in that it would allow borrowers to refinance out of the loan more easily. The ban would lower the cost of refinancing to allow borrowers whose creditworthiness has improved to take advantage of that improvement, rather than sticking them with an interest rate based on their former creditworthiness. Because home purchase money loans are excluded from the proposal, more creative loan structuring, sometimes useful for helping people achieve homeownership, would not be affected.

2. Prohibiting Prematurity of Commitment: The Consumer Chilling-Out Period.—The simplified disclosure would have to be given to the borrower in a manner such that, and at a time when, the borrower could, as a practical and psychological matter, use the disclosure to price shop. My suggestion is to require that the disclosure be given before

interest rate, which borrowers could meaningfully shop to compare. This requires borrowers to understand and shop based on interest rates, percentage figures that are poorly understood. The proposal would give the lender an incentive to keep the borrower rather than refinancing the borrower to strip more equity out through fees at each flip. However, it could also lead lenders to avoid borrowers with high origination costs—likely to be low- and moderate-income borrowers with subprime credit histories—because these borrowers, once qualified for a loan, would be able to use that paperwork to easily refinance at a lower rate with another lender.

460. The prohibition on balloons and negative amortization also addresses the risk side of the equation in that these products tend to be risky because borrowers often do not have the money to refinance the balloon payments when they come due. My proposal would exempt reverse mortgages, highly regulated instruments through which senior citizens can extract the equity in their homes for living expenses, yet without fear of foreclosure because the loan instrument must permit the homeowner to stay in the home until death.

461. The effect of prohibiting prepayment penalties would be to virtually eliminate YSPs because lenders need prepayment penalties to cover the up-front outlay to brokers on YSPs if the borrower refinances elsewhere.
the borrower has sunk anything greater than minimal application fee costs into the process, such as a $50 application fee. A small enough fee would allow cash-constrained consumers to apply to several lenders. It would also make the borrower less psychologically committed to the first loan, because fewer sunk costs would be invested in that application.

Again for both practical and psychological reasons, the simplified disclosure should be given no later than one week after application and between twenty-five and thirty days before closing, so that the borrower has enough time to effectively price shop before becoming financially and psychologically committed to the loan. The idea is to give the borrower a tool to use to shop at a time when the borrower is still in a decisionmaking frame, rather than at the implementation stage. This would further provide the borrower with a “chilling out” period in which to shop for a better loan price, and to decide whether to take any loan at all. A rash loan application submitted under the “hot state” influence of a personal crisis or a manipulative loan salesperson would thereby not lead to a rash loan origination. The disclosure should instruct the borrower to use it to comparison price shop among lenders and warn the borrower that the loan she is being offered may be overpriced.462

In a sense, this proposal gives every nonpurchase money home loan borrower a price lock, not just those borrowers savvy enough to know what a price lock is, and how to truly lock the price of a loan.463 The proposal brings a thirty-day lock, common now in the prime market, to the subprime market.464 But because in-the-money refinanceings are excluded from the proposal, it would not prevent a consumer from taking quick advantage of a change in market rates.

462. My proposed language is: “It is possible that this loan is not the lowest priced available. This paper is the Price Tag for this loan. You should use it to shop with other lenders or brokers for the best loan at the best price, just as you would for any major purchase.”; and a none-too-subtle double entendre, “Time to go shopping!”

463. Not all prime borrowers manage to lock the price of the loan now, even when they think they are getting a lock. The “lock” often applies to only the note interest rate on the loan, and not the APR, so the lender can increase the non-interest price components of the deal to raise the price despite the lock. See Jack Guttentag, What’s Covered by a Lock? (2004) (unpublished article by Wharton School Professor Jack Guttentag), available at http://www.mtgprofessor.com/A%20-%20Locking%20Loan/what’s_covered_by_a_lock.htm (last visited Mar. 23, 2006).

