Subprime Lending Developments with Implications for Creditors and Consumers

Alvin C. Harrell, Oklahoma City University School of Law

Available at: https://works.bepress.com/alvin_harrell/187/
Subprime Lending Developments with Implications for Creditors and Consumers

By Alvin C. Harrell

I. Introduction

On April 23-24, 1998 the Conference presented its annual institute on Subprime Mortgage Lending and Vehicle Finance. As with reports on previous institutes, these comments reflect our author's perceptions of matters discussed at the institute or in related meetings, and should not be attributed to institute speakers absent further confirmation.

II. The New York State Banking Department Remediation Agreement with Roslyn Savings Bank

On February 17, 1998, the Roslyn Savings Bank (Roslyn) a New York state-chartered savings bank and Residential First, Inc. (RFI) Roslyn's wholly owned subsidiary mortgage company) signed a "Remediation Agreement" (agreement) with the New York State Banking Department (the Department), covering alleged statistical disparities with regard to loan charges (e.g., "overages") charged to minority as opposed to non-minority borrowers. The agreement is of interest nationwide because it appears to break new ground with regard to fair lending issues.

Roslyn purchased RFI in August, 1995, apparently in part as a means to increase its market share in low-income and minority areas. When the Department examined Roslyn beginning in December, 1996, the Department concluded that higher overages were being charged by RFI in low-income and minority areas compared to loans that were extended by Roslyn in higher-income areas. An overage is a loan interest rate higher than that required by the lender for that loan, typically negotiated by and split with the loan officer who negotiated the rate. The obvious purpose of an overage is to provide an incentive for the loan officer to obtain the best possible rate for the lender.

Roslyn and RFI undertook their own statistical analyses of these disparities, which they believe demonstrated that there was no unlawful discriminatory basis for the disparities, but the Department disagreed. Reportedly the Department undertook over 100 different types of statistical analyses in an effort to identify an allegedly unlawful disparity. All parties seem to agree that the disparities resulted from differences in the negotiating skills of individual borrowers rather than any intention to discriminate.

The resulting remediation agreement is quite comprehensive, in the mold of the U.S. Department of Justice fair lending settlements. It provides for overages that remain after RFI adopts a training and monitoring program acceptable to the Department. Roslyn, RFI and their directors, officers, employees and any successor entities agree to cooperate in any actual or threatened lawsuit in order to capture the Flavor of the enforcement. The Department reportedly feels that it went easy on Roslyn because, all after, it is one of their book and a continuing relationship is anticipated. Consumer advocates have argued that a banking institution with a subsidiary mortgage company (like Roslyn) should be scrutinized more carefully than an independent finance company that makes only unpar loans, because the bank can refer good credits up from the mortgage company to the bank (to provide a lower rate) just as the bank refers credits to the mortgage company (at a higher rate). Apparently a failure to notify borrowers that they can get a better deal elsewhere is now to be considered a discriminatory practice. While the Department may consider this a lenient settlement, lenders elsewhere may consider the Department's approach unsuitable, intrusive, and perhaps uncivilized.

The agreement also contains specific requirements and prohibitions. A required element is the level of overages: a new record system to "accurately [record] data related to the charging of overages" (including specified information); "a comprehensive system to permit detailed and ongoing monitoring of mortgage origination and pricing practices"; the designation of managers (including senior level managers) to monitor compliance with the agreement; and a specific disciplinary policy for employees. The agreement provides for the development of procedures for employee training. Roslyn and RFI were given 30 days to amend their training programs to comply with the agreement and to submit such amendments to the Department. Upon any disagreement, Roslyn is given 15 days to conform. Roslyn also agreed to pay $3 million, within three business days, into a "Remediation Fund" for distribution to all minority borrowers who were charged overages between August, 1995, and December, 1997, on a pro rata basis (determined by dividing the Remediation Fund by the number of payments, regardless of how much of an overage was paid by each).

There are other requirements, but the above are sufficient to capture the Flavor of the agreement. The Department reportedly feels that it went easy on Roslyn because, all after, it is one of their book and a continuing relationship is anticipated. Consumer advocates have argued that a banking institution with a subsidiary mortgage company (like Roslyn) should be scrutinized more carefully than an independent finance company that makes only unpar loans, because the bank can refer good credits up from the mortgage company to the bank (to provide a lower rate) just as the bank refers credits to the mortgage company (at a higher rate). Apparently a failure to notify borrowers that they can get a better deal elsewhere is now to be considered a discriminatory practice. While the Department may consider this a lenient settlement, lenders elsewhere may consider the Department's approach unsuitable, intrusive, and perhaps uncivilized.

