Ability to Pay*

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The landmark Dodd-Frank Act of 2010 ("Dodd-Frank") transforms the regulation of consumer credit in the United States.[1] Many of its changes have been high-profile, attracting considerable media and scholarly attention, most notably the establishment of the Consumer Financial Protection Bureau ("CFPB").[2] Even specific consumer reforms, such as a so-called "plain vanilla"

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

2. The Bureau was initially proposed as an Agency; its conversion to a Bureau was both a source of contention and transition of uncertain significance. *See, e.g.*, Jim Puzzanghera, *Downgrade of Consumer Financial Protection Agency Threatens Obama's Overhaul Plan*, L.A. TIMES, Mar. 4, 2010, http://articles.latimes.com/2010/mar/04/business/la-fi-financial-reform4-2010mar04; Hon. Jeb Hensarling, *Punishing Consumers to "Protect" Them*, WASH. TIMES, July 22, 2009, http://www.washingtontimes.com/news/2009/jul/22/dont-punish-consumers-in-the-name-of-protection/?feat=home_headlines; Tom Petruno, *Debate Heats up over "Financial Protection Agency" Proposal*, L.A. TIMES, July 23, 2009, http://latimesblogs.latimes.com/money_co/2009/07/harvard-law-professor-elizabeth-warren-and-rep-jeb-hensarling-r-texas-are-in-a-new-smackdown-this-week-over-the-idea-of.html; Paul Krugman, *Financial Reform Endgame*, N.Y. TIMES, Feb. 28, 2010, http://www.nytimes.com/2010/03/01/opinion/01krugman.html. As an example of the reasoned, deliberative engagement of ideas within the academy, consider the critique that the agency/bureau would "risk reversing the decades-long trend towards the democratization of credit[;] create a 'supernanny' agency . . . designed to substitute the choice of bureaucrats for those of consumers[; and] jeopardize the financial recovery." David S. Evans & Joshua D. Wright, *The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit*, 22 LOY. CONSUMER L. REV. 277, 280 (2010). A compromise emerged in the commutation of the "Agency" into a "Bureau" of the Federal Reserve Board, which may have been a deft middle road or a

proposal, drew hot debate and lobbying firepower.[3] But when the dust settled, one profoundly transformative innovation that did not garner the same outrage as plain vanilla or the CFPB did get into the law: imposing upon lenders a duty to assure a borrower's ability to repay.[4]

Ensuring a borrower's ability to repay is not an entirely unprecedented legal concept, to be sure,[5] but its wholesale embrace by the Dodd-Frank represents a sea change in U.S. consumer credit market regulation. This Article does three things regarding the new duty to assess a consumer's ability to repay mortgage loans. First, it traces the multifaceted pedigree of this requirement by looking at fledgling strands in U.S. consumer law, as well as other areas such as securities law; it also considers its more robust embrace in foreign systems. Second, it offers conjecture regarding how this broadly stated principle might be put into practice by the federal regulators. Finally, it provides a brief normative comment, siding with the supporters of this new obligation on lenders.

DESCRIPTION: WHAT IS IT AND WHERE DID IT COME FROM?

Ability to Pay: The Statutory Requirements

As enacted, Dodd-Frank Section 1411(b) amends the Truth In Lending Act ("TILA") Chapter 2, 15 USC § 1631 *et seq.* (2006), by inserting a new section 129C. Title XIV of Dodd-Frank is subtitled the "Mortgage Reform and Anti-predatory Lending Act," and Section 1411 provides the following new obligation on all mortgage lenders (originators and brokers):

> MINIMUM STANDARDS FOR RESIDENTIAL MORTGAGE LOANS.
>
> Ability to Repay.—
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> In general.—In accordance with regulations prescribed by the Board, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the

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largely atmospheric move given the as-enacted Bureau's independent budgetary powers, director, etc. *See* Dodd-Frank, *supra* note 1, §§ 1011-1012, 124 Stat. 1964-66, § 1017, 124 Stat. 1975-79.

3. *See Congress Wary of "Plain Vanilla" Bank Proposal: Industry Thinks President Obama's Proposal Would Be Too Intrusive*, ASSOCIATED PRESS, Sept. 22, 2009, *available at* http://www.msnbc.msn.com/id/32968985/ns/business-consumer_news/; Richard H. Thaler, *Economic View: Mortgages Made Simpler*, N.Y. TIMES, July 4, 2009, http://www.nytimes.com/2009/07/05/business/economy/05view.html. Plain vanilla rules (offering safe harbor to financial product providers who offer exotic products in conjunction with simplified ones) find their origin in Michael S. Barr, Sendhil Mullainathan & Eldar Shafir, *Behaviorally Informed Financial Services Regulation*, New America Foundation (2008), *available at* http://www.newamerica.net/files/naf_behavioral_v5.pdf. One lobbyist at a recent conference described the Barr et al. paper as "terrifying" upon realizing it was authored by the Assistant Secretary of the Treasury who would become a chief architect of Dodd-Frank. *See* Nessa Feddis, VP & Sr. Counsel for Regulatory Compliance, Am. Bankers Ass'n, Remarks at the 2011 Marquette Law School Public Service Program: New Directions in Consumer and Community Financial Protection (Feb. 25, 2011).

4. Dodd-Frank, *supra* note 1, § 1411, 124 Stat. 2142.

5. See discussion *infra* of U.S. precedents and analogues.

> time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.[6]

In fleshing out the discharge of this duty, Dodd-Frank continues:

> (3) Basis for determination.—A determination under this subsection of a consumer's ability to repay a residential mortgage loan shall include consideration of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling . . . . A creditor shall determine the ability of the consumer to repay using a payment schedule that fully amortizes the loan over the term of the loan.[7]

Similar requirements of assuring repayment ability are found in the cognate-spirited Credit CARD Act ("CARD"), with near-identical terminology.[8] CARD preceded Dodd-Frank in passage, but its content is part of omnibus reform of the financial markets.

Past as Prologue: Pre-Dodd-Frank Mortgage Regulations

Those versed in contract law doubtless appreciate the departure from the spirit of caveat emptor that these revisions impose. Contract Law 101 insists that you are not your brother's keeper,[9] and this is especially so with lenders. "[A]bsent special circumstances, a loan does not establish a fiduciary relationship between a commercial bank and its debtor."[10] Case law repeatedly affirms that lenders need only look out for themselves and has consistently rejected attempts to inject a duty to analyze the borrower's ability to pay.[11]

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6. Dodd-Frank, *supra* note 1, § 1411, 124 Stat. 2142.

7. *Id.* at 2143.

8. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, § 109, 124 Stat. 1743 (2009) ("A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.").

9. *See, e.g.*, Laidlaw v. Organ, 15 U.S. 178 (1817):

> The maxim of *caveat emptor* could never have crept into the law, if the province of ethics had been co-extensive with it. There was, in the present case, no circumvention or manoeuvre practised by the vendee, unless rising earlier in the morning, and obtaining by superior diligence and alertness that intelligence by which the price of commodities was regulated, be such. It is a romantic equality that is contended for on the other side. Parties never can be precisely equal in knowledge, either of facts or of the inferences from such facts, and both must concur in order to satisfy the rule contended for. The absence of all authority in England and the United States, both great commercial countries, speaks volumes against the reasonableness and practicability of such a rule.

10. Das v. Bank of America, 186 Cal. App. 4th 727, 740 (2010).

11. *See, e.g.*, Renteria v. U.S., 452 F. Supp.2d 910 (D. Ariz. 2006) (lack of duty is because any assessment would be for lender's, not borrower's, protection); Nymark v. Heart Fed. Savs. & Loan, 231 Cal.App.3d 1089 (1991) (commercial lenders look after own interests only); Wagner v. Benson, 101 Cal. App.3d 27 (1980) (same). John D. Wright, *Dodd-Frank's "Abusive" Standard: A Call for Certainty*, 8 BERKELEY BUS. L. J. (forthcoming Oct. 2011), *available at* http://www.law.berkeley.edu/files/bclbc/Dodd_Frank_Abusive_Standard_Paper.pdf. (I am grateful to John D. Wright for suggesting

"[T]he lender has no judicially imposed duty to ensure ability to repay the loan . . . ."[12] In fact, "lenders do not even owe borrowers a duty of care to avoid negligence in the lending process."[13] One bank lawyer confidently asserted that "[s]trong public policies support a solvent financial system and low barriers to home ownership and these policies militate against exposing mortgage lenders to fiduciary duties and litigation risks."[14]

No more under Dodd-Frank. Section 1411 represents a great step for commercial law. Yet the seeds of change were cross-metaphorically percolating well before 2010. Consider the recent history of residential mortgage regulation.[15] Prior to 1982, there were good, old-fashioned rules (not standards) imposed by statute on mortgage originators, such as the hard cap of a ninety percent "loan-to-value" ("LTV") ratio for improved real estate loans issued by national banks and maximum thirty-year full amortization terms for residential mortgages.[16] Then the headiness of 1980s deregulation brought such developments as the Garn-St. Germain Act[17] (and the related Alternative Mortgage Transactions Parity Act),[18] which boldly dispatched such backward-thinking, heavy-government suffocation of consumer credit. Recall that the Community Reinvestment Act ("CRA") was passed in 1977,[19] and so such deregulatory moves were not only consonant with the spirit of the 1980s but could also be couched in the credit-opening rhetoric of bringing homeownership to historically underserved communities under the civil-rights

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these sources in his paper.).

12. Frank A. Hirsch, *The Evolution of a Suitability Standard in the Mortgage Lending Industry: The Subprime Meltdown Fuels the Fires of Change*, 12 N.C. BANKING INST. 21, 23 (2008) (noting, however, FDIC regulatory action enjoining lender from making loans without assessment of ability to pay at fully indexed rate). Hirsch provides a lengthy collection of case law citations. *Id.*

13. *Id*; *see also, e.g.*, Tenenbaum v. Gibbs, 813 N.Y.S. 2d 155, 156 (App. Div. 2006) ("Plaintiffs have no distinct cause of action to recover damages for negligence because, as a mortgagee bank, Eastern Bank did not owe any duty of care to ascertain the validity of the documentation presented by the individual who falsely claimed to have authority to act on behalf of the borrower corporation.");.Nymark v. Heart Federal Savings & Loan Assn., 231 Cal.App.3d 1089, 1093 n. 1 (1991) ("The relationship between a lending institution and its borrower-client is not fiduciary in nature. A commercial lender is entitled to pursue its own economic interests in a loan transaction. This right is inconsistent with the obligations of a fiduciary which require that the fiduciary knowingly agree to subordinate its interests to act on behalf of and for the benefit of another.").

14. Hirsch, *supra* note 12, at 11-12 (citation omitted).

15. Mortgage regulation has a complex and institution-specific history in this country, dating back well before the 1970s. This historical analysis is restricted to the 1980s and beyond to underscore the significance of the 1982 changes.

16. Housing and Community Development Act of 1974, 12 U.S.C. § 371, §24(a)(1) (1974) (repealed).

17. Garn–St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320 (1982).

18. Title VIII of the Garn–St Germain Depository Institutions Act of 1982, Pub. L. No. 97–320, 96 Stat. 1469, 1545 (1982) (codified at 12 U.S.C.A. § 3801 *et seq.*). Another similarly spirited deregulatory statute was the Depository Institutions Reregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980).

19. Community Reinvestment Act of 1977, Pub. L. No. 95-128 (1977), Title VIII of the Housing and Community Development Act of 1977, 91 Stat. 1147.

era policies of the CRA.[20] With traditional mortgage lenders liberated from their "stodgy" underwriting standards, housing would come to everyone at last![21]

Post Garn-St. Germain, regulators basked in their newfound freedom. History could have unfolded in one of two ways at this inflection point: (1) regulators could have taken over to "fill the void" after the rollback and promulgated an all-encompassing swath of regulation to discipline (or, depending on one's priors, suffocate) the mortgage market in the post-LTV cap environment; or, (2) regulators might have "gotten the message" and taken a hands-off, light-touch approach, loath to impose regulations that could be seen as mere re-treads of the now unfashionable LTV limits.

Regulators got the message. The Office of the Comptroller of the Currency ("OCC"), for example, considered using its rulemaking power over national banks to craft new underwriting restrictions on mortgages (along the lines of, e.g., a new LTV cap), but politely declined: "Decisions concerning the forms and terms of national bank lending are properly the responsibility of each bank's directorate and management."[22] One by one, rules governing real estate loan origination standards were systematically eliminated.[23] The last to fall—proscriptions on loans with an LTV ratio greater than 100% and those with longer than forty-year amortization terms—were finally repealed in 1996.[24] In less than two decades, mortgage lenders went from facing hard LTV caps to facing discipline by the market alone, with all its attendant foibles.[25]

There was some nominal backlash. In 1991, Congress jumped in and required regulators to adopt uniform standards for real estate lending in the

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20. This linking of the CRA with relaxed underwriting standards is a common bank lobbying move. *See infra* note 21. Of course, an even more cynical account would be one of trying to save the thrifts during a high-inflation period by facilitating "product innovation," such as adjustable rate mortgages. In retrospect, encouraging thrift risk-taking may not been such a great idea. *See* FDIC, *The S&L Crisis: A Chrono-Bibliography*, http://www.fdic.gov/bank/historical/s&l/ (last visited May 25, 2011).