464. Even without the loan and disclosure simplification I have proposed, a mandatory thirty-day waiting period from the day the lender gives the borrower a written locked price quote to the day of closing would create a useful shopping window.
3. Bringing Price Competition to the Borrower.—The simplified price shopping disclosure described above could be even more useful to borrowers if, once one lender has given the borrower a loan offer in the form of the Loan Price Tag, other lenders sent the borrower competing offers, the terms of which were disclosed in the same simplified Loan Price Tag format. To bring price competition to the borrowers, I propose that a government agency, perhaps the Department of Housing and Urban Development (HUD) or the Federal Trade Commission (FTC), set up a method to facilitate such a reverse auction competition.\footnote{465}

A possible regulatory scheme would be for the agency to act as a neutral “bidding agent” linking borrowers and lenders. The first lender to give a borrower an offer would simultaneously transmit the simplified disclosure, along with all pertinent borrower and loan information, to the bidding agent. The information transmitted would consist of anything and everything the lender used to determine its offer, including the application and supporting documentation, appraisal, and credit score details. The agent would post the terms of the loan offer\footnote{466} and supporting materials on the Internet, at a website accessible only to lenders. Lenders would then submit competing bids to the bidding agent, who would transmit them to the borrower during the twenty-five- or thirty-day window. Competing lenders would have to pay an administrative fee to the bidding agent and a finder’s fee to the first lender, to cover the first lender’s costs of searching for the borrower and qualifying the borrower for the loan. The borrower would be free to accept the original offer or any com-

\footnote{465. Cf. Paul Milgrom, Auctions and Bidding: A Primer, 3 J. Econ. Perspectives 3, 18-20 (1989) (explaining some reasons why auctions are often preferable to posted prices or bargaining for nonstandardized goods, where sufficient competition exists).}

\footnote{466. Whether the price components of the loan offer should be revealed or not (that is, whether the system should be structured as an open auction or a sealed bidding system) depends on a number of factors. An open auction is likely to lead to more honesty from the finding lender because the amount of the finding lender’s bid is itself information that tells competitors about the finding lender’s evaluation of the borrower. An open auction could also lead to a sea of bids, each only slightly lower priced than the last, flooding the borrower’s mailbox and overwhelming her. Because the practicalities here require the auction to have a hard close (rather than a soft moving close that stays open, for example, until the last day on which no further bids come in), an open auction could also lead to “sniping”—submitting bids at the last moment to try to undercut the last, effectively transforming the open auction to a sealed-bid system. Sandy D. Japp, Online Reverse Auctions: Issues, Themes, and Prospects for the Future, 30 J. Acad. Marketing Sci. 506, 508 (2002). A sealed-bid system plays into the hands of a finding lender who hoards private information, but would presumably lead to just a single bid from each competitor who wanted to bid. Of course, even a single bid from every lender in a market might be too many bids for a borrower to sort through. Some experimentation to sort through these and other logistics will be necessary.}
peting bid, and the competing bids would not have to go through the same posting and bidding process.467

This system would help borrowers in a number of ways. First, borrowers would not be required to undergo multiple iterations of the financial strip search or subject themselves to multiple possibilities of experiencing a discriminatory loan denial. Second, borrowers could receive competing offers without expending any time, effort, or expense. Third, borrowers could shop without challenging the trusted "friendship" with the first loan broker or officer in the same way borrowers challenge that relationship by affirmatively shopping on their own. Fourth, by receiving competing offers, or even the initial Loan Price Tag directing borrowers to price shop, borrowers are alerted that contrary to widespread belief, loan prices do vary, and lenders are not required to give borrowers the best rate for which they qualify.468 Finally, by eliminating face-to-face interaction between borrowers and lenders giving subsequent offers, the ability of these lenders to assess borrower vulnerability to price gouging is decreased.469

Such a system would require careful monitoring by the agency. Regulations would be needed to prevent gaming of the system, such as the first lender failing to make all information available to other lenders or engaging in side deals with borrowers or the competing lenders

467. I thus take up Susan Wachter's suggestion to "use the Internet as a fee based price-revelation facility." Wachter, supra note 450, at 417. The model here is similar to the service provided to prime borrowers through the on-line home loan broker LendingTree, but which is currently unavailable to subprime borrowers, because LendingTree does not arrange for loans to true subprime risk borrowers. Even if a subprime LendingTree were to be created, many borrowers at risk of experiencing predatory lending would be unable to effectively use such a service, both because they fall on the other side of the digital divide (i.e., lack effective access to the Internet), and because they lack the ability to gather the paperwork and accurately extract and submit the detailed information required for a subprime lender to make a firm loan offer.

468. Peterson has suggested that lenders be required to disclose their price offers in a document that also discloses "the average annual percentage rate on comparable credit within the borrower's geographic location correlated against the borrower's FICO credit score." Peterson, supra note 6, at 304. For this data to impel borrowers to price shop would require far greater understanding of percentages, APR, and FICO scores than borrowers currently possess, apart from any heuristics, biases, or coping mechanisms that would infect consumer interpretation of the data. I am pessimistic about developing such understanding through legal regulation of the borrowing process.