III. FRB Issuances

The Federal Reserve Board (FRB) has been very active over the past six months, beginning with revisions to Regulation B (Equal Credit Opportunity) providing a limited legal privilege for "self-tests" conducted by lenders to detect and remedy illegal discrimination. This was followed by the issuance on March 13, 1998, of an advance notice of proposed rulemaking to revise Regulations B, Z, M and DD to adjust for technological developments, to delete obsolescence provisions, and to better balance consumer protections and industry burdens.

Also on March 13, 1998, the FRB published an interim amendment to Regulation E (Electronic Funds Transfer) to permit disclosures to be delivered to consumers electronically if the consumer agrees. The FRB also published a proposed rule to limit the number of statements that will reduce the time period for investigating errors involving debit cards in use.

IV. Credit Insurance, Upcharges, TIL, RICO and Kickback Claims

Cotton v. Fleet Consumer Discount Co. is an important case addressing alleged RICO and TIL violations by reason of Fleet Consumer Discount Company's Fleet sale of credit life insurance. The courts have held that $2,022.50 for 36 months, and purchased credit life insurance in a like amount for $33.71. The loan agreement expressly provided that the insurance was optional and was not a requirement to obtain the loan. The amount financed disclosure indicated a $33.71 payment to the insurance company. All other required TIL disclosures were provided.

The consumer alleged that Fleet violated RICO because Fleet shared in the income derived from the credit insurance premium; it was alleged that Fleet misrepresented the $33.71 premium and represented a "kickback" by retaining a portion of the premium. In addition it was argued that Fleet should have rebated a portion of that premium when the loan was prepaid. State fraud and deceptive trade practices claims and breach of contract claims were also asserted.

On November 26, 1997, the Magistrate Judge rejected all of these claims and recommended that the defendant's motions to dismiss be granted. The District Court upheld this decision in January, 1998. The Magistrate Judge concluded that Fleet's contracts may not have complied with the TIL requirements, but noted that this does not make the contract a "scheme to defraud" or a RICO violation.

The court also held that the case was factually and accurately disclosed that the insurance was optional and could be cancelled at any time. There was no misrepresentation of the charges to the consumer. In these circumstances there was no "scheme to defraud" under RICO.

Another interesting case is Brown v. Coleman Investments, Inc. Brown and Gomes (the plaintiffs) asserted TIL and RICO claims and a state law claim for breach of an oral installment sales contracts with Coleman Toyota (Coleman) for the purchase of a 1994 Toyota. For Ms. Brown, Coleman included in the $13,517.52 amount financed a $40 charge for a "license fee." The actual license fee charged by the State of Louisiana was $82.92 and the defendant was charged on the consumer purchase and is dependent on information not generally known when the disclosures are prepared. The Coleman contract was similar.

The plaintiffs contended that Coleman violated the TIL requirements by charging (and excluding from the disclosed finance charge) any fees that are necessary to achieve cash in excess of the actual fees charged by the state (in Ms. Brown's case the difference was $17.08). Ms. Gomes' case it was $72). There was also an allegation that Coleman understated the finance charge by charging Gomes $21 for ad valorem

1. The consumer (Brown) v. Coleman Investments, Inc.
2. The consumer (Brown) v. Coleman Investments, Inc.
3. The consumer (Gomes) v. Coleman Investments, Inc.
4. See also, U.S. v. Smith, E. F. (in District Court) 101, 875 (E.D. N.Y. 1994) (Albany County)
5. See also, U.S. v. Smith, E. F. (in District Court) 101, 875 (E.D. N.Y. 1994) (Albany County)
8. The proposed rule is intended to establish a "financial institution" as used in the Consumer Financial Protection Act, 15 U.S.C. 2101 (1996).
tances which were legally owed by Coleman. An examination of the finance charge also creates an overstatement of the "amount financed," and an understatement of the annual percentage rate (APR) on the note.

The court characterized the difference between the actual finance charge and the stated finance charge as "significant," and held that Coleman's defense that this does not constitute a finance charge because it is also imposed in transaction charges. The court concluded that the plaintiff failed to prove that the amounts of material fact sufficient to defeat Coleman's summary judgment motion.

The plaintiff also alleged a duty to disclose certain information related to the finance charges. The court specifically held that Coleman had a duty to disclose the true interest rate and finance charges.

The plaintiff alleged that the FDCPA and the Truth in Lending Act (TILA) required the defendant to disclose the finance charge in violation of the TILA disclosure requirements.