21. "Stodgy" here is used purposely because it was the characterization used by the ABA's Vice-President and Senior Counsel for Regulatory Compliance at a lively recent speech. *See* Feddis, *supra* note 3. Her gist was that the banks were faulted for being too "stodgy" in underwriting mortgages in the 1970s, but are now being mulcted in being too carefree. Moreover, as she pointed out, one man's "suitability" could be another's "discrimination," if more rigorous underwriting standards effect a disparate minority impact. The pejorative use of "stodgy" thus seems intended to downplay the benefits from further stringency in underwriting standards (imposed by government regulation). Fair enough, from a lobbyist's perspective, but one could equally characterize a compelled increase in underwriting stringency as "prudential, crisis-averting cost internalization."

22. Real Estate Lending by National Banks, 48 Fed. Reg. 40,699 (Sept. 9, 1983) (codified at 12 C.F.R. pts. 7, 34).

23. An excellent summary of the regulatory history during this period is found in a current Working Paper by Vincent DiLorenzo, *The Federal Financial Consumer Protection Agency: A New Era of Protection or Mode [sic] of the Same?* (St. John Legal Studies Working Paper No. 10-0182 (2010)), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1674016.

24. *See id.* at 12.

25. The paradigmatic "20% downpayment" was thus historically the result of government regulation, not a social thrift ethic.

FDIC Improvement Act.[26] This finally prompted the OCC to issue its *Real Estate Lending Standards*.[27] But again, a light-touch approach prevailed; the OCC eschewed rules in favor of "guidelines" that included general admonitions toward "prudential underwriting standards."[28] The Office of Thrift Supervision ("OTS") followed suit.[29] Even with these interventions, moreover, the policy impetus was a duty of "safety and soundness"—the underlying mandate for depository institution regulation—not any duty to the borrower as the beneficiary of some form of protective relationship.[30] Thus, even when goaded by Congress into action, the agencies remained deep in the thrall of free-market laissez faire that was the legacy of Garn-St. Germain.

How strong was their resistance to regulate (and how ill-conceived in twenty-twenty hindsight)? Consider the aforementioned *Real Estate Lending Standards*. The OCC specifically excluded as unrelated to the safety and soundness of the underlying depository institution all loans that were "sold promptly after origination."[31] (After all, what greater assurance to the safety and soundness of a bank than getting a loan off its books through prompt securitization? Who cares about those loans? What possible impact could they have?)[32]

Concomitant to this robust resurgence in caveat emptor starting in the 1980s was a rise in abusive mortgage practices. This run-up in unscrupulous lending culminated in yet another congressional intervention: the Home Ownership Equity Protection Act ("HOEPA") of 1994.[33] HOEPA allows the Federal Reserve System ("the Fed") to regulate high-cost (i.e., subprime) mortgage loans. As such, the Act's regulatory panoply chiefly descends only upon loans that trip a high-cost trigger. For example, HOEPA applies to

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26. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 304, 105 Stat. 2354 (1991). In the notice of final rulemaking for the uniform standards, the federal banking agencies rationalized:

The legislative history of section 304 indicates that Congress wanted to curtail abusive real estate lending practices in order to reduce risk to the deposit insurance funds and enhance the safety and soundness of insured depository institutions. Congress considered placing explicit real estate lending restrictions in the form of loan-to-value (LTV) ratio limitations directly into the statute. Earlier versions of the legislation included specific LTV limits. Ultimately, however, Section 304 was enacted without LTV limits, or any other specific lending standards. Instead, Congress mandated that the federal banking agencies adopt uniform regulations establishing real estate lending standards without specifying what these standards should entail.

Real Estate Lending Standards, 57 Fed. Reg. 62,890 (December 31, 1992) (codified at 12 C.F.R. pt. 34).

27. *Id.* at 62,890.

28. *Id.* at 62,889.

29. Office of Thrift Supervision, 61 Fed. Reg. 50,951, 50,978, §§ 560.100-101 (Sept. 30, 1996) (codified at 12 C.F.R. 545, 556, 560, 563, 566, 571, 590).

30. *See, e.g.*, Home Owners' Loan Act, Pub. L. 101-73, Title III, § 301, 103 Stat. 277 (1989).

31. Real Estate Lending Standards, *Supra* note 26, at 62,896, 62,900.

32. Compare Dodd-Frank, *supra* note 1, § 1413(k)(1), 124 Stat. 2141 (augmenting assignee liability).

33. Home Ownership and Equity Protection Act (HOEPA) (1994), 15 U.S.C. § 1639 (amending the Truth in Lending Act (TILA), 15 U.S.C. §§ 1601-1649, by adding Section 129 to TILA).

refinancing loans (not purchase-money loans) only when the rate exceeds ten percent above the like-duration U.S. Treasuries rate.[34] HOEPA is of particular interest to examining Dodd-Frank's ability-to-pay mandate because one of the duties HOEPA imposes upon lenders whose loans trigger its scrutiny is analysis of an "ability to repay"—but only, as interpreted, for lenders who are shown to have engaged in a "pattern or practice" of asset-based lending, i.e., originating loans based on, at best, collateral appraisals alone or, at worst, the incentive to generate fees.[35]

HOEPA thus had some kick, but it was of limited effect. The Fed was only given jurisdiction over lenders whose products triggered the high-cost loan threshold;[36] the OCC and OTS continued to oversee their own depository institutions. Each did pass its own set of regulations in 1996, but the regulatory thrust was not in the direction one might have expected. For example, OCC's big regulatory move was to *confirm* the permissibility of Adjustable Rate Mortgages ("ARMs"), and then to announce federal preemption of that decision over contrary ARM-banning state laws.[37] OTS, in turn, downgraded many of its own regulations to "guideline" status, explaining almost apologetically to those by whom it was well captured: "OTS will continue to emphasize to examiners that guidance documents should not be confused with regulations."[38] Thus, while there were some regulatory stirrings, doubtless prompted in part by HOEPA, no meaningful change to mortgage underwriting—or mortgage regulation—occurred during the 1990s.

By the turn of the millennium, however, the federal regulators took more active notice.[39] In June 2000, the Treasury Department and the Department of Housing and Urban Development ("HUD") issued a joint report on *Curbing Predatory Home Mortgage Lending*, documenting the inadequate and

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34. Regulation Z, 12 C.F.R. Part 226 (2010) (amended by Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325, 108 Stat. 2160 (Truth in Lending, 60 Fed. Reg. 15,463 (March 24, 1995) (codified at 12 C.F.R. pt. 226)) implementing HOEPA (TILA, 75 Fed. Reg. 46,837 (Aug. 4, 2010) (codified at 12 C.F.R. pt. 226)) (HOEPA "sets forth rules for home-secured loans in which the total points and fees payable by the consumer at or before loan consummation exceed the greater of $400 or 8 percent of the total loan amount. In keeping with the statute, the Board has annually adjusted the $400 amount based on the annual percentage change reflected in the Consumer Price Index as reported on June 1. The adjusted dollar amount for 2011 is $592.").

35. TILA, 75 Fed. Reg. 46,837 (Aug. 4, 2010) (codified at 12 C.F.R. pt. 226).

36. The scope of HOEPA was tinkered with over the years, but the big change came in 2008, contemporaneous with the negotiation of Dodd-Frank, in which the Fed extended HOEPA's reach to all mortgage originators under a new national legal standard. *See* Truth in Lending, 73 Fed. Reg. 44,522, 44,526 (July 30, 2008) (codified at 12 C.F.R. pt. 226).

37. Real Estate Lending and Appraisals, 61 Fed. Reg. 11,294 (March 20, 1996) (codified at 12 C.F.R. pt. 34) (final rule).

38. Lending and Investment, 61 Fed. Reg. 1,162, 1,163-64 (Jan. 17, 1996) (codified at 12 C.F.R. pts. 545, 556, 560, 563, 571) (proposed rulemaking); Lending and Investment, 61 Fed. Reg. 50,951 (Sept. 30, 1996) 12 C.F.R. pts. 545, 556, 560, 563, 566, 571, 590 (final rule).

39. So did Congress. *See, e.g., Predatory Mortg. Lending: Hearings Before the S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 107-774 (2001); *Hearing Before the H. Comm. on Banking and Fin. Servs. on Predatory Lending Practices*, 106th Cong. 24-49 (2000).

gap-filled coverage of TILA, HOEPA, and the Real Estate Settlement Procedures Act ("RESPA") as statutory interventions for abusive mortgage lending.[40] The joint report recommended reforms, including, quite specifically, relaxing or repealing the restriction on HOEPA's asset-based lending ban to only "pattern or practice" lenders—in other words, expanding the imposition of a duty to analyze a borrower's ability to repay.[41] Furthermore, the OCC and OTS finally joined the Fed and the National Credit Union Administration to promulgate a set of interagency guidelines titled *Interagency Guidelines on Nontraditional Mortgage Product Risks* ("Subprime Lending Guidelines)".[42] (State regulators, such as North Carolina, led the charge in applying pressure, and one suspects this pressure made continued under-activity at the federal level unsustainable.)[43] In these new Subprime Lending Guidelines, the regulators begrudgingly admitted that much mortgage lending in the subprime market was abusive, although they still insisted it was a problem only to the extent that it imperiled the safety and soundness of regulated depository institutions.[44]

Significantly, and roughly contemporaneous with the drafting of the

40. HUD-Treasury Task Force on Predatory Lending, *Curbing Predatory Home Mortgage Lending* (2000), *available at* http://www.huduser.org/publications/pdf/treasrpt.pdf. Many of the recommendations of this report, if followed, may have mitigated or averted the housing market crisis.

41. *Id.* at 77-78. The joint report had numerous other recommendations, including working within the HOEPA framework by changing its trigger threshold. *See id.* at 86-88.

42. Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006) (final guidance). Note these guidelines were passed on an effective interim basis; the final version of the guidelines did not pass until 2007. *See* Interagency Guidance on Nontraditional Mortgage Products, 70 Fed. Reg. 77,249, 77,252 (Dec. 29, 2005) (proposed guidance). There were also earlier guidances touching on the issue, such as, e.g., Press Release, FDIC, Expanded Guidance for Evaluating Subprime Lending Programs (January 31, 2001), *available at* http://www.fdic.gov/news/news/press/2001/pr0901a.html, which warned banks that originating unaffordable loans would be viewed by supervising regulators as "imprudent."

43. *See, e.g.*, N.C. GEN. STAT. § 24-1.1F(c)(1) (2011) (requiring ability to pay analysis of so-called "rate spread" loans). North Carolina also was an earlier mover on anti-flipping laws. *See id.* § 24-10.2(c) (1999) (2011) ("No lender may knowingly or intentionally engage in the unfair act or practice of 'flipping' a consumer home loan. 'Flipping' a consumer loan is the making of a consumer home loan to a borrower which refinances an existing consumer home loan when the new loan does not have reasonable, tangible net benefit to the borrower considering all of the circumstances, including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances. This provision shall apply regardless of whether the interest rate, points, fees, and charges paid or payable by the borrower in connection with the refinancing exceed those thresholds specified in G.S. 24-1.1E(a)(6)."); *see also* Georgia Fair Lending Act, H.B. 1361 (2002) (prohibiting flipping a new home loan within five years unless it provides a "tangible net benefit to the borrower"); California Assembly Bill No. 489 (2001) (requiring covered loan originators to consider the consumer's ability to repay the loan). Macey et al. conclude in a survey that "Colorado, Illinois, Maine, Minnesota, and Pennsylvania all have at least some hint of [ability-to-pay, like 'suitability' requirements]." Jonathan R. Macey, Geoffrey P. Miller, Maureen O'Hara & Gabriel D. Rosenberg, *Helping Law Catch up to Markets: Applying Broker-Dealer Law To Subprime Mortgage*, 34 J. CORP. L. 789, 832 (2009).

44. Interagency Guidance on Nontraditional Mortgage Products, *supra* note 42 (proposed guidance) ("[O]ur concern is elevated with nontraditional products due to the lack of principal amortization and potential accumulation of negative amortization. The Agencies are also concerned that these products and practices are being offered to a wider spectrum of borrowers, including some who may not otherwise qualify for traditional fixed-rate or other adjustable-rate mortgage loans, and who may not fully understand the associated risks.").

Subprime Lending Guidelines, the OCC and OTS in 2003 for the first time embraced imposing a duty on lenders to analyze borrowers' "ability to repay" mortgages, at least in the subprime market.[45] The OCC's *Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices*[46] and *Avoiding Predatory and Abusive Lending Practices in Borrowed and Purchased Loans*,[47] both cautioned banks against—but did not prohibit them from—issuing or buying mortgages made without analyzing the borrower's ability to pay. A year later, these cautions ripened into regulations that explicitly prohibited mortgages issued without the lender considering the borrower's ability to pay.[48]

The scope of these anti-predatory mortgage rules, however, was limited, applying only to depository institutions and their subsidiaries; bafflingly, the rules did not apply to their mortgage-originating affiliates until much later.[49] Moreover, the rules were promulgated in conjunction with a preemption decision of state predatory lending laws, some of which were quite expansive in their protection of mortgage borrowers, and so the net regulatory effect was unclear.[50]

Certainly the relaxation in credit by macroeconomic policy following the early 2000s tech-bubble correction provided counter-pressure to attempts to rein in mortgage credit. Thus, while the mid-2000s saw the first emergence of an "ability to pay" duty imposed on mortgage lenders through regulation, it seems to have been a half-hearted effort of considerable foot-dragging.[51] For example, the decision to omit the clearly mortgage-dominated "affiliates" of banks and thrifts until 2006 from subprime mortgage lending regulations is difficult to explain away as regulatory caution; the more likely narrative of a

45. The FTC also determined subprime loans made knowing debtors cannot repay are unfair and deceptive. *See* Ronald G. Isaac, Assistant to the Dir. of the Fed. Trade Comm'n Bureau of Consumer Prot., Before the Cal. State Assembly Comm. on Banking and Fin. on Predatory Lending Practices in the Home-Equity Lending Mkt. (Feb. 21, 2001) (prepared statement *available at* http://www.ftc.gov/be/v010002.shtm) (cataloguing enforcement efforts over several years that included a settlement with national subprime lender engaged in asset-based lending).