469. Subsequent lenders would have some clues on which to base vulnerability assessments; the borrower's address, credit history, and employment may reveal her race, class, age, and education, and the price of the initial offer may reveal the first lender's vulnerability assessment of the borrower. These are less revealing of vulnerability than face-to-face negotiations. Cf. Fiona Scott Morton et al., Consumer Information and Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?, 1 QUANTITATIVE MARKETING & ECON. 65, 91 (2003) (finding that Internet car shopping reduces race- and gender-based price discrimination in car sales).
going directly to the borrower rather than paying the finder's and administrative fees. Calibrating the right size finder's fee would also be difficult, because too high a fee would result in too few competing bids, and too small a fee would make it unprofitable for the first lender to search for and qualify some borrowers. Because those borrowers who require the greatest assistance from the lender to qualify tend to be low- and moderate-income borrowers with less established and documented credit history, the finder's fee might need to be larger for these borrowers. But if the system worked, then at equilibrium, few competing bids would be made because the first lender would have a much stronger incentive than currently exists to give the borrower a competitive price.

Through a system of early, simplified Loan Price Tag disclosures and active price competition, the power to price shop would be placed in the hands of the borrower, and greater autonomy of consumer decisionmaking would be achieved. The money, time, and effort required to submit multiple applications to various lenders in the current market would no longer be a barrier to receiving competing loan offers. Although fear of the financial strip search and of a loan denial due to poor credit history or discrimination would probably continue to lead borrowers to apply to the lender who advertises a guaranteed yes, that lender would no longer have a monopoly position over the applicant. Because the transaction must take place over the course of a month, borrowers will be less likely to remain in a hot stressed state and will have time away from the influence of the broker or loan officer. Real price competition would displace the current problems of rent seeking by lenders, price inefficiency, and regressive income redistribution from lower-income (and disproportionately African-American and Latino) borrowers to lenders.

The proposal tries to capture some of the benefits enjoyed by the structure of the prime market and distribute these benefits to the subprime market as well. First, prime borrowers can use Internet services such as LendingTree to obtain competing price quotes.470 This proposal provides the advantages of LendingTree to the other side of the digital divide. Second, prime borrowers can lock in rates, often for thirty days, to create firm quotes to use in price shopping. Although prime borrowers often have to pay for a lock-in, restricted budgets of subprime borrowers and thus the greater sunk costs effect of paying

470. I have been alerted to the possibility that lenders using LendingTree give low-balled, nonfirm quotes, and then spring higher prices on consumers after they are practically and psychologically committed to the loan. Because my proposed system would have narrow tolerances, low-balling should not be a problem.
such a fee counsels in favor of eliminating the fee, at least for these borrowers.

4. Giving Wall Street Some Skin in the Game.—As many others have also recognized, any regulation of the home loan market must give the secondary market some skin in the game. The broker or lender that originates the loan may disappear or lack the capital necessary to make the borrower whole down the line. Further, only the holder of the loan can change the terms of the loan as a legal remedy for non-compliance with the disclosure rules set forth above.

I therefore propose that failure to provide the Loan Price Tag disclosure under the loan sales rules outlined above would nullify the mortgage or result in a comparable deterrence-aimed penalty, such that the holder of the loan in the secondary market would have an incentive to police the originating lender and broker. By eliminating the holder in due course defense for loans that violate the above sales rules, as has already been done for HOEPA loans, the secondary market would have an incentive to police the loan sellers.471 Violations of the above loan sales rules would generally be discernable on the face of the Loan Price Tag disclosure and the other loan documents, and so the secondary market can enforce the sale rules through monitoring of these documents. The secondary market could also place significant bonding requirements on the originating brokers and lenders, so that they would have the resources to pay any penalty required for violation of these home refinance loan sales rules.

E. Critique of Proposals

Will the above proposals reduce the supply of credit to subprime customers? Undoubtedly the answer must be yes. These are not merely process solutions; by requiring loans to be structured in simplified and standardized ways, and requiring borrowers to wait to obtain loan proceeds, some choice narrowing will follow.