The defendant moved to dismiss, on the grounds that the plaintiff did not meet the pleading requirements of TILA. The court granted the defendant's motion for summary judgment on all issues.

V. Higher Credit Than Cash Sales Price

Most readers of this journal will be aware that an automobile transaction is a part of a credit transaction constitutes a finance charge that must be disclosed as such under TILA. A difficult issue in some of these cases is whether the credit sales price has been raised as a part of the credit transaction.

In Cameron v. Viking Dodge, Inc., the plaintiff alleged that Viking Dodge (Viking) raised the sales price when customers financed their purchases. They also alleged that the FDCPA and TILA required the defendant to disclose the finance charge.

The court dismissed the assignee liability claim, but allowed the claims of a finance charge liability to go forward. The court also denied the assignee's motion to dismiss a claim regarding upcharges in extended warranty sales, on grounds that the assignee's arrangement with the dealer to rebate part of the premium constituted knowledge sufficient to create a material issue of fact.

Hoffman v. Grossinger Motor Corp. involved a series of issues in the context of a dealer who specializes in subprime buyers. In this case the dealer sold a car with a "Blue Book" value of $3,800 for a price of $14,040. The contract APR was 25%. Such cases may strain the court's ability to remain dispassionate, because those of us accustomed to borrowing at a 7.9% APR may be shocked that a consumer would agree to such a deal.

It is important to remember that a consumer like Walter is likely to have much inferior credit history or collateral in the context of a dealer who specializes in subprime buyers. The court agreed that the plaintiff had a good chance of success in this case, but also noted that the court was not sure that the dealer's overall cost structure could be deemed a hidden finance charge.

The court disagreed that the plaintiff had sufficiently stated a claim for a finance charge violation.

VI. FTC Enforcement Actions


The complaint is noteworthy because of the rather detailed nature of some of the allegations (e.g., a failure to release liens promptly when loans are paid off), and because of the FTC's emphasis on the fact that the "defendants frequently charge higher interest rates to minority borrowers, elderly persons, or those with fixed or low incomes." The FTC press release goes on to note:

The loans often are interest-only balloon loans in which the borrower, after making payments for the term of the loan, still owes the entire amount of the loan principal. These loans are often secured by the subprime lender's interest in the borrowers' houses and typically are based on the worth of the home rather than on a borrower's creditworthiness or income.

While some of the violations alleged in the complaint are very serious, this kind of language may lead the reader to infer that a part of the lender's transgressions was its policy of making asset-based mortgage loans to low income and minority borrowers at 20 to 24 percent interest. But these rates may seem quite attractive compared to the subprime auto credit (see Part V above), and it does not seem clear that asset-based lending is an inappropriate approach to meeting the credit needs of low income or credit-ineligible consumers.

This does not appear to be a case like the Bonar Loan settlement, where the FTC imposed a $70,000 civil penalty and a consent decree on the basis of relatively technical allegations of minor errors (primarily a failure to provide proper adverse action notices and use of the terms "comlaw," "single," "divorced," and "widowed") to describe marital status. The Capital City Mortgage complaint, in contrast, provides an extensive list of alleged violations, some extremely serious, including allegations of deception, false statements, advertising violations, and the failure to take written loan applications or collect the ECOA monitoring information.

If true, these obviously represent serious violations that should be addressed, and the FTC enforcement action is justified. Regardless of this, however, the Capital City Mortgage settlement appears to be an emerging trend in regulatory law: the use of a very complex set of regulatory requirements, which no one can be sure of meeting with perfection, to create an uncertain legal environment that allows regulators and plaintiffs' counsel to pick and choose victims on any criteria they choose, confident that any target can be found in violation of something to justify litigation or an enforcement action. Thus a lender with a business strategy that a regulator favors can target for TILA, ECOA, FCPOA or whatever violations, when the real target is the lender's business strategy. This kind of legal environment threatens even the best of lenders.

The best defense to the Capital City case, which may or may not deserve everything it got (your author has no information on which to base such a judgment). And of
course the federal agencies must target someone: their job, if you want, or the recommendations made by the federal agencies, consumer credit laws and regulations, which are complex and unworkable. Sometimes it is necessary to create a new law that is easier to follow. The letter is directed to consumers, and it is not uncommon for a company to issue them.

Waller v. Horeaux

Waller v. Horeaux involves a challenge to a provision of the Georgia's pawnbroker statute allowing charges up to 25% per month on a $100 pawn, on grounds that it was not constitutional. Waller alleged that the law violated his constitutional right to freedom of speech. The case was a test of the constitutionality of an ordinance that was constitutional under the First Amendment.