46. *Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices*, OCC Advisory Letter 2003-2 (Feb 21, 2003) 7, http://www.occ.gov/static/news-issuances/memos-advisory-letters/2003/advisory-letter-2003-2.pdf.

47. *Avoiding Predatory and Abusive Lending Practices in Borrowed and Purchased Loans*, OCC Advisory Letter 2003-3, (Feb. 21, 2003), http://www.occ.gov/static/news-issuances/memos-advisory-letters/2003/advisory-letter-2003-3.pdf.

48. Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (codified at 12 C.F.R. pts. 7, 34).

49. *Id.* at 1905 (applying the final rule to "national banks and their operating subsidiaries"); Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609, 58,610, n.3, (Oct. 4, 2006).

50. *Id.* at 1908-11.

51. *See, e.g.*, DiLorenzo, *supra* note 23, at 101 ("Enforcement actions have, however, rarely been brought [by federal banking regulators] for originating or purchasing loans without regard to ability to repay.").

reluctant regulator has been noted even by the popular press.[52] Indeed, anyone skeptical of a cynical account of regulatory capture by these federal mortgage overseers should consider that Countrywide's decision to relinquish its bank charter so it could relocate its regulatory oversight to the OTS from the OCC was quite candidly explained as driven by the OTS's wisdom to interpret the Subprime Lending Guidelines with more "restraint."[53]

Finally, in the grand tradition of belated government action to crisis, only in 2008, after the housing collapse was well afoot, did the Fed amend TILA's Regulation Z to ban high-cost HOEPA-esque loans (defined as ones with rates over prime plus 1.5% for first liens) made without the lender analyzing the borrower's ability to pay and verifying income and assets.[54] The 2008 Regulation Z amendment was significant because, even though limited to high-cost mortgages that tripped its HOEPA-like trigger, it was not limited to specific covered entities, such as depository institutions or their affiliates.[55] All mortgage lenders fell under its scope. (Since the amendments did not come into force until October 1, 2009, however, they had no appreciable impact on the housing market collapse.)[56]

Understandably, Dodd-Frank's 2010 injunction on all mortgage originators—of all mortgages—to consider a borrower's ability to repay the loan was a watershed.[57] Not only did it cut through the crazy-quilt of OCC, OTS, the Fed, and others by casting a uniform statutory duty on all mortgage lenders, but, having seen the contagion from the subprime market to the Alt-A market and beyond, it applied for the first time to all mortgage loans—a duty irrespective of a complex (not to mention easily evaded) jurisdictional trigger.[58] "Ability to pay" had been adopted whole hog.[59]

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52. Edmund L. Andrews, *Fed and Regulators Shrugged as the Subprime Crisis Spread*, N.Y. TIMES, Dec. 18, 2007, http://www.nytimes.com/2007/12/18/business/18subprime.html.

53. Barbara A. Rehm, *Countrywide to Drop Bank Charter in Favor of OTS,* AM. BANKER, Nov. 10, 2006, at 1.

54. Truth in Lending, 73 Fed. Reg. 44,522, 44,523 (codified at 12 C.F.R. pt. 226) (July 30, 2008).

55. In fact, some amendments applied to all residential mortgages (not just high-cost ones), such as, e.g., the proscription against coercing real estate appraisers to inflate valuations. *See* Truth in Lending, *supra* note 36, at 44,522-23.

56. Opponents to Dodd-Frank predictably claimed that the Regulation Z amendments should be allowed time to take effect before Congress "rush" to statutory intervention. "Last July, the Federal Reserve issued new regulations under the Home Ownership and Equity Protection Act ... . As part of this implementation, new Federal rules have been developed which address predatory practices and products ... . But rather than allowing the Fed's carefully constructed regulations to take effect, this new majority has decided to draft their own mortgage reform bill with their own unique twist. Unfortunately, this twist includes new and untested mandates and duties, that even if they can be implemented, they may end up punishing the very consumers that this majority party is trying to protect." 111 Cong. Rec. H5175, H5177 (daily ed. May 6, 2009) (Remarks of Rep. Sessions), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2009-05-06/pdf/CREC-2009-05-06-pt1-PgH5174-3.pdf.

57. States appeared ahead of this regulatory curve. Minnesota, for example, passed a statute requiring analysis of ability to pay (and verification of income) of all loans. *See* 2007 Minn. Laws Ch. 18, §58.13(1)(a)(23).

58. Note the jurisdictional trigger survives today embedded within Dodd-Frank's definition of "qualified mortgages." *See* Dodd-Frank, supra *note* 1, at 2145-50, discussed in Part II, *infra.*

"Suitability": Analogues Outside the Mortgage Regulation World

Review of the fitful development of the ability-to-pay duty might suggest that it was a foreign concept to American law. That assumption would not be true. The requirement to gauge a borrower's ability to pay is in fact similarly spirited to "suitability" requirements found in securities regulation (and other areas).[60] Broker-dealers, even when not full-fledged fiduciary investment advisers, owe their clients a duty to recommend only "suitable" investments, mindful of the client's particular circumstances.[61]

HOEPA has had a tumultuous enforcement history. For example, in 2001, the Fed amended TILA to address consumer advocates' complaints that creditors were structuring high-cost loans as open-ended home equity lines expressly to evade HOEPA requirements. *See* Truth in Lending, 66 Fed. Reg. 65,604, 65,614-15 (Dec. 20, 2001) (codified at 12 C.F.R. pt. 226) ("[Section] 226.34(b) explicitly prohibits structuring a mortgage loan as an open-end credit line to evade HOEPA's requirements, if the loan does not meet the TILA definition of open-end credit . . . . Where a loan is documented as open-end credit but the features and terms or other circumstances demonstrate that it does not meet the definition of open-end credit, the loan is subject to the rules for closed-end credit, including HOEPA if the rate or fee trigger is met."). Still, the charge that HOEPA's triggers were too easily evaded remained:

"Unfortunately, at the same time, HOEPA has had little success in eliminating those abusive practices it identifies. As consumer advocates have been arguing for years, HOEPA's points and fees triggers are simply too high. As a result, very few subprime loans – less than one percent in 1999 – fall within HOEPA's points and fees trigger and are subject to regulation. Predatory lenders have successfully managed to conduct the bulk of their abusive activities using rates just below the HOEPA triggers but still high enough to provide enormous room for exploitation and profitability."

Baher Azmy, *Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation*, 57 FLA. L. REV. 295, 355-56 (2005); *see also* Christopher Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 59 (2005) (bemoaning that HOEPA failed to prevent "most abusive costs associated with predatory mortgages" and offering example that "mortgage lenders commonly exclude yield spread premiums from calculation of the HOEPA points and fees trigger").

59. The all-encompassing reach of Dodd-Frank renders the continued relevance of HOEPA's triggers unclear. That is, if only high-cost loans fall under HOEPA's purview, but all loans are now subject to the Dodd-Frank ability to pay duty, then at least that aspect of HOEPA is redundant. Bizarrely, Dodd-Frank itself *amended* parts of HOEPA's (seemingly redundant) high-cost loan definitional triggers. At a recent conference on consumer enforcement under Dodd-Frank, I asked a regulator about this (off-record) and was met with the worldly response that yes, Dodd-Frank did reveal some legislative inelegance and redundancy.

60. The Gramm-Leach-Bliley Act of 1999 requires insurance products to be "suitable and appropriate for the consumer." Gramm-Leach-Bliley Act, Pub. L. No. 106-102 (1999), Subtitle C, 113 Stat. 1422-24. The act required a majority of states to enact reciprocal laws or uniform laws governing the licensure of individuals and entities authorized to sell and solicit insurance no later than three years after its enactment date. States could satisfy the uniformity requirement when they "established uniform criteria to ensure that an insurance product . . . sold to a consumer is suitable and appropriate for the consumer." If after three years a majority of states had failed to enact uniform or reciprocal licensing laws, then the National Association of Registered Agents and Brokers would have been established to carry out multi-state licensing, but a majority did so enact so this nationalizing threat never realized. *See* National Association of Insurance Commissioners, *NAIC Producer Licensing Assessment Aggregate Report of Findings* (Feb. 19, 2008) 2, *available at* www.naic.org/Releases/2008_docs/producer_licensing_assessment_report.pdf.

61. *See* Hirsch, *supra* note 12, at 21-24 ("Suitability is a concept recognized in the securities law that imposes a duty on a securities broker to sell only securities to a buyer that are 'suitable' for the buyer based on the buyer's financial wherewithal, tax status, investment objectives and other factors."). The suitability obligation is only triggered when the securities broker-dealer recommends a specific purchase; the obligation is not present when the broker is given an order of self-directed trading. *Id.* at 26-27, 29. Some have argued, however, that the duty should expand to encompass brokers acting in any capacity given the implicit expectations of clients. *See, e.g.*, Donald C. Langevoort, *Brokers as*

This suitability duty has a long pedigree, tracing back to the 1930s. The Maloney Act of 1938 charged the SEC to register self-regulating securities agencies, such as the National Association of Securities Dealers ("NASD"), in order "to prevent fraudulent and manipulative acts and practices."[62] NASD Rule 2310, passed in 1939, in turn imposes an obligation regarding non-institutional clients to obtain information on the customer's financial status, tax status, investment objectives, and "such other information used or considered to be reasonable by a [broker-dealer] in making recommendations to a customer."[63] (Thus were born the check-boxes we enjoy when opening a brokerage account.) Other kindred entities followed suit; for example, the New York Stock Exchange's ("NYSE"') Rule 405, while not explicitly cast as a suitability rule, is referred to as the "Know Thy Customer Rule" and has been interpreted to require a suitability analysis.[64]

The SEC itself has not explicitly passed a suitability rule, although its practices have been to read one into its general anti-fraud proscription and its broad injunction of "fair dealing."[65] Relatedly, the SEC has, with a few exceptions,[66] eschewed direct ex ante regulation in favor of case-by-case adjudication to delineate a suitability standard incrementally.[67] Moreover, the case-by-case adjudication of suitability does not even occur at the SEC; it actually occurs primarily through NASD self-discipline (i.e., FINRA arbitrations),[68] albeit with occasional SEC direct enforcement against wayward broker-dealers.[69] A private right of action for suitability is also implied under

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Fiduciaries, 71 U. PITT. L. REV. 439 (2010).

62. Maloney Act, Pub. L. 75–719, 52 Stat. 1070 (1938) (codified as amended at 15 U.S.C. 78o) (authorizing the U.S. Securities and Exchange Commission to register national securities associations).

63. NASD Conduct Rule 2310 (formerly Article III, Section 2 of the NASD Rules of Fair Practice).

64. Financial Industry Regulatory Authority (FINRA), Regulatory Notice 09-25, *Suitability and "Know Your Customer" Proposed Consolidated FINRA Rules Governing Suitability and Know-Your-Customer Obligations*, (May 2009), at n.5, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118709.pdf.

65. SEC, *Guide to Broker-Dealer Registration* (2008), http://www.sec.gov/divisions/marketreg/bdguide.htm.

66. Those few exceptions included the SECO Rule for Non-NASD brokers that governed before mandatory registration was passed in 1983, which required "reasonable grounds to believe . . . [a] recommendation is not unsuitable for such customer," 17 C.F.R. § 240.15b10-3, as well as Rule 15c2-5 on margin trading, *see id.* § 240.15c2-5. The SEC does have what might be considered "indirect" ex ante suitability regulations, such as the categorical exclusionary effects of the accredited investor rules of Regulation D, *see id.* § 230.501, §§ 230.505-506, and more specifically Rule 15g-9's restrictions on trading in penny stocks, *see id.* § 240.15g-9, http://www.sec.gov/rules/final/34-51983.pdf, but for the most part has declined promulgating direct ex ante rules squarely on topic.

67. *See* Macey et al., *supra* note 43, at 839.

68. FINRA, *Arbitration & Mediation Rules*, *available at* http://www.finra.org/Arbitration Mediation/Rules. Suitability violation is actually pled quite frequently in arbitration claims. *See* Stephen J. Choi, Jill E. Fisch, and Adam C. Pritchard, *Attorneys as Arbitrators*, 39 J. LEG. STUD. 109, 123 (2010) (finding suitability violations pled in 49.76% of arbitrations). For a cogent analysis of the business costs of suitability monitoring, *see* Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, COLUM. BUS. L. REV. 71, 95-98 (2002).

69. *See* Securities Exchange Act of 1934, 48 Stat. 891, § 10(b) (1934), 15 U.S.C. § 78j(b) (1958); *see also, e.g.*, SEC v. Ainsworth, No. EDCV 08-1350 (C.D. Cal. Sept. 29, 2008) (SEC suit against group

securities law, but this right has not been known to generate landmark awards.[70]

Accordingly, although the SEC's suitability standard has not been elaborated through regulation, it has developed over time with a rich interpretative history. Not only has that history shown the content of the standard but also its deep-seated paternalism. Consider, for example, that it has been determined to be no defense to a suitability violation to plead disclosure; unsuitable investment recommendations are categorically prohibited, regardless of what the broker tells the client.[71] This paternalism reveals that while suitability is most avowedly not a fiduciary duty, it is, like a duty to analyze ability to repay, a strong abrogation of caveat emptor.