471. Baher Azmy & David Reiss, Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002, 35 RUTGERS L.J. 645, 713-16 (2005) (New Jersey’s elimination of holder in due course defense for loans with predatory characteristics caused secondary markets to stop funding these loans, resulting in subprime borrowers being offered loans with lower costs and better terms); Eggert, supra 45, passim (arguing for abrogation of holder in due course defense for predatory loans); Engel & McCoy, supra note 37, at 741-44.
But more choice is not always better. The "bewildering array" of home loan products available in today's market has contributed to the dearth of price shopping by a significant group of borrowers. Thus, it is unsurprising that part of the solution to mortgage overpricing will require reducing loan structure choices.

Some complexly structured nonpurchase money loans that are not predatory will be eliminated by these changes. There is no way to perfectly disaggregate predatory and nonpredatory uses of some loan products, absent a pricing suitability standard applied on a case-by-case basis in the courts or an administrative body, an infeasible solution for the reasons discussed above. Weighing in favor of my proposal is its potential to reduce the harm caused by noncompetitively priced loans, including inefficiencies, money spent capturing rents, and regressive income redistribution. Weighing against it is the benefit, in the refinance and second mortgage context, of the availability of complex loan products such as balloons, negative amortization, and escalating monthly payments. These products allow borrowers to more completely leverage their equity and to tailor their loan payments to their projected income stream, where that income stream is increasing. Note that my proposal would not prevent people from achieving homeownership through creatively structured financing because it would not apply to purchase money loans, which tend not to be predatory.

A further cost is the delay in obtaining loan proceeds that refinance and home equity borrowers would face due to the mandated shopping period. Although victims of predatory lending are precisely those with an emergency need for cash, the long-term costs of an over-priced home loan are too steep to warrant using equity to meet the emergency that quickly. This seems true even if during the shopping period some borrowers would have to use credit card and payday loans to meet the emergency. We use waiting periods in other contexts to encourage deliberation about major life decisions.

472. E.g., George Loewenstein, Social Security Brief: Is More Choice Always Better? 3-4 (Nat'L Academy of Social Insur. Oct. 1999), available at http://www.nasi.org/usr_doc/ss_brief_7.pdf ("Expanded choices are inadvisable when they require expertise that people don't possess. In such situations: (1) the benefits from competition are likely to be minimal; (2) the decisions are likely to take considerable time to make; (3) people are more likely to make bad decisions; and (4) decision making is likely to be a considerable source of anxiety and anticipated regret.").

473. APCAR, supra note 58, at 5.

474. Cf. Eggert, supra note 96, at 733-35 (recognizing that reducing the home loan options available to vulnerable consumers may assist their ability to meaningfully exercise autonomy in choosing a loan).

475. E.g., marriage, adoption, divorce, handgun purchase, and naturalization.
ance, particularly in light of widespread uniformity of prime loan terms, and the common practice of rate lock-ins in the prime market, it seems that the benefits of my proposal outweigh the costs it would impose.476

A final question is whether the subprime loan industry as a whole is dependent on price gouging. Does the subprime loan market have a "hollow core," meaning that there is no core set of viable single price equilibria for each otherwise identical loan?477 It is possible that the way in which subprime loans are currently made profitable depends on gouging a few customers and giving most customers low priced loans, similar to the pricing system used in the airline flight industry. If so, the question is whether eliminating the gouged borrowers from the mix would make the provision of subprime loans unprofitable and therefore dry up fairly priced subprime lending. The fact that some subprime lenders do not appear to price gouge in the current market makes clear that subprime lending can be price competitive and profitable.

It is true that competitive pricing will result in fewer resources expended on expensive push marketing sales techniques. Such techniques would be unlikely to generate sufficient profit to survive, price competition and exist now only due to rents. There is probably some archetypal little old lady homeowner who will not get her roof fixed because no lender will be able to afford, in a price competitive environment, to go door-to-door selling roofing services packaged with loans, and she will not otherwise discover that she could leverage her equity to get the roof fixed. However, that little old lady will also avoid paying exorbitant rates for that loan, and her neighbors who are currently inundated with subprime loan marketing will welcome the change.

Conclusion

This Article has deconstructed the *homo economicus* model imputed to consumers engaging in home loan borrowing by current fed-

476. Given that the current "procedural" set of legal rules governing home lending affect the substantive outcomes, there is no escape from "paternalism"; the distinction between "market facilitative" "procedural" rules and "paternalistic" "substantive rules" lacks any deep basis. Cf. Mark Kelman, *Law and Behavioral Science: Conceptual Overviews*, 97 Nw. U. L. Rev. 1347, 1347-48 (2003) (noting that people make poor decisions "not just because information is difficult to obtain, but because they misuse the information they get or because they misapprehend the task that they are trying to accomplish"); see also Camerer et al., supra note 181, at 1211-12, 1219; Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. Chi. L. Rev. 1159, 1162 (2003).

477. Ayres, supra note 350, at 870.
eral law, and pragmatically applies a recognition of real
decisionmaking behavior to the problem of predatory lending. The
current information-based legal paradigm confuses disclosure with
knowledge, understanding, and rational choice. It is used as a crutch
by the courts to decide whether a loan complies with the law, a crutch
with which the lending industry clobbers vulnerable borrowers. A
thoroughgoing evaluation of borrowers' behaviors in this context
leads to the conclusion that some restriction of the choice set availa-
ble in the market is necessary to prevent harm to vulnerable subprime
borrowers. The most important policy implications, for immediate
use, are that decreasing practical, cognitive, and emotional transac-
tion costs through radical transparency and required home loan price
shopping waiting periods show promise as methods likely to reduce
the current chasm between the behaviors of vulnerable segments of
borrowers and the law.

The solutions proposed here for predatory lending break
through the impasse presented in a number of modern domains in
which consumers are now expected to understand complicated disclo-
sures, such as insurance, investments, and retirement arrangements,
in addition to consumer credit generally. Policymakers preferring a
free market approach generally favor disclosure, and those favoring a
paternalist approach generally favor substantive controls on terms.
My approach is to understand what conditions are necessary for con-
sumers to use disclosures to make good decisions, and to propose a
market intervention to create those conditions. Only decisions made
under these conditions can be truly autonomous, in the senses of re-
reflecting the decisionmaker's own meta-preferences and giving the
decisionmaker a feeling of personal control over decisions, actions,
environment, and life path.

Some of the prior legal scholarship examining home loan bor-
rowing through a behavioral decisionmaking lens has failed to recog-
nize the real-world heterogeneity of cognitive and emotional contexts
in which borrowers are—or are not—shopping. These scholars have
argued that the heuristics, biases, and coping mechanisms identified
in psychology call for a weak form of paternalism in legal regulation,
dubbed asymmetric paternalism. Asymmetric paternalism is legal reg-
ulation that procedurally manipulates framing effects to guide con-
sumers' choices in the right directions, without substantive constraints
on choice. The idea is that those who currently make poor decisions
will be assisted by the procedural solution, but those who are doing
well in the current environment will not bear the costs that would be
imposed by substantive regulation.
Given that autonomy is a necessary component of human flourishing, asymmetric paternalism is a worthwhile goal. But in the area of consumer lending, some of these authors have erroneously claimed that the practice of home lending under current federal law provides support for their theory. They posit that the disclosures required by TILA and HOEPA pose only minimal costs to society in the form of small administrative costs to lenders. They assert that the TILA price disclosure "enormously" benefits the vulnerable consumer by protecting her from unscrupulous lenders through educating her about the price of the loan, which in turn will help her to "act more properly in her own best interest." They base these claims on a generic understanding of consumer decisionmaking, without analyzing any data about home loan decisionmaking in the real world.

A closer look at borrowing in action paints a very different picture. The disclosures do not help a significant segment of consumers to price shop, because these consumers do not understand the disclosures, do not make use of the disclosures to price shop, and even misinterpret the price information provided in the disclosures. Moreover, the costs of disclosures include more than administrative costs to the lender; the disclosures themselves may create an information overload and may cause the borrower to focus on less important dimensions of the decision. The disclosures give the veneer of legality to the transaction, falsely assuring some borrowers that they are more protected in the transaction than they are. Lenders, courts, and the borrowers themselves are more likely to blame the borrower for obtaining an overpriced loan, and to exonerate the seller of the loan, because the borrower received the disclosures.