Given this lengthy history of usage in the securities arena, it is perhaps unsurprising that this quasi-fiduciary concept of suitability was on the minds of many leading up to the passage of Dodd-Frank. Indeed, one of Dodd-Frank's precursors, the would-be Borrower's Protection Act of 2007, went so far as to propose that "[i]n the case of a home mortgage loan, the mortgage brokers shall have a fiduciary relationship with the consumer, and each such mortgage broker shall be subject to all requirements for fiduciaries otherwise applicable under State or Federal law."[72] The Mortgage Reform and Anti-Predatory Lending Act of 2007 (which mostly found its way into Title XIV of Dodd-Frank) ended up taking a more modest approach, avoiding the contentious concept of suitability and instead suggesting tweaks to the "high-cost loan" trigger for HOEPA in order to expand its regulatory reach over problematic mortgages.[73] Expressly bowing to the charged nature of suitability and not wanting a fight, House sponsor Representative Barney Frank assured, "We felt a suitability standard was too vague . . . . We don't want to give people an

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of securities brokers alleging they sold unsuitable securities to customers with little formal education, poor English fluency, and insufficient funds to purchase the securities recommended by defendants absent refinancing).

70. *See* Macey *et al.*, *supra* note 43, at 817 (2009) ("SEC and federal courts have found broker-dealers personally liable for suitability violations under section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, under which private rights of action are implied."); *cf.* Sparta Surgical Corp. v. Nat'l Ass'n of Sec. Dealers, Inc., 159 F.3d 1209, 1213 (9th Cir. 1998) (finding a party has no private right of action against an exchange for violating its own rules); Jablon v. Dean Witter & Co., 614 F.2d 677, 681 (9th Cir. 1980) (holding that SRO suitability rules do not create a private right of action); Kathleen Engel & Patricia McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1316, 1338-39 (2002) (describing how "low and uncertain damage awards" reduce the number of suitability cases and that punitive damage awards are capped at $11,000 under FHA limits).

71. *See In re* Stein, S.E.C. Release No. 47335, 79 SEC Docket 1777 (Feb. 11, 2003), 2003 WL 431870, at *2 ("Registered representative does not satisfy the suitability requirement simply by disclosing the risk of an investment that he or she has recommended.").

72. Borrower's Protection Act of 2007, S. 1299 § 2, 110th Cong. (2007).

73. *See* Dodd-Frank, 124. Stat. 2157-60, § 1431. Note these HOEPA-altering provisions remained in the law. *See also Legislative Proposals on Reforming Mortgage Practices: Hearing on H.R. 3915 Before the H. Fin. Servs. Comm.*, 110th Cong. (2007) (statement of Marc Savitt, President-Elect, Nat'l Ass'n of Mortgage Brokers) (discussing suitability).

obligation that is too vague and obscure because you can scare people away from doing anything. We think these [proposals] are less subjective than suitability."[74]

Similarly, the Final Guidance on Subprime Mortgage Lending from 2007 (implementing the *Subprime Lending Guidelines*, discussed above) made clear that while the participating agencies were passing specific regulations proscribing certain lending practices,[75] they were most unequivocally not going to embrace suitability:

> The Agencies disagree with the commentators who expressed concern that the proposed statement appears to establish a suitability standard under which lenders would be required to assist borrowers in choosing products that are appropriate to their needs and circumstances. The commentators argued that lenders are not in a position to determine which products are most suitable for borrowers, and that this decision should be left to borrowers themselves. It is not the Agencies' intent to impose such a standard, nor is there any language in the Statement that does so.[76]

The final pre-enactment draft of Dodd-Frank, while eschewing suitability outright, did get close. In addition to shouldering lenders with the affirmative duty to analyze ability to repay that is the subject of this article, it even sought to propose a specific "net tangible benefit" test for refinancing loans, building up the plausible theory that loans saddled on debtors who cannot repay them confer no actual benefit.[77]

While this net tangible benefit requirement was left on the cutting room floor to ensure passage at the last minute, the surviving ability to pay requirement captures most if not all of the content of that rule. (Some have argued that suitability and ability to pay are wholly different concepts,[78] but that is debatable.)[79]

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74. Binyamin Appelbaum, *Frank's Bill Seeks Rules for Lenders*, BOSTON GLOBE, Oct. 23, 2007, http://www.boston.com/business/personalfinance/articles/2007/10/23/franks_bill_seeks_rules_for_lenders/ (quoting Representative Barney Frank).

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

76. *Id.* at 37,572.

77. *See* Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. sec. 202, § 129B(b)(1)-(b)(3) ("No creditor may extend credit in connection with any residential mortgage loan that involves a refinancing of a prior existing residential mortgage loan unless the creditor reasonably and in good faith determines, at the time the loan is consummated and on the basis of information known by or obtained in good faith by the creditor, that the refinanced loan will provide a net tangible benefit to the consumer."), *available at* http://www.gpo.gov/fdsys/pkg/BILLS-110hr3915eh/pdf/BILLS-110hr3915eh.pdf. As discussed *supra* note 43, the net tangible benefit requirement persists at state law..

78. *See* Macey *et al.*, *supra* note 43, at 832, 836-37 (borrower's ability to repay is a necessary but not sufficient condition of suitability). Bankers' lobbyists fear both. *See* Duncan, *supra* note 21, at 127 (opposing ability to pay rules as "too prescriptive") and 140 (opposing suitability standards as "too subjective").

79. To be sure, the latter is technically a constitutive factor of the former, but in the context of a residential mortgage, it is surely the lion's share of the relevant consideration. Requiring lenders to gauge a borrower's ability to repay creates enough quasi-fiduciary obligation that the marginal imposition of, say, an additional assessment of the suitability of a fixed or adjustable-rate mortgage (both of which have already been found affordable) seems negligible. Accordingly, much of the work of suitability standard is already achieved through the ability to pay duty.

Thus, it was not just the regulatory trial balloons in the mortgage oversight realm that gave rise to the Dodd-Frank ability to pay duty; securities law played a rich parallel role, too.[80]

Foreign Cognates

A duty to consider ability to pay, while perhaps late-coming to the American scene, has existed in other countries' laws for some time. France, for example, has prohibited banks to advise borrowers to assume more debt than they can repay, and even has a quite specific thirty-three percent debt service cap on disposable income.[81] Denmark, which has been singled out for praise by the International Monetary Fund ("IMF") for its stable mortgage market regulation, passed a 2003 Mortgage-Credit Loans and Mortgage-Credit Bonds Act, capping residential, owner-occupied mortgages at eighty percent LTV.[82]

Others, too, have been galvanized by the mortgage crisis. For example, the Canadians in October 2008 changed minimum standards for government-backed mortgages (mortgages with less than twenty percent down-payments, for which the government mandates mortgage insurance) to impose upon the lender a "reasonable effort to verify that the borrower can afford the loan payment."[83] Additionally, in February 2010, the Canadian government lowered the permissible principal amount a homeowner can take out in refinancing such

80. Interestingly, some creative litigants have sought to advance suitability duties for mortgage brokers by extending state unfair/abusive practices laws. *See, e.g.*, Tingley v. Beazer Homes Corp., 2007 WL 1902108 (D.N.C. April 25, 2008); Leff v. EquiHome Mortgage Corp., 2007 WL 2572362 (D.N.J. Sept. 4, 2007);.

81. *The French Model: Vive la différence! The French Way of Doing Things Looks Pretty Good—at Least in These Troubled Economic Times*, THE ECONOMIST (May 7, 2009); *see also* Financial Stability Board, Thematic Review on Mortgage Underwriting and Origination Practices Peer Review Report 9 (Mar. 17, 2011) (French law summary), www.financialstabilityboard.org/publications/r_110318a.pdf.

82. Mortgage-Credit Loans and Mortgage-Credit Bonds Act, unofficial English translation (2003), § 5(1), *available at* http://www.finanstilsynet.dk/upload/Finanstilsynet/Mediafiles/newdoc/Acts/Act454_100603H.pdf. Denmark used to be the darling of mortgage regulation analysts by having MBS's comply with its famous "balance principle," which required matching the underlying mortgage security dates to the term of the securities issues. *See* INTERNATIONAL MONETARY FUND, DENMARK: FINANCIAL SECTOR ASSESSMENT PROGRAM – TECHNICAL NOTE – THE DANISH MORTGAGE MARKET – A COMPARATIVE ANALYSIS 5 (2007). To comply with the EU Capital Requirement Directive, however, Denmark passed a revised mortgage act in 2007, U.S. Dept. of State, Bureau of Economic, Energy and Business Affairs, *2011 Investment Climate Statement – Denmark*, (April 2011), http://www.state.gov/e/eeb/rls/othr/ ics/2011/157267.htm, which gave lenders the option to choose compliance with the existing specific pass-through balance principle or a more general, "flexible" balance principle that essentially vitiated the strict coverage requirement. Harmonization enthusiasts should be careful what they wish for. For a detailed analysis of the differences between these two specific and general balance principles, see Realkreditraadet, Association of Danish Mortgage Banks, *General and Specific Balance Principle*, http://www.realkreditraadet.dk/Danish_Mortgage_Model/General_and_specific_balance_principle.aspx.

83. Press Release, Annette Robertson, Press Sec'y, Office of the Minister of Fin., *Government of Canada Takes Action to Strengthen Housing Financing – Backgrounder*, (Feb. 16, 2010) (*available at* http://www.fin.gc.ca/n10/data/10-011_1-eng.asp).

a mortgage from ninety-five percent to ninety percent.[84] In the most populous province of Ontario, moreover, provincial regulators went even further by adopting in 2008 an express suitability standard for mortgage brokers, which requires consideration of "the needs and circumstances of the borrower," as well as the implementation of procedures and practices to ensure "the suitability of a mortgage . . . for a borrower."[85]

Australia went beyond a mere duty to analyze ability to repay to an even broader affirmative duty of "responsible lending" in its National Consumer Credit Protection Act of 2009.[86] This duty includes an obligation to assess "whether the credit contract will be unsuitable for the consumer if the contract is entered or the credit limit increased."[87] Australia's suitability duty expressly requires consideration of the likelihood the consumer will be unable to comply with the financial obligations of the contract or whether compliance will engender "substantial hardship" on the consumer.[88]

Australia's invocation of a duty of "responsible lending" implicates a hotly contested policy debate that has been brewing in Europe for some time. There, several civil jurisdictions place fiduciary-like responsibility squarely on lenders. For example, Germany recognizes "sittenwidrige Uberschulduing" (immoral overburdening with debts) in its domestic law,[89] and Sweden's Consumer Credit and Banking Act bans the extension of credit to borrowers who cannot be expected to repay, allowing a private remedy of "debt adjustment" by the borrower for violation.[90] These strong consumer protections, by way of saddling arms-length lenders with affirmative duties to consider the needs of borrowers, helped ground a movement at the European Union ("EU") level to revise its Consumer Credit Directive to impose upon member states standardized policies of policing lending practices.[91] (This project ultimately ended up excluding mortgage products from its scope, but they in turn faced their own regulation, as discussed below.)

The initially proposed EU Consumer Credit Directive, floated in 2002, had a "responsible lending" section that contained an obligation to gauge a debtor's

84. *Id.*

85. Ontario Regulation 188/08, *enacted pursuant to* Mortgage Brokerages, Lenders and Administrators Act, 2006, § 24, *available at* http://www.e-laws.gov.on.ca/html/source/regs/english/2008/claws_src_regs_r08188_e.htm#BK29.

86. National Consumer Credit Protection Act 2009 (Austl.), *available at* http://www.comlaw.gov.au/Details/C2009A00134.

87. *Id.* at Ch. 3, Part 3-1, Div. 4, § 116(1)(b), Ch. 3, part 3-2, Div. 3, § 129(b).

88. *Id.* at Ch. 3, Part 3-1, Div. 4, § 118(2)(a), Ch. 3, part 3-2, Div. 3, § 131(2)(a).

89. *See* Udo Reifner *et al.*, CONSUMER OVERINDEBTEDNESS AND CONSUMER LAW IN THE EUROPEAN UNION, 100-01 (2003).

90. *Id.* at 100.

91. *See* Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC, *available at* http://eur-lex.europa.eu/Result.do?T1=V3&T2=2008&T3=48&RechType=RECH_naturel&Submit=Search.

ability to repay.[92] This concept met marked opposition from the United Kingdom ("UK"), which in commentary expressed "doubts about the value of a 'responsible lending' provision."[93] Consequently, the next draft in 2005 whittled down this duty to become one of only "advising" and "providing adequate information,"[94] with an explicit admonition that the *borrower* bears ultimate responsibility for deciding what credit is appropriate.[95]

When the credit collapse hit, however, the UK's resistance to burdening lenders with purportedly unfair duties lost punch; thus, the final version of the Directive, as enacted in 2008, while employing vaguer language than the initial draft, unquestionably shifts most responsibility back to the lender: "Member states should take appropriate measures to promote responsible lending practices . . . ." [96] Expanding, the Directive chides, "It is important that creditors should not engage in irresponsible lending or give out credit without prior assessment of creditworthiness . . . ."[97]

In March 2011, the European Commission followed up on the Consumer Credit Directive with its carved-out proposal for a Directive on Credit Agreements Relating to Residential Property.[98] The proposal "requires the creditor to assess the consumer's ability to repay the credit," clarifying that if the "consumer's creditworthiness results in a negative prospect for his ability to repay the credit over the lifetime of the credit agreement" the creditor must refuse credit.[99] This mortgage lending proposal builds upon the practices of many member states. A 2009 Public Consultation, for example, catalogs how Austria, Belgium, Hungary, Ireland, Malta, and the Netherlands already require suitability assessments of mortgage products based on the consumer's personal circumstances.[100]

The proposed Mortgage Directive of the European Commission, however,

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92. *See* Proposal for a Directive of the European Parliament and of the Council on the harmonization of the laws, regulations and administrative provisions of the Member States concerning credit for consumers, at 15-6, 40, COM (2002) 443 final (Sept. 11, 2002), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2002:0443:FIN:EN:PDF.

93. Dep't Trade & Indus., PROPOSAL FOR AN EC CONSUMER CREDIT DIRECTIVE – SUPPLEMENTARY CONSULTATION 5, 13 (2006), *available at* http://www.dti.gov.uk/files/file27459.pdf.

94. *See* Modified Proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers Amending Council Directive 93/13/EC, at 2, 6, 31, COM (2005) 483 final (Oct. 7, 2005) (stating that it is only necessary to consult databases "where appropriate"), *available at* http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/2ndproposal_en.pdf.

95. *Id.* at 6.

96. Directive, *supra* note 91, § 26.

97. *Id.*

98. European Commission, PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON CREDIT AGREEMENTS RELATING TO RESIDENTIAL PROPERTY (March 2011), *available at* http://ec.europa.eu/internal_market/finservices-retail/docs/credit/mortgage/com_2011_142_en.pdf.

99. *Id.* at 11, 35. Article 5(1) mandates that credit providers act "in accordance with the best interests of the consumer," which sounds fiduciary. *Id.* at art. 5(1).

100. EUROPEAN COMMISSION, PUBLIC CONSULTATION ON RESPONSIBLE LENDING AND BORROWING IN THE EU, 7 n.17 (June 2009), *available at* http://ec.europa.eu/internal_market/consultations/docs/2009/responsible_lending/consultation_en.pdf.

is at once both expansive and vague. In terms of the scope of ability to pay, it capaciously counsels consideration of "all necessary factors that could influence a consumer's ability to repay . . . including, but not limited to, the consumer's income, regular expenditures, credit score, past credit history, ability to handle interest rate adjustments, and other existing credit commitments."[101] It further demands acquisition of "necessary information regarding the consumer's personal and financial situation, his preferences and objectives."[102] On the other hand, whether that translates into specific rules is left up to each country: "Member States may issue guidance on the method and criteria to asses a consumer's creditworthiness, for example by setting limits on loan-to-value or loan-to-income ratios."[103] Furthermore, a suitability-like duty arises in a provision that requires the lender to "identify products that are not unsuitable for the consumer given his needs, financial situation and personal circumstances."[104]

The Europeans thus have not only had suitability (and even fiduciary duties) imposed on their lenders for some time, they are clearly strengthening and expanding those duties in EU-wide responses to the economic crisis. Indeed, even the UK, a previous holdout, has apparently had second thoughts on the efficacy of market discipline alone. In a Financial Services Authority ("FSA") Discussion Paper of 2009 on Mortgage Market Review, an "Affordability Assessment Model" was put forward to require lenders to assure credit be extended only to homeowners who could afford repayment.[105] The Model further imposes an obligation to verify affordability by calculating the borrower's "free disposable income" that is available for debt service.[106] FSA backed off, however, from suggestions for more rule-based limits, such as a hard LTV cap or debt-to-income ("DTI") cap on residential mortgage loans.[107] FSA's Mortgage Market Review of 2010 confirmed this affordability approach

101. PROPOSAL, *supra* note 98, at Pmbl. ¶ 24.

102. *Id.* at art. 14(4); *see also id.* at art. 17(b) (requiring gathering of "necessary information" on "personal and financial situation, preferences and objectives so as to enable recommendation of suitable credit agreements"). Article 17(a) even mandates lenders to consider a "sufficiently large number of credit arrangements." *Id.* at art. 17(a).

103. *Id.* at Pmbl. ¶ 24.

104. *Id.* at art. 14(5). The Proposal implements the suggestion of the 2010 Working Paper preceding the proposal that "the creditor . . . should thoroughly assess the suitability of credit contracts for the consumer's personal and financial circumstances on the basis of sufficient information, where appropriate obtained from the consumer." *Responsible Mortgage Lending and Borrowing* 9 (European Commission Working Paper, 2010), *available at* http://www.fininc.eu/gallery/documents/efin-news/work-paper-resp-lending-2010-07-22.pdf. Unlike "hard" suitability under U.S. securities law, however, the Working Paper envisions an insistent consumer being able to proceed with an unsuitable credit contract after express disclosure, warning, and written waiver – waiveable ("soft") suitability, but suitability nonetheless. *Id.* at 8-9. The Proposal seems to have shut this down. *See* PROPOSAL, *supra* note 98, at art. 29(1) ("[C]onsumers may not waive the rights conferred on them by . . . this Directive.").

105. FINANCIAL SERVICES AUTHORITY, DISCUSSION PAPER 09/3 MORTGAGE MARKET REVIEW 51 (October 2009), *available at* http://www.fsa.gov.uk/pubs/discussion/dp09_03.pdf.

106. *Id.* at 12.

107. *Id.* at 11, 37.

and even considered stricter rules for "credit impaired" borrowers, such as a twenty percent "buffer" in calculating free disposable income.[108]

Finally, quick mention should be given to other international approaches to mortgage market regulation, such as the Basel Committee on Banking Supervision ("Basel"). Because the mortgage meltdown had global systemic ramifications, Basel also became involved in offering recommendations for banks.[109] Minimum underwriting standards, including repayment capacity analysis, effective income verification, and "appropriate" LTVs, have all been included in Basel's suggestions, although with nowhere close to the specificity found in many domestic proposals.[110]

This brief comparative law overview shows how some countries have had ability to pay, suitability, and even full-throated responsible lending duties imposed upon mortgage credit providers for some time.[111] It also reveals a convergence of concepts and terminology. The panic-inducing collapse of global mortgage markets may well have herded countries toward a harmonizing regulatory path, where a duty to ensure ability to repay no longer seems innovative but commonplace. While it would likely be overstatement to contend that we are witnessing the emergence of a harmonized global standard, it is fair to observe that what seems like a shocking innovation to U.S. consumer law may be nothing more than the U.S. catching up (or, some would argue, being led astray) to where most other developed mortgage markets already are.

Academic Support

Finally, just as Elizabeth Warren agitated for a consumer financial protection agency for some time,[112] so too have academics kept the pressure on for some form of suitability or similar duty on mortgage lenders. Kathleen Engel and Patricia McCoy (the latter of whom is now tapped to run one of the CFPB's mortgages units)[113] win the salience award for their 2002 *Texas Law Review* article, in which they propose "a duty of suitability in subprime

108. FINANCIAL SERVICES AUTHORITY, CONSULTATION PAPER 10/16 MORTGAGE MARKET REVIEW 9, 28 (2010), *available at* http://www.fsa.gov.uk/pubs/cp/cp10_16.pdf.

109. JOINT FORUM, REVIEW OF THE DIFFERENTIATED NATURE AND SCOPE OF FINANCIAL REGULATION – KEY ISSUES AND RECOMMENDATIONS (2010), *available at* http://www.bis.org/publ/joint24.htm.

110. *Id.* at 15-7.

111. Some countries have even broader consumer protection laws that are so protective that suitability would appear subsumed. *See, e.g.*, Consumer Protection Act, 2008, Ch. 2, Part G (S. Afr.) ("Right to fair, just and reasonable terms and conditions.").

112. *See* Elizabeth Warren, *Unsafe at Any Rate*, 5 DEMOCRACY 8 (2007), *available at* http://www.democracyjournal.org/pdf/5/Warren.pdf.

113. Press Release, U.S. Dep't of the Treasury, Press Center, Treasury Department Announces Senior Hires for CFPB Implementation Team (Feb. 17 2011) (McCoy hired as Assistant Director for Mortgage and Home Equity Markets), http://www.treasury.gov/press-center/press-releases/Pages/tg1070.aspx.

mortgage lending."[114] Making their case, Engel and McCoy "draw upon suitability in securities and insurance" to explain that the "new duty of suitability puts the onus of preventing predatory lending on those who can afford it most cheaply (i.e., predatory lenders and brokers) by authorizing the federal government and aggrieved victims to sue for loan reformation, disgorgement, and damages."[115] Note that even Engel and McCoy were not so bold as to suggest blanket application of suitability to the entire mortgage market—as Dodd-Frank does—but just to the subprime market. (It is amazing what an intervening global economic collapse will do.) Their focus on private remedies to enforce newly placed duties on lenders mirrored other agitants' cries demanding more dramatic remedies to combat the "reckless lending" infecting the consumer credit markets.[116]

Engel and McCoy were not alone. Daniel Ehrenberg also advocated suitability, borrowing more directly from securities law.[117] Some even made the argument that suitability could (and should) be attached under current securities law, under the theory that mortgage sales could be seen as transactions "in connection with" the purchase and sale of securities.[118] In addition to like-minded supporters, there were also the critics, such as Todd Zywicki and Jack Guttentag, the latter of whom snorted, "Nobody makes loans known to be unaffordable at the outset except collateral lenders . . . and perpetrators of fraud."[119] One of the more bizarre critiques came from Anthony Yezer, who protested that a suitability standard would be tough for the average bank because loan officers would need to have committed to memory hundreds of their products to discharge this duty effectively.[120] (Even leaving aside the likelihood that a broker-dealer surely needs familiarity with a similar number of

114. Engel and McCoy, *supra* note 70, at 1259.

115. *Id.*

116. Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1, 17–18 (1975); *see also* John A. E. Pottow, *Private Liability for Reckless Lending*, 2007 U. ILL. L. REV. 405, 408.

117. Daniel S. Ehrenberg, *If the Loan Doesn't Fit, Don't Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending*, 10-WTR J. AFFORDABLE HOUS. & CMTY. DEV. L. 117, 125-27 (2001).

118. *See* Macey et al., *supra* note 43, at 792, 809, 813 (arguing, inter alia, subprime mortgage might be a "note" for securities law purposes (and not a mere "debt") under the so-called *Reves* test because "we believe that some mortgages have crossed the line between financial vehicles used to finance personal consumption (which are not securities) and financial instruments with significant investment components that should be categorized as notes regardless of the fact that there is a consumption component involved").

119. Jack Guttentag, *Suitability Standards Could Carry Unintended Consequences*, WASH. POST, Mar. 31, 2007, http://www.washingtonpost.com/wp-dyn/content/article/2007/03/30/AR2007033001016.html; *see also, e.g.*, Todd Zywicki and Joseph Adamson, *The Law & Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 78 (2009).

120. *See Ending Mortgage Abuse: Safeguarding Homebuyers: Hearing Before the Sen. Subcomm. on Hous., Transp. and Community Dev. of the Sen. Comm. on Banking, Hous., and Urban Affairs*, 109th Cong. 5 (2007) (written testimony by Professor Anthony M. Yezer, George Washington University), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=827e024c-707e-4edb-b4b5-ffa285d19982&Witness_ID=877fac70-cca2-42c6-bf27-0f94c336e054.

investment products to discharge his suitability duty, and the fact that securities law has not collapsed under the weight of such a rule, one is left wondering just how non-repeat mortgage borrowers would be better situated to memorize such offerings than their loan officers.)[121] Finally, Richard Posner contributed his requisite chime-in, arguably signaling conclusion of the intellectual discussion.[122]

Thus, Dodd-Frank's ability-to-repay duty can be seen not just as an acceleration of the gradual change working its way through the field of extant U.S. mortgage regulations that was triggered by the unprecedented housing market collapse, but as the product of a convergence of intellectual pressure from domestic regulators, state legal entrepreneurs (such as North Carolina),[123] non-mortgage regulators in the securities field, foreign jurisdictions, and academic commentators.

ANALYSIS: WHAT WILL IT ACTUALLY LOOK LIKE?

Dodd-Frank offers remarkable specificity in many aspects. Consider, for example, the highly detailed, timeline-setting deadlines for the passage of specific regulations.[124] By contrast, there is little guidance in the statute on just how this landmark duty to analyze ability to pay should be enforced. For example, in the UK, regulators expressed serious reservation about how to implement sets of these provisions, particularly the "inflexibility" of imposing strict caps on LTV and DTI to bar certain types of loans.[125] On the other hand,

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121. Engel and McCoy also note the inherent regressivity of such an argument, pointing out that because "suitability is appropriate for financial instruments that have been the traditional province of the affluent, certainly it is appropriate for financial instruments that are peddled to the poorest rung of society." Engel & McCoy, *supra* note 70, at 1319.

122. Richard A. Posner, *Treating Financial Consumers as Consenting Adults*, WALL ST. J., July 22, 2009, http://online.wsj.com/article/SB10001424052970203946904574302213213148166.html.

123. This article has avoided an extensive survey of state laws, other than a brief comment, *supra*, at note 43. For a good discussion of state-level innovations, see Hirsch, *supra* note 12, at 30-33, who describes, e.g., Colorado as imposing a "quasi-fiduciary duty" on mortgage brokers. *See also* Engel & McCoy, *supra* note 70 at 1299-1305 (discussing state law remedies for predatory lending).

124. *See* Dodd-Frank, *supra* note 1, at 2136, § 1400(c) (regulations under Title XIV become effective twelve months after the Board issues final regulations and guidelines and the Act requires the Board to issue final regulations within eighteen months after the transfer date); *see also* 75 Fed. Reg. 57,252-53 (Sept. 20, 2010) (transfer date is July 21, 2011, when "'consumer financial protection functions' currently carried out by the Federal banking agencies, as well as certain authorities currently carried out by the Department of Housing and Urban Development and the Federal Trade Commission, will be transferred to the CFPB"); Dodd-Frank, *supra* note 1, at 2148, §1412(3)(ii) (HUD, Dept. of Agriculture, Dept. of Veterans Affairs and the Rural Housing Service shall in consultation with the [Federal Reserve] Board prescribe rules defining the types of loans they insure, guarantee or administer that are qualified mortgages for the purposes of the safe harbor provision). On the transfer date, "consumer financial protection functions" carried out by Federal banking agencies, HUD and FTC will be transferred to the CFPB; specifically the CFPB will "assume responsibility for consumer compliance supervision of very large depository institutions and their affiliates and promulgating regulations under various Federal consumer financial laws" and "take steps to implement the risk-based supervision of nondepository covered persons." 75 Fed. Reg. 57,253.