The lesson here is that disclosures alone are not a panacea, but can only work when conditions are right, and substantive intervention in the market may be needed to create those conditions. Only by examining the evidence on the ground closely can we know whether procedural "framing" or substantive "choice narrowing" regulation—or, as I have proposed here, some combination of both—is likely to reduce the incidence of a social problem. Although the insights of behavioral science in one realm can help us form working hypotheses

478. Camerer et al., supra note 181, at 1233.
479. Id. at 1232-33; see also Christine Jolls & Cass R. Sunstein, Debiasing Through Law 29 (Univ. of Chi. Law & Econ. Working Paper No. 225, 2005) (positing that by requiring lenders to disclose the total interest payments over the life of a loan, the law "counteracts forms of bounded rationality that reduce welfare, but . . . does not significantly affect people who did not previously exhibit boundedly rational behavior"); Rachlinski, supra note 362, at 1224 & n.296 (asserting that the current home loan disclosure regime works well).
about how people are making decisions in other realms, we must care-fully check those hypotheses against data. Solutions depend crucially upon detailed contextualized analysis, including the experiences of all affected population segments, rather than abstract theorizing. Just as parsimonious models of rational actor decisionmakers must give way to heterogeneous models of consumer decisionmaking behavior, so too a parsimonious model of asymmetric paternalism must give way to an admission that one form of solution will not fit all problems.

In a market where heterogeneous decisionmakers are facing individualized and opportunistic pricing of multifarious products, no one solution will perfectly respond to the needs of all. But we have more sophisticated tools to develop solutions than the scholarship currently reflects. We can understand the heterogeneity and we can check our theory against data. Once we have done that, we can make conscious tradeoffs in developing regulation that will create a nondiscrimina-tory, price competitive market.
APPENDIX

Sample GFE:

[Name of Lender]

The information provided below reflects estimates of the charges which you are likely to incur at the settlement of your loan. The fees listed are estimates - the actual charges may be more or less. Your transaction may not involve a fee for every item listed. The numbers listed beside the estimates generally correspond to the numbered lines contained in the HUD-1 or HUD-1A settlement statement that you will be receiving at settlement. The HUD-1 or HUD-1A settlement statement will show you the actual cost for items paid at settlement.

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<th>Item</th>
<th>HUD-1 or HUD-1A</th>
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<tr>
<td>Loan discount fee</td>
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<td>Appraisal fee</td>
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<td>CLO access fee</td>
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</tr>
<tr>
<td>Tax related service fee</td>
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<tr>
<td>Interest for [X] days at $XXXX per day</td>
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<td>$XXXX</td>
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Applicant: ___________________________ Date: __________

Authorized Official: ___________________________ Date: __________

480. 24 CFR pt. 3500, App. C.
Sample HUD-1[^481]:

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<td>2. ___ FmHA</td>
<td></td>
</tr>
<tr>
<td>3. ___ Conv. Unins.</td>
<td></td>
</tr>
<tr>
<td>4. ___ VA</td>
<td></td>
</tr>
<tr>
<td>5. ___ Conv. Ins.</td>
<td></td>
</tr>
</tbody>
</table>

C. Note: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.

<table>
<thead>
<tr>
<th>D. Name &amp; Address of Borrower</th>
<th>E. Name &amp; Address of Seller</th>
<th>F. Name &amp; Address of Lender</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>G. Property Location</th>
<th>H. Settlement Agent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Place of Settlement</td>
<td>Settlemet Date</td>
</tr>
</tbody>
</table>

J. Summary of Borrower's Transaction

<table>
<thead>
<tr>
<th>100. Gross Amount Due From Borrower</th>
<th>400. Gross Amount Due to Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>102. Personal property</td>
<td>402. Personal property</td>
</tr>
<tr>
<td>103. Settlement charges to borrower (line 1400)</td>
<td>403. Adjustments for items paid by seller in advance</td>
</tr>
</tbody>
</table>

Adjustment for items paid by seller in advance

<table>
<thead>
<tr>
<th>106. City/town taxes to</th>
<th>406. City/town taxes to</th>
</tr>
</thead>
<tbody>
<tr>
<td>107. County taxes to</td>
<td>407. County taxes to</td>
</tr>
<tr>
<td>108. Assessments to</td>
<td>408. Assessments to</td>
</tr>
</tbody>
</table>

120. Gross Amount Due from Borrower

<table>
<thead>
<tr>
<th>120. Gross Amount Due from Borrower</th>
<th>420. Gross Amount Due to Seller</th>
</tr>
</thead>
</table>