125. *See supra* text accompanying note 107.

within the HOEPA framework, there is ready willingness to set very specific numerical rules, right down to the jurisdictional trigger.[126] How should we read between the statutory lines with Dodd-Frank? For instance, is the expansion of the duty to analyze a borrower's ability to pay to all loans (rather than just high-cost ones) an implication that Congress wants the reach of regulation to be as broad and as strict as possible?

Legislative Guidance

The relevant commands of the statute itself are intriguing. They begin with a general injunction of barring loans that are underwritten without analyzing the borrower's ability to repay.[127] This broad exhortation is followed by a statutory list of mandated factors to consider, which includes the:

> consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan.[128]

This is a comprehensive-sounding list, to be sure, but one that actually requires no specific weighting of any of its constitutive elements. Moreover, the statutory specificity continues even down to the next level of implementation, where the duty to verify income is in turn micromanaged regarding which documents to requisition: W-2s, tax returns, payroll receipts, etc.[129] Countless other examples abound of this statute-level detail, such as how to account properly for an ARM or non-fully amortizing loan in working the ability to repay analysis.[130]

Perhaps most significantly, the statute also provides a presumption to implement the ability to repay duty, in a section captioned, "Safe Harbor and Rebuttable Presumption." Section 1412 amends (as amended!) TILA section 129C after subsection (a) with a new subsection (b):

> (b) Presumption of Ability to Repay.—
>
> (1) In General.—Any creditor with respect to a residential mortgage loan, and any assignee of such loan subject to liability, may presume that the loan has met the requirements of subsection (a), if the loan is a qualified mortgage.
>
> (2) Definitions.— . . .
>
> (A) Qualified Mortgage.——[defining the term over a page of statutory text,

126. *See supra* text accompanying note 34; *see also* Dodd-Frank, *supra* note 1, at 2146-47, §1412(2)(c), 124 Stat. 2157-60, §1431.

127. *See* Dodd-Frank, *supra* note 1, § 1402, 124 Stat. 2142, § 1411.

128. *Id.* at 2143, § 129C(a)(3). One virtue of the comprehensiveness of this list is that its flexibility to consider future income dispatches many of the horribles oaraded by detractors. *See, e.g.*, Zywicki, *supra* note 119, at 79 (presenting example of medical resident on the cusp of transformative salary increase).

129. Dodd-Frank, *supra* note 1, § 129C(a)(4).

130. *Id.* at 2144, § 129C(a)(6).

> including in relevant part: "(vi) that complies with any guidelines or regulations established by the Board in relation to ratios of total monthly debt to monthly income, alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Board may determine relevant and consistent with the purposes described in paragraph (3)(B)(i)."][131]

Note that this highly detailed statutory definition is in turn followed by a broad re-definition authority conferred in the subsequent subsection:

> (3) Regulations.—— . . .
>
> (B) Revision to Safe Harbor Criteria.——The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B to prevent circumvention or evasion thereof, or to facilitate compliance with such sections."[132]

Making sense of this interpretative presumption is difficult. At first blush, it seems a back-door resurrection of the excised "plain vanilla" rules that sought to privilege certain forms of standard form mortgages (by according safe harbor) over others.[133] That is, by defining qualified mortgages to exclude negative-amortizing mortgages, ones with certain high balloon payments, etc., Dodd-Frank effectively privileges the residuum by according them a rebuttable presumption of demonstrated ability to repay. It is not complete safe harbor from statutory scrutiny, to be sure, but exemption (or, more precisely, rebuttable exemption) from one of its more significant and transformative requirements. On the other hand, the privilege is perhaps a hollow one, because in the multi-pronged definition of "qualified mortgage" lies the express criterion of compliance with the Fed's (or CFPB's) guidelines and regulations relating to DTI, which surely stands in as a regulatory proxy for ability to pay.[134] Thus, mortgages that have a demonstrated ability to pay under the Fed's

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131. *Id.* § 1412, 124 Stat. 2145-46. Note that, cruelly, "Qualified Mortgages" are expressly distinguished from "Qualified Residential Mortgages." The latter come from the sexpartite multi-agency "Risk Retention Rules" that were promulgated in initial proposed form on March 31, 2011. In requiring sponsors and securitizers of asset-backed securities to retain five percent of the credit risk for each securitization transaction, the regulators propose exempting issuances that entirely comprise "qualified residential mortgages." Credit Risk Retention by Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Office of the Comptroller of Currency, Securities and Exchange Commission, 144-45 (March 31, 2011) (to be codified at 12 C.F.R. pt. 244) (proposed rulemaking), *available at* http://www.fdic.gov/news/news/press/2011/pr11062.html. While the definition of "qualified residential mortgage" is stringent, rule-based and includes an "ability to pay" requirement (twenty-eight percent "front end" mortgage DTI and thirty-six percent total "back end" DTI), *id.* at 20, 127-30, 144-45, that definition "should not be interpreted in any way as reflecting or suggesting the way in which the Qualified Mortgage standards under TILA [per Dodd-Frank] may be defined either in proposed or final form." *Id.* at 103-04.

132. Dodd-Frank, *supra* note 1, § 1412(b)(3), 124 Stat. 2148. On the transfer date, the authority over safe harbor criteria will go to the CFPB. *See id.* § 1061(b), 124 Stat. 2036.

133. *See supra* note 3, at 9-10.

134. *See* Dodd-Frank, *supra* note 1, § 1412(b)(2)(A), 124 Stat. 2145-46.

guidelines are rebuttably presumed to have an ability to pay!

Perhaps this is not gibberish. For example, were the Fed to decline to issue any DTI guidelines at all, then the safe harbor would presume ability to pay for otherwise qualified mortgages, and hence the privileging would be doing some work. But if we anticipate a subversive Fed trying to undermine the Act through refusal to pass DTI guidelines, why would such a Fed not just exercise its regulatory power to define "qualified mortgage" more broadly to exempt everything, as it clearly has power to do under section 1412(b)(3)(B)? In sum, it is not clear the enabling legislation provides much in the way of helpful guidance regarding delineation of ability to pay.

Kindred Regulations

Limited but nevertheless useful insight on how to interpret ability to pay can also be gleaned from the regulations just promulgated under CARD that seek to provide guidance on *that* statute's duty to assess "ability to pay."[135] The Fed took its crack with Proposed Rules in October 2009 and followed up with Final Rules in February 2010. The regulations provide credit card lenders with a safe harbor if they assess repayment following certain assumptions, including that the full line of credit is drawn for new accounts and that the "real" APR (not the teaser rate) is applied. Note, however, that the regulations do not assume any fees are incurred, other than mandatory ones such as annual membership fees, for fear they are "too speculative,"[136] and the inclusion of annual fees only came as a compromise after protest over the "no fees" aspect of the Proposed Rule.[137] Safe harbor under CARD does not require verification of income, assets, etc., as is mandated under Dodd-Frank, because according to the Fed, such a requirement is "burdensome," especially for telephonic applications; plus there is "no evidence," the Fed insists, of income-inflating liar loans in the credit card market.[138] Most toothlessly, alas, the ability to pay analysis only requires scrutiny of the ability to make the minimum monthly payment, not (as suggested by one commentator on the Proposed Rules) scrutiny of payment that amortizes the loan within a reasonable period of time. This omission is grounded in part on statutory text of the specific "ability to pay" provision in CARD.[139] (This lender leniency is perhaps why one banking

135. Truth in Lending, 74 Fed. Reg. 22,948 (March 18, 2011) (to be codified at 12 C.F.R. pt. 226) (final rulemaking), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20110318b.htm. Note that additional insight apparently cannot be gleaned – by regulatory command – from the new "Qualified Residential Mortgage" provisions of the inter-agency Risk Retention Rules. *See supra* note 131.

136. Truth in Lending, 74 Fed. Reg. 54,124, 54,127, 54,160-61, 54,125-26 (Oct. 21, 2009) (codified at 12 C.F.R. pt. 226) (proposed rule), Truth in Lending, 75 Fed. Reg. 7658, 7660, 7721-22, (Feb. 22, 2010) (codified at 12 C.F.R. pt. 226) (final rule).

137. 75 Fed. Reg. 7722.

138. 74 Fed. Reg. 54,161, 75 Fed. Reg 7721.

139. *Id.*

lobbyist praised CARD's ability to pay regulations as having "worked OK, with some tweaks.")[140]

One recurrent comment after the Proposed Rules came out was for "more guidance" on just how to measure ability to pay. This resulted in the Fed's inclusion in the Final Rule of two interesting additions. First, at the prodding of consumer advocates, numerical ratios were injected: lenders must now "consider" the borrower's debt-to-income ratio, debt-to-assets ("DTA") ratio, or "residual income" (defined as the income left after the debtor services debt, but not living expenses, so perhaps this is "quasi-net income"), although there is no specific trigger of what might constitute an excessive ratio.[141] Second, at the pushing of industry, the Fed will allow the use of "reasonable policies and procedures" to estimate a borrower's "obligations" in assessing ability to pay, including income and asset estimates based on "empirically derived, demonstrably and statistically sound models."[142] The Fed's discussion of the rules reveals strong lobbying and a clear aversion by industry to conduct individual borrower analysis beyond credit score review, modeling, and other quantitative algorithms.[143] (One worries about reliance on statistical models after the financial collapse of 2008, but maybe the Fed envisions a brave new world of even bigger, more unsinkable, models.) It is interesting to note that these rules were being finalized during the final jockeying over Dodd-Frank, which may explain the incorporation of greater specificity into that statute's text tracking wording from the Fed's regulations interpreting CARD (e.g., "residual income").

Whether and to what degree these CARD regulations will help shed light on Dodd-Frank remains to be seen. Indeed, even the revisions to the rules were insufficient guidance for some, requiring a still further set of "clarifying" amendments that came down in March 2011, dealing with such down-in-the-weeds detail as how to define "household income."[144] To the extent that this moving target can be tracked, it certainly seems consistent with further

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140. *See* Feddis, *supra* note 3.

141. 75 Fed. Reg. 7660. "Residual income" is used elsewhere in federal housing regulation, such as by the Dept. of Veterans Affairs ("VA") in its underwriting standards for VA loans. *See Foreclosure Prevention and Sound Mortgage Servicing Act: Hearing Before the Subcomm. on Hous. & Cmty. Opportunity, H. Comm. on Fin. Servs.*, 110th Cong. 110-108 (2008) (statement of Judith Caden, Director, Loan Guaranty Service, Dept. of Veterans Affairs) ("Lenders underwriting VA loans must ensure that the contemplated terms of repayment bear a proper relation to the veteran's present and anticipated income and expenses, and that the veteran is a satisfactory credit risk. VA's credit standards employ the use of residual income guidelines and debt-to-income ratios in determining the adequacy of the veteran's income."). For a good discussion of this construct, *see* John Eggum, Katherine Porter & Tara Twomey, *Saving Homes in Bankruptcy: Housing Affordability and Loan Modification*, 2008 UTAH L. REV. 1123, 1136.

142. 75 Fed. Reg. 7660, 7718, 7720.

143. *Cf.* Ruth Simon, *Banks Get Back to the People Business*, WALL ST. J., Mar. 7, 2011, at C1 (discussing return to "character analysis" in loan underwriting in addition to numerical scoring).

144. *See* Board of Governors of the Federal Reserve System, Truth in Lending, 107, 111 (Mar. 18, 2011) (to be codified at 12 C.F.R. pt. 226) (final rulemaking).

emphasis on highly specific rules, a topic explored in more depth immediately below.

Rules or Standards?

What about the perennial rules vs. standards debate? In lobbying against the imposition of a suitability standard, the Mortgage Bankers Association warned against the perils of a "subjective" standard of suitability, taking the position (as a back-up to rejecting the suitability standard altogether) that were a federal intervention made, it would have to be "clear and objective,"[145] i.e., a rule.[146] Yet at the same time it lobbied against subjectivity in opposing a standard such as suitability (and, by analogy one assumes, ability to repay), the Mortgage Bankers Association also railed against the dangers of a DTI ceiling of forty-five percent[147] Some rules are apparently better than others. Section 1412 of Dodd-Frank clearly indicates that the Fed could indeed say a borrower with a DTI above forty-five percent lacks ability to pay, and so perhaps the most significant interpretative impact of the qualified mortgage rebuttable presumption of ability to pay is not so much its content (which could be rendered meaningless) but its explicit countenancing of specific rules, such as DTI caps. Indeed, it is that possible approach that so frightened regulators in the UK.[148] and perhaps explains the Europeans' ambivalence.[149] As discussed just above, the CARD regulations seem to be grasping toward requirement that include "consideration" of rule-like DTI formulas, but in a watered-down sense that allow a modeling bypass.

Accordingly, a highly plausible conjecture is that as Dodd-Frank unfolds, we will see the proliferation of many specific rules and formulas that in turn will be revised over time.[150] That is, in prognosticating on the rules-standards continuum, rules will rise ascendant. This prediction stems from a culmination of factors: first, the specific cue in Section 1412 to embrace such rules as a DTI

145. Hirsch, *supra* note 12, at 27 (quoting lobbying positions).

146. It also insisted that any mortgage reform not entail a private right of action as a remedy, although one fails to see how this follows from its insistence on objectivity over subjectivity. *See id.*

147. *Id.*

148. The 45% DTI ratio comes from, in part, proposals from consumer advocacy groups. *See, e.g.*, Paul Leonard, Cal. Office Dir., Ctr. for Responsible Lending, Remarks before Cal. State S. Banking, Fin. & Ins. Comm. 12 (Mar. 5, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/states/final-3-05-08-senate-banking-testimony-on-fed-rules-final.pdf. Some of these proposals are discussed in Hirsch, *supra* note 12, at 26.

149. *See supra* text accompanying note 103.

150. This prediction is fully mindful of the explicit disassociation by the CFPB's proto-head. *See infra* note 155. That may well be her intention, but she will have to reverse a tide of rule-enthusiasm. For the latest manifestation of such rule-enthusiasm, *see* Credit Risk Retention *supra* note 131, at 20, 127-30 (multi-agency release specifying the "risk retention rules" under Dodd-Frank, which exempt "qualified residential mortgage" securities from the Dodd-Frank five percent retention requirement; "qualified residential mortgages" in turn are defined as loans with a mortgage DTI ratio of no more than twenty-eight percent and total DTI ratio of no more than thirty-six percent).

ratio;[151] second, the proliferation of prohibitory rules already in the Statute (e.g., ban on prepayment penalties for unqualified mortgage,[152] ban on mandatory arbitration for residential mortgage loans under an open-end, consumer credit plan,[153] etc.); third, the conceptually contagious "niggling" provisions of the express statutory text, such as Section 129C's insistence on which types of tax documents to examine in underwriting a debtor's loan;[154] fourth, baseline hyperactivity of newly created and newly invigorated federal agencies;[155] and finally, bureaucratic hindsight conviction that the recent housing collapse might have been avoided had we simply retained rules like the pre-1982 hard LTV caps on residential mortgages. One can even envision categorical bans of certain products (the analogy of the accredited investor rule from securities law's Regulation D comes to mind).[156] The power of the Fed to expand and contract the definition of a "qualified mortgage" as it sees fit surely suggests the lesser power to pass such categorical rules banning products it sees as generating an inherent risk of inability to pay. And rules and categories certainly seem popular with the swath of regulations rolling out under Dodd-Frank.[157] Although the normative debate of preference for rules or standards in regulating residential mortgages is not one suited for the present discussion,[158]

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151. Dodd-Frank, *supra* note 1, § 1412(b)(2)(A)(vi), 124 Stat. 2146. Technically, one might envision a Fed regulation banning an "unreasonable DTI" (*i.e.*, a standard), but that borders on silly. Then again, in interpreting CARD, the Fed only requires vague "consideration" of DTI. *See* Credit Risk Retention, *supra* note 131, at 108.

152. *See* Dodd-Frank, *supra* note 1, § 1414(a)(c)(1)(A)-(B), (a)(c)(3) 124 Stat. 2149-50.

153. *See* Dodd-Frank, *supra* note 1, § 1414(e), 124 Stat. 2151.

154. Dodd-Frank, *supra* note 1, § 129C(a)(4), 124 Stat. 2143.

155. The activity level of an agency will depend on its head, a point emphasized by many. *See, e.g.*, Wright, *supra* note 11 (emphasizing criticality of CFPB's first director). Elizabeth Warren, one possible contender, has made clear she has no intention of a regulatory binge if at the helm of the CFPB. Embracing a position of the Financial Services Roundtable, Warren opines,

"Instead of creating a regulatory thicket of 'thou shalt nots,' and instead of using ever-more-complex disclosures that drive up costs for lenders and provide little help for consumers, let's measure our success with simple questions. . . . . Instead of layering on regulations that don't fully protect consumers, a better approach would focus on how to give consumers the power to make the right choices for their families – and, at the same time, to ease the regulatory burden for the lenders."

Shahien Nasiripour, Elizabeth Warren Extends Olive Branch, Borrows Idea From Lenders in First Major Speech, HUFFINGTON POST, Sept. 29, 2010, http://www.huffingtonpost.com/2010/09/29/elizabeth-warren-financial-services-roundtable_n_744619.html (reporting on prepared remarks to the Financial Services Roundtable from September 2010).

156. *See supra* note 66. Note that the proto-CFBP head, at least in some contexts, appears to like categorical rules. "It is impossible to buy a toaster that has a one-in-five chance of bursting into flames and burning down your house. But it is possible to refinance an existing home with a mortgage that has the same one in-five chance of putting the family out on the street." Warren, *supra* note 112, at 8.

157. The March 31, 2011 Risk Retention Rules, *see supra* note 131, while explicitly impermissible to rely upon in interpreting the mortgage lending ability to pay rules, do provide interesting insight on the presence of categorical distinctions in analyzing ability to pay. For example, the rules expressly counse that ability to pay should be scrutinized differently for an automobile loan (current income and DTI) than for a business loan (liabilities, leverage, and coverage ratios). *Id.* at 150-52, 161-62.

158. Vincent DiLorenzo offers interesting analysis on whether Dodd-Frank signals an end to what he contends was the disastrous "principles-based" standards approach that prevailed after 1982. He sees Dodd-Frank as clearly "two steps forward" toward the resurgence of rules, but also feels the quasi-cost-benefit constraint on generating new regulations, *see* Dodd-Frank, *supra* note 1, §1031, 124 Stat. 2005-

it is worth quickly noting that the proto-head of the CFBP, while at times having expressed interest in rules, has gone on record in agreeing with banking industry leaders on the need to have flexible regulatory standards.[159]

Sister Statutory Fields

How else might an "ability to pay" duty be operationalized? One area that confronted this problem recently is bankruptcy law, where the 2005 amendments to the Bankruptcy Code under the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") mandated an "ability to pay" screen for Chapter 7 (liquidation) bankruptcy through revised 11 U.S.C. § 707(b).[160] There, Congress took two approaches to measuring ability to repay debts in the bankruptcy context: a gross income screen and a net income screen. For gross income, the statute deems bankrupt debtors unable to repay their debts as a matter of law if they earn less than the applicable state median gross income.[161] For net income, the statute specifies a highly detailed and routinized test of permissible budgetary expenses that is largely driven by IRS guidelines used by field agents negotiating repayment schedules with tax delinquents.[162] What the brief experience of BAPCPA to date has taught us, however, is that even a highly routinized "means tests" crafted by ex ante rules can create a maelstrom of ex post litigation. For example, in the few years since its effective date, already three means test statutory disputes have required Supreme Court intervention.[163]

This ominous BAPCPA lesson could lead to several possible outcomes. First, it might embolden the Fed to seize upon per se gross income rules, deeming some products categorically off limits for certain income demographics (or categorically permissible for others). Second, it could be ignored (or passingly acknowledged) by a resolute Fed ready to bite the bullet

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06, as "a step backward" toward standards. DiLorenzo, *supra* note 23, at 62-66, 81-83. Interestingly, Engel and McCoy too prefer rules to standards, arguing that the concept of suitability in the securities laws context (which found outlet in standards) would transpose poorly to mortgages. *See* Engel & McCoy, *supra* note 70, at 1343-44.

159. *See supra* note 156. Warren's comments are presumably intended as an olive branch to the lending industry, but it is not clear whether standards are preferable to rules by the regulated entities. Maybe they think standards provide plausible deniability for captured regulators? It seems equally likely, as a theoretical matter, that they might actually prefer the certainty of brighter rules.

160. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-08, § 707, 119 Stat. 27 (2005).

161. *Id.* § 707(b)(6)-(7); *cf.* § 707(b)(3) (re-imposing judicial scrutiny for means-test passers under certain circumstances).

162. *Id.* § 707(b)(2)(A)(ii)(I)-(V) ("The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service . . ..").

163. *See* Ransom v. FIA Card Services, N.A., 131 S. Ct. 716 (2011); Hamilton v. Lanning, 130 S. Ct. 2464 (2010); Milavetz, Gallop & Milavetz, P.A. v. U.S, 130 S.Ct. 1324 (2010).

of crafting net income rules.[164] Note that the UK, for all its insistence on not wanting to have hard-and-fast rules like LTV or DTI caps, apparently believes it will be able to police an obligation on lenders to calculate "free disposable income," a number that includes deductions for "committed expenditures for the borrower's and borrower's dependents (income tax, national insurance, utility bills, alimony and maintenance payments, school fees) as well as personal expenditures (food, clothing, health and personal care, transport, recreation and holidays)."[165] As such, the Fed might use the UK as a guinea pig in coming up with its own BAPCPA-like list of deductions in getting to the appropriate "income" that grounds the ability to pay analysis. (It is also, of course, possible that the Fed learns the ultimate BAPCPA lesson and tries to fob everything off to the IRS.)[166]

Complicating Considerations

Complicating the analysis of what ability to pay regulation will look like is the issue of preemption. Weighing in on a long-fought battle,[167] Dodd-Frank makes clear that federal preemption of state consumer protection laws is lifted; federal law is to become a "floor" from which more consumer-protective states are free to depart upward.[168] This raises the prospect that some practices that survive categorical proscription at the federal level may nevertheless be banned by specific states (so long as they do not create an actual conflict).[169] Compounding this potential confusion is the restriction on remedies. One of the fighting lines in the battle over Dodd-Frank was the creation of a private right of action for consumers, which was resolved in favor of industry by generally

164. This seems unlikely based on the experience of the new CARD amendments to Regulation Z. *See supra* note 135, at 108. There, the Fed initially suggested that lenders be required to consider a debtor's "obligations" in gauging ability to pay in its proposed rules, but when pressed for more guidance in the final rules, simply suggested "consideration" of specific financial ratios, such as DTI, DTA, or something called "residual income," which was defined as income after service of debts (and is better thought of as "quasi-net income").

165. Mortgage Market Review, *supra* note 105, at 16, 23. Fannie and Freddie automated underwriting systems, which provide perhaps some basis of measuring ability to pay, but one might reasonably have diminished confidence in the output of these institutions.

166. Note that either path would be consistent with a prediction of rules-enthusiasm.

167. *See* Watters v. Wachovia Bank, 550 U.S. 1 (2007).

168. *See* Dodd-Frank, *supra* note 1, § 1041, 124 Stat. 2011.

169. It is difficult to overstate the co-federalism significance of Dodd-Frank. The Attorney General of Indiana recently remarked in public comments that state regulators are conscious of the significant role they will be expected to play in co-enforcing the new financial reform laws. *See* Hon. Greg Zoeller, Attorney General of Indiana, Remarks at the 2011 Marquette Law School Public Service Program: New Directions in Consumer and Community Financial Protection (Feb. 25, 2011). Legal writing is emerging too on this topic. *See, e.g.*, Lauren Saunders, *The Role of the States Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, Nat'l Consumer Law Ctr. (2010) (analyzing Dodd-Frank's explicit invocation of state co-enforcement of federal consumer protection laws and restricted preemption of state consumer protection laws), *available at* http://www.nclc.org/images/pdf/legislation/dodd-frank-role-of-the-states.pdf.

omitting such relief.[170] But the new preemption rule now implies a state could permit its own consumer protection laws that do allow private rights of action to persist and grant consumers newfound powers, liberated from the yoke of federal preemption.[171] (Indeed, Dodd-Frank's resurrection of assignee-liability suggests that even more putative defendants will be added to the mix than perhaps previously imagined.)[172]

The final aspect of this wildcard is the rollback of mandatory arbitration.[173] Not only will many matters of dispute now reach court for public, media-attracting resolution, but the full judicial powers of preclusion and precedential effect will attach. Accordingly, while myriad rules will spew from the regulatory maw in upcoming years, we cannot ignore the possibility that the relevant the interpretation of those rules (or similar, stronger state ones) will effectively be transferred to, or perhaps even hijacked by, the courts. (Imagine, as one scenario, a resurgence of the heady 1960s unconscionability caselaw.)[174]

In final analysis, then, notwithstanding the preemption and private action wrinkles, the most likely implementation of the new ability to pay duty will be a proliferation of constantly updating rules emanating from the Fed and CFPB. Naysayers, of course, predict whatever comes out will be indecipherable: "We have such nebulous terms as 'reasonable ability to repay.'"[175] But those are cheap shots. There is ample evidence for an active regulator that will promulgate a swath of (hopefully coherent) rules.[176]

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170. This is a crude generalization. Some significant private causes of action survive and are enhanced under Dodd-Frank. *See, e.g.*, Dodd-Frank, *supra* note 1, § 1404, 124 Stat. 2141 (creating cause of action against mortgage originators that violate § 129B of TILA, a prohibition on steering incentives); § 1413, 124 Stat. 2148-9 (allowing defense by recoupment or setoff to residential foreclosure by asserting creditor violated prohibition on steering incentives or ability to pay standard); § 1414(c), 124 Stat. 2151 (prescribing that no residential mortgage loan term can waive a statutory cause of action or bar a consumer from bringing an action for damages or relief in connection with any alleged violation of Title XIV provisions). For discussion of the private action battle, *see* Hirsch, *supra* note 12, at 27. That said, a private cause of action for general violations of the statute is neither express nor implied.

171. Indeed, many state "unfair and deceptive acts and practices" statutes ("UDAPs") provide for private causes of action, unlike the FTC Act. *See* NATIONAL CONSUMER LAW CENTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES (7th ed. 2008). Engel and McCoy discuss the uses of these statutes in combating predatory lending. *See* Engel & McCoy, *supra* note 70, at 1303-05. For an example of a recovery, *see, e.g.*, Leff, *supra* note 80 (unsuitable mortgage for eighty-two-year-old homeowner violated state UDAP).