200. Amounts Paid by or in Behalf of Borrower

<table>
<thead>
<tr>
<th>200. Amounts Paid by or in Behalf of Borrower</th>
<th>500. Reductions in Amount Due to Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>201. Deposit or earnest money</td>
<td>501. Excess deposit (see instructions)</td>
</tr>
<tr>
<td>202. Principal amount of new loan(s)</td>
<td>502. Settlement charges to seller (line 1400)</td>
</tr>
<tr>
<td>203. Existing loans taken subject to</td>
<td>503. Existing loans taken subject to</td>
</tr>
<tr>
<td>204.</td>
<td>504. Payoff of first mortgage loan</td>
</tr>
<tr>
<td>205.</td>
<td>505. Payoff of second mortgage loan</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Adjustments for items unpaid by seller</th>
<th>Adjustments for items unpaid by seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>210. City/town taxes to</td>
<td>510. City/town taxes to</td>
</tr>
<tr>
<td>211. County taxes to</td>
<td>511. County taxes to</td>
</tr>
<tr>
<td>212. Assessments to</td>
<td>512. Assessments to</td>
</tr>
<tr>
<td><strong>220. Total Paid by/for Borrower</strong></td>
<td><strong>520. Total Reduction Amount Due Seller</strong></td>
</tr>
<tr>
<td>500. Cash at Settlement from/to Borrower</td>
<td>600. Cash at Settlement to/from Seller</td>
</tr>
<tr>
<td>501. Gross amount due from borrower (line 120)</td>
<td>601. Gross amount due to seller (line 420)</td>
</tr>
<tr>
<td>502. Less amounts paid by/for borrower (line 220)</td>
<td>602. Less reductions in amount due seller (line 520)</td>
</tr>
<tr>
<td>503. Cash _From _To Borrower</td>
<td>603. Cash _To _From Seller</td>
</tr>
</tbody>
</table>
Sample HUD, cont:

L. Settlement Charges

<table>
<thead>
<tr>
<th>Settlement Charges</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>700. Total Sales/Broker's Commission based on price $ @ % = Division of Commission (line 700) as follows:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>701. $ to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>702. $ to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>703. Commission paid at settlement</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

800. Items Payable in Connection with Loan

<table>
<thead>
<tr>
<th>Items Payable in Connection with Loan</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>801. Loan origination fee %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>802. Loan discount %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>803. Appraisal fee to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>804. Credit report to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>805. Lender's inspection fee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>806. Mortgage insurance application fee to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>807. Assumption fee</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

900. Items Required by Lender to be Paid in Advance

<table>
<thead>
<tr>
<th>Items Required by Lender to be Paid in Advance</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>901. Interest from to @ $ /day</td>
<td></td>
<td></td>
</tr>
<tr>
<td>902. Mortgage insurance premium for months to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>903. Hazard insurance premium for years to</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1000. Reserves Deposited with Lender

<table>
<thead>
<tr>
<th>Reserves Deposited with Lender</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1001. Hazard insurance months @ $ per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1002. Mortgage insurance months @ $ per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1003. City property taxes months @ $ per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1004. County property taxes months @ $ per month</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1005. Annual assessments months @ $ per month</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1100. Title Charges

<table>
<thead>
<tr>
<th>Title Charges</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1101. Settlement or closing fee to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1102. Abstract or title search to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1103. Title examination to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1104. Title insurance binder to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1105. Document preparation to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1106. Notary fees to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1107. Attorney's fees (includes above items numbers:) to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1108. Title insurance (includes above items numbers:) to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1109. Lender's coverage $</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1110. Owner's coverage $</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1200. Government Recording and Transfer Charges

<table>
<thead>
<tr>
<th>Government Recording and Transfer Charges</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1201. Recording fees: Deed $ ; Mortgage $ ; Releases $</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1202. City/county tax/stamps: Deed $ ; Mortgage $</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1203. State tax/stamps: Deed $ ; Mortgage $</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1300. Additional Settlement Charges

<table>
<thead>
<tr>
<th>Additional Settlement Charges</th>
<th>Paid From Borrower's Funds at Settlement</th>
<th>Paid From Seller's Funds at Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1301. Survey to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1302. Pest inspection to</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1400. Total Settlement Charges (enter on lines 103, Section J and 502, Section K)
Sample TILA Disclosure:

Federal Truth In Lending Disclosure Statement

<table>
<thead>
<tr>
<th>ANNUAL PERCENTAGE RATE</th>
<th>FINANCE CHARGE</th>
<th>Amount Financed</th>
<th>Total of Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>The cost of your credit as a yearly rate.</td>
<td>The dollar amount the credit will cost you.</td>
<td>The amount of credit provided to you or on your behalf.</td>
<td>The amount you will have paid after you have made all payments as scheduled.</td>
</tr>
</tbody>
</table>

% $ $ $%

You have the right to receive at this time an itemization of the Amount Financed.

[ ] I want an itemization.
[ ] I do not want an itemization.