172. *See* Dodd-Frank, *supra* note 1, § 1404, 124 Stat. 2141.

173. *See* Dodd-Frank, *supra* note 1, § 1414(c), 124 Stat. 2151.

174. *See, e.g.*, Williams v. Walker-Thomas Furniture, 350 F.2d 445 (D.C. Cir. 1965); *see also* Hirsch, *supra* note 12, at 36-42 (discussing private litigations seeking relief against lenders for "unsuitable" mortgages).

175. 111 Cong. Rec. H5182 (2009), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2009-05-06/pdf/CREC-2009-05-06-pt1-PgH5179-2.pdf (Rep. Hensarling).

176. As discussed above, suitability standards have been around for decades in securities law, and somehow that system has survived. The rich empirical research of talking to a colleague who is knowledgeable in securities law revealed the dirty secret that the FINRA arbitrations are actually quite useless in crafting standards for "suitability," because the generalist arbitrators are usually poorly versed in underlying securities laws and norms.

COMMENT: WHAT DOES IT ALL MEAN?

Whatever its form of implementation, the question arises whether shouldering banks with a requirement to assess their customers' ability to pay will be all that big a deal. It will. This is so both for the actual doctrinal effect as well as the broader conceptual and expressive significance. The actual doctrinal effect will unfold through the effective nationalization of underwriting standards that the Fed and CFPB will exercise under their new regulatory powers.[177] This could well be a return to 1982. The broader conceptual leap (as we saw with the UK's crumbling resistance to "responsible lending") lies in dispatching the fictions that acquiring a suitable mortgage is fully up to the borrower alone, and that assessing its rightful fit is up to him alone too as an arms-length contractual counterparty. Relatedly, the duty to analyze the borrower's ability to repay constitutes recognition of the failure in relying upon market forces alone to discipline lenders (i.e., admitting the natural profit motives of lenders did not assure the extension of credit to repayment-likely borrowers).

A duty—an affirmative mandate imposed by the state—now lies on mortgage lenders to assure their erstwhile contractual adversaries can pay back their loans. The imposition of this new, proto-fiduciary duty fundamentally changes the landscape of how we understand the debtor-creditor relationship in the consumer realm. This transformation is significant, but it comes of course with two possible consequences: first, an increased paternalistic regulatory mindset (pejoratively, the rise of the "nanny state"), and second, a reduction or rationing of mortgage credit.

Lest there be any doubt, paternalism was Epithet Number One hurled at Dodd-Frank in the battles over its passage. As one opponent railed, "This is Uncle Sam telling you, with a couple of exceptions, if you can't qualify for a 30-year fixed mortgage, then we are going to deny you the homeownership opportunity in America, because we are smarter than you. We know better than you. We have to protect you from yourself."[178] Condemned another, "That is not the American Dream; that's the Government Dream."[179] The title of one prominent jurist's Op-Ed said it all: "Treating Financial Consumers as Consenting Adults."[180]

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177. A co-participant at a recent conference on the CFPB gets credit for the insight that ability to pay is effectively a compulsory underwriting term.

178. 145 Cong. Rec. at H5182 (statement of Rep. Hensarling).

179. *Id.* at H5183 (statement of Rep. Neugebauer).

180. Posner, *supra* note 122. In what he presumably considers hyperbole, Posner rhetorically questions regarding prepayment penalties, "[M]ortgages that include such penalties compensate by charging a lower interest rate. Is the choice among such alternatives really beyond the cognitive competence of the average home buyer?" The FTC has some insight on that question. In a recent study, it found sixty-eight percent of respondents could not identify whether a mortgage disclosure statement revealed that the underlying mortgage contained a prepayment penalty, and only five percent, having found it, could identify what that penalty amount was. *See* James M. Lacko & Janis K. Pappalardo, Fed.

Dodd-Frank is paternalistic—highly so. Supporters can squirm at this attribute as a necessary evil, distract critics with the Panglossian distinction between "libertarian" and "ordinary" paternalism,[181] or otherwise try to deflect this charge by changing the subject. But the better approach is to confront it head on and celebrate the law's inherent paternalism.[182] After all, the evil (for those who see it as an evil) of paternalism lies in reducing the autonomy and dignity of private contracting actors.[183] But if the market is malfunctioning,[184] and especially if the basis of that malfunction is in part deception, then the autonomy concerns largely evaporate.[185] Moreover, with autonomy concerns set aside, the instrumentalist benefits of using the lenders as the policy targets is clear.[186] (As for the sub-debate of "hard" vs. "soft" paternalism,[187] one can nudge the reader into considering the emerging draft of the EU Directive on Responsible Mortgage Lending. Under that proposal, at least in its first iteration, mortgage lenders will be burdened with a suitability duty toward their borrowers, but the duty may be waiveable with sufficient disclosure.)[188]

Trade Comm'n, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS 78-79 (2007), *available at* http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf.

181. *See* Posner, *supra* note 122 ("Mr. Thaler, whose views are taken seriously by the Obama administration, calls himself a 'libertarian paternalist.' But that is an oxymoron. He is a paternalist with a velvet glove—as the agency will be.").

182. For one article doing so, see Mechele Dickerson, *Vanishing Financial Freedom*, 61 ALA. L. REV. 1079, 1119 (2010) ("If greater financial freedom means giving people unlimited choices and the unfettered opportunity to go deeper into debt, then less financial freedom and fewer choices would be better for many people because it would make them happier and ultimately increase their well-being.").

183. For a nice roundup of Kantian concerns, see Seana Valentine Shiffrin, *Paternalism, Unconscionability Doctrine, and Accommodation*, 29 PHIL. & PUB. AFF. 205, 220 (2000), which discusses concern that paternalistic legal interventions accord "insufficient respect for the underlying valuable capacities, powers, and entitlements of the autonomous agent."

184. Note too that the economics of the subprime market are fiercely contested. For example, in a scholarly debate on the merits of regulatory intervention, both Engel & McCoy and Zywicki & Adamson lay greater claim to Stiglitz & Weiss's informational asymmetries, *see* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981). *Compare* Engel and McCoy, *supra* note 70, at 1258, 1278, 1280-84 (claiming) *with* Zywicki and Adamson, *supra* note 119, at 71, 73, 78-82 (counterclaiming). The latter contend that their basic model suggests it is madness to saddle the lender with a duty to know the private information of the borrower, while the former retort that the complexity of current credit instruments and sophistication of credit scoring algorithms actually do diminish (and arguably reverse) the asymmetry.

185. *See* John A. E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405, 454-55 (exploring paternalism critiques to consumer credit regulation).

186. *See, e.g.*, *id.* at 432-34 (discussing reasons lenders, rather than borrowers, are more likely to be cheapest-cost implementers of oversight policy); Engel & McCoy, *supra* note 70, at 1336-37 (same, regarding mortgage lenders specifically).

187. *See, e.g.*, Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism is Not an Oxymoron*, 70 U. CHICAGO L. REV. 1159 (2003). For a discussion of various forms of paternalism, including "soft" and "hard," see Evans & Wright, *supra* note 2, at 30-31.

188. *See European Commission, supra* note 104 (suggesting this option may actually have been eliminated by most recent version of the proposal). *But cf.* Engel & McCoy, *supra* note 70, at 1348 (defending non-waiveability as permissible autonomy intrusion justified by utilitarian considerations).

The second grievance with the new ability to pay duty is simply the well-known lament of usury law opponents: reduction in credit availability, either through pernicious substitution or outright rationing.[189] "The more likely result of stricter mortgage origination rules is a return to rationing, which could result in lower overall homeownership since some of the recent increase in homeownership was due to the ability of subprime borrowers to access credit."[190] This worrying even made it into the legislative debates. One opponent complained, for example, that "this bill . . . will functionally be taking away homeownership opportunities from [the] American people . . . . So, ultimately what we are going to have are fewer mortgages being made."[191] Another predicted that homeownership after Dodd-Frank will be "more expensive and less available to those people who need it the most."[192]

Again, the appropriate rejoinder to this rhetoric is direct admission and confrontation.[193] One of the intended consequences of Dodd-Frank is for fewer people to acquire mortgages—those who lack the ability to repay them in the cold calculus of rigorous underwriting. Of course there will be errors, both Type I and II.[194] The question is whether one type is preferable to the other. The mantra of increased homeownership as an intrinsic social good presumes the former are better than the latter, but that is far from clear.[195] On the

189. *See, e.g.*, James J. White, *The Usury Tromp l'Oeil*, 51 S.C. L. REV. 445 (2000) (against usury laws); *see also* Cathy L. Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473 (2000) (for usury laws). An empirical cottage industry has developed seeking to prove the link between usury laws and credit availability. For a recent example of this conceit, at least carefully executed and specifically focused on subprime mortgage lending, see Giang Ho & Anthony Pennington-Cross, *The Impact of Local Predatory Lending Laws on the Flow of Subprime Credit*, 60 J. URB. ECON. 210 (2006).

190. Zywicki & Adamson, *supra* note 119, at 78.

191. 145 Cong. Rec. H5181 (daily ed. July 1, 1999) (statement of Rep. Hensarling).

192. 155 Cong. Rec. H5176 (daily ed. May 6, 2009) (statement of Rep. Sessions).

193. Consider in this regard an emerging UK proposal envisions making it even harder for "credit impaired" borrowers to get a mortgage by requiring a twenty percent "buffer" in calculating "free disposable income." *See* Consultation Paper, *supra* note 108, at 28.

194. Indeed, some researchers have noted that credit restriction may be ill-founded. *See, e.g.*, Debbie Guienstein Bocian, Keith S. Ernst, & Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (Ctr. for Responsible Lending), May 31, 2006. This might be considered a "Type I ½" error.

195. *See, e.g.*, Edward M. Gramlich, Fed. Bd. Member, Remarks at the Financial Services Roundtable Annual Housing Policy Meeting (May 21, 2004) (noting that increased foreclosures of subprime loans "do not seem high enough to challenge the overall positive assessment" of increased homeownership), *available at* http://www.federalreserve.gov/boarddocs/Speeches/2004/20040521/default.htm. Professor DiLorenzo explores Governor Gramlich's comments on subprime lending in more detail in his comprehensive analysis, including his clashes with then-Chairman Alan Greenspan. *See* DiLorenzo, *supra* note 23, at 80. The implementation of this vision through legislation such as the 1992 Federal Housing Enterprise Financial Safety and Soundness Act, 12 U.S.C. § 4501 *et seq.*, and its related enabling of HUD to target "goals" of minimum portfolio percentages of Fannie Mae and Freddie Mac of low and moderate income ("LMI") borrowers seems ill-considered in retrospect. *See* HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) 65 Fed. Reg. 65,044 (Oct. 31, 2000) (codified at 24 C.F.R. pt. 81) (final rulemaking), *available* at http://www.gpo.gov/fdsys/pkg/FR-2000-10-31/pdf/00-27367.pdf. For a general literature review on the social benefits of homeownership, see Christopher Herbert & Eric S. Belsky, *The Homeownership Experience of Low-Income and Minority Families: A Review and Synthesis*

contrary, the spillover effects of the housing collapse, as shown in the plunging property values of the non-foreclosed neighbors, have sharpened our appreciation of the dangers of "false grantings" of mortgage credit.[196] Even staunch critic Jack Guttentag admits, "Perhaps the costs associated with borrowers who fail [in their mortgages]—costs to both themselves and their communities—more than offset the benefits to those who succeed."[197] (And this worry was published in 2007, when the ice was just beginning to crack.) Accordingly, rather than awkwardly tap dancing around the possible reduction in mortgage origination due to Dodd-Frank's elimination of asset-based mortgage lending, we should embrace it and find its likely social costs dwarfed by its welfare benefits.

CONCLUSION

While they are not fiduciaries, mortgage lenders are now no longer arms-length contractual counterparties: they have a duty to assess a prospective borrower's ability to repay her loan.[198] Reliance on the asset value alone, or on flipping the debt to another through securitization, will no longer suffice. This dramatically transforms the debtor-creditor relationship in the residential mortgage market. This Article has tried to chart the source of this innovation by showing how it did not spring fully formed from Chris Dodd's head. Lenders' duties of "responsible lending" (in the European parlance) have a rich pedigree, both domestic and foreign. The article also offered conjecture as to how this new duty will unfold in the United States, predicting a swath of new technical rules of great specificity from appropriate agencies. Finally, this Article briefly registered its alignment with the supportive normative camp: Dodd-Frank is not just a big deal for the mortgage markets, but a good deal. Properly interpreted, the duty to analyze ability to repay could realign the residential mortgage market and ensure that 2008 becomes a closed chapter in commercial law history.

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of the Literature, U.S. Dep't of Hous. & Urban Dev. (Feb. 2006).

196. A rich literature exists on this topic. Foreclosures drag everyone down. *See, e.g.*, Zhenguo Lin, Eric Rosenblatt & Vincent W. Yao, *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. REAL ESTATE FINAN. ECON. 387 (2009) (collecting studies on the threat foreclosures pose to neighborhood property value); *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average Over Next Four Years, 91.5 Million Families to Lose $1.9 Trillion in Home Value; $20,300 on Average* (Center for Responsible Lending), May 2009, *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf.

197. Guttentag, *supra* note 119.

198. As a black-letter matter, the duty of course runs to the borrower. Given the negative social consequences of the housing market collapse, however, an interesting argument can be made that the duty is owed to the public more broadly. Such a contention, while conceptually intriguing, likely faces an uphill doctrinal battle under current standing law. *See, e.g.*, Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992).