Your payment schedule will be:

<table>
<thead>
<tr>
<th>Number of Payments</th>
<th>Amount of Payments</th>
<th>When Payments Are Due</th>
</tr>
</thead>
</table>

**Insurance:** Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

- Type: Premium Signature
- Credit Life: I want credit life insurance: ___________________
- Credit Disability: I want credit disability insurance: _____________
- Credit Life and Disability: I want credit life and disability insurance: _____________

You may obtain property insurance from anyone you want that is acceptable to [creditor].

If you get the insurance from [creditor], you will pay $________/year.

**Security:** You are giving a security interest in:

- O the goods or property being purchased
- O (brief description of other property):

<table>
<thead>
<tr>
<th>Filing fees $</th>
<th>Non-filing insurance $</th>
</tr>
</thead>
</table>

**Late Charge:** If a payment is late, you will be charged $____/____ % of the payment.

**Prepayment:** If you pay off early, you may or may not have to pay a penalty and be entitled to a refund of part of the finance charge.

- O may O will not

**Assumption:** Someone buying your home

- O cannot assume the remainder of the mortgage on the original terms.
- O may, subject to conditions, be allowed to assume the remainder of the mortgage on the original terms.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

I(we) have received and read a copy of this disclosure:

__________________________  __________________________
Applicant  Date
Sample HOEPA Disclosure\textsuperscript{483}:

<table>
<thead>
<tr>
<th>Disclosure Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application.</td>
</tr>
<tr>
<td>If you obtain this loan, the lender will have a mortgage on your home.</td>
</tr>
<tr>
<td>You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.</td>
</tr>
<tr>
<td>You are borrowing $ \quad \quad \quad \quad \quad [\text{Optional credit insurance is } [\quad \quad \quad \quad \quad \text{is not} [\quad \quad \quad \quad \quad \text{included in this amount}].</td>
</tr>
<tr>
<td>The annual percentage rate on your loan will be: \quad \quad \quad \quad \quad % .</td>
</tr>
<tr>
<td>Your regular \quad [\text{frequency} \quad \quad \quad \quad \quad \text{payment will be: } $ \quad \quad \quad \quad \quad \quad .</td>
</tr>
<tr>
<td>[\text{At the end of your loan, you will still owe us: } $ [\text{balloon amount}].</td>
</tr>
<tr>
<td>[Your interest rate may increase. Increases in the interest rate could raise your payment. The highest amount your payment could increase is to $ \quad \quad \quad \quad \quad \quad .]</td>
</tr>
</tbody>
</table>

\textsuperscript{483} \text{No HOEPA disclosure sample appears in the regulations. This sample is copied from Fed. Res. Bank of Atlanta, \textit{Changes to Regulation Z Expand Loans Subject to HOEPA}, 12 PARTNERS (Summer 2002), available at http://www.frbatlanta.org/invoke.cfm?objectid=28317C62-2D5B-4F40-AFD373F5D77920F5&method=display, and complies with the requirements listed in 12 CFR § 226.32(c).}
Sample Proposed Price Shopping Disclosure:

<table>
<thead>
<tr>
<th>LOAN PRICE TAG</th>
</tr>
</thead>
<tbody>
<tr>
<td>These are the terms of the loan that [name of lender or broker] is offering to sell to you:</td>
</tr>
<tr>
<td>Total loan proceeds: $ __________</td>
</tr>
<tr>
<td>Total up-front fees, points &amp; costs: $ __________ (You must pay this nonrefundable amount even if you pay off or refinance the loan)</td>
</tr>
<tr>
<td>Maximum monthly payment: $ _____ plus taxes and insurance</td>
</tr>
<tr>
<td>Loan length: ___ years</td>
</tr>
</tbody>
</table>

This offer is good for 30 days from today's date: ___/___/20__. 

It is possible that this loan is not the lowest priced available.

This paper is the Price Tag for this loan. You should use it to shop with other lenders or brokers for the best loan at the best price, just as you would for any major purchase.

You have 30 days to shop for the best-priced loan, and to decide whether you want to buy this loan.

Information about this offer is being given to other lenders and brokers, and they may contact you by mail to offer you a different price for this loan.

If you decide to purchase this loan, [name of broker or lender] must allow you to sign the contract for this loan up until ___/___/20__ [30 days from date given to borrower], and cannot allow you to contract for this loan before ___/___/20__ [25 days from date given to borrower].

Time to go shopping!