VIII. State and Federal Legislative and Regulatory Developments

At the April 19, 1998 Subprime Lending Program, Robert A. Cook discussed common allegations of open-end credit, noting that the new FRB Regulations Z Commentaries address the issue of what constitutes a consummation of a repeated transaction (required for charge- acterization of open-end credit).17 The result is a "reasonable man" test and a reference to the FRB commentary to the need for an objective test, as applied to the lender's entire portfolio.18 Mr. Cook also noted new FTC initiatives relating to "equity stripping," "packing" and "flipping."19 He also cited FTC enforcement actions against lenders alleged to use deceptive mortgage lending practices designed to result in foreclosure of low-income borrowers' homes.

Mr. Cook also noted the recent U.S. Supreme Court decision in Breach v. Owens Federal Bank,20 holding that borrowers cannot exercise the rights of rescission more than three years after consummation, even as a defense to foreclosure. 21

IX. Consumer Litigation

Alan S. Kaplanis and Craig A. Varga discussed consumer litigation at the Subprime Lending program. Mr. Kaplanis argued that consumer litigation continues to increase, and while there has been much publicity regarding alleged scam artists in consumer lending, much of the risk of exposure has stirred up legitimate lenders and practices. He argued that the upsurge in litigation does not reflect a new consumption of credit, but rather that the increase is due to employment (a deductible amount).22

Thomas B. Hudson noted the final Regulation M (Consumer Lending), and March 1998 proposed revisions to address perceived problems in the 1996 final rule.23 He also addressed allegations of upticks, yield spread premiums and sales price increases as part of financing arrangements in vehicle finance. He suggested creditors look at the following issues in the new FRB commentary: Payment schedule disclosures must state the first payment due date if payment intervals are disclosed in lieu of disclosing all payment due dates; upside-down tracts (where the debtor owns more than its value on the vehicle); and gap payment disclosures. He also noted the revisions to the Illinois Consumer Lending Statutes, including a provision specifying that discounts in secondary market sales need not be disclosed to the consumer.

Mr. Kaplanis predicted that a new wave of litigation will focus on the solicitation and marketing process. This includes deceptive advertising, and misleading "interest" rates. Advertising copy may be viewed as part of the contract when a dispute arises. Fees charged by mortgage lenders and loan-related commissions are also potential bases for litigation.

She noted the FTC and FRB are working together to develop interpretations of the FRCA, this would help to get a better interpretation of the FTC, in terms of resolving ambiguities under the FRCA. Ms. Fortney described the major issues in consumer lending and discussed permissible purposes for credit reports (sections 604(c) and 607(a) of the FRCA), the adverse action notice requirement (sections 621(b) and 621(c) of the FRCA), the sharing of information among affiliates (sections 603(o)-(z)), the use of reports for employment purposes (sections 609(b)(p); prescreening (sections 603(n), 606(c), (e) and (i)); and liability (section 621(a)).

She raised the question whether a consumer who gets a loan at a rate higher than the creditor's "best rate" must be given an adverse action notice. It would not be required by the definition of adverse action in the ECOA, and therefore should not be required under the FRCA in view of the FCPA reference to the ECOA definition. This is the view of the FRB, despite some potential ambiguity in the ECOA, and it is also the FTC's view.

Linda Deubro discussed the use of credit reports for employment purposes, an area where there have apparently been many violations. The notice to the consumer that the employer is planning to use a credit report, and the consumer's authorization of such use, may be included in the same document, but there may be no other information in that document. Thus the notice and authorization may not be required if not included in the employment application.

Craig Varga discussed assigned liability, criticizing the Gobahn decision as being poorly worded. He noted the pending decision in Taylor v. Quality Hyundai, Inc., which will be a key decision on several issues relating to assigned liability for dealer violations.24 Mr. Varga noted that the locative language in Gobahn is at odds with what will be a key decision on several issues relating to assigned liability. Mr. Varga noted that the locative language in Gobahn is at odds with what will be a key decision on several issues relating to assigned liability.
In response to an inquiry, the FTC alleged that independent contractors are employees for purposes of the FCRA. This may indicate the principle that one should be cautious about making inferences when one is not sure of the answer. Mr. Dohnew also noted the potential liability of employers who provide these credit reports to their employees in circumstances not mandated by the FCRA.

Ms. Mattel addressed and answered previously uncertain issues regarding the sharing of information among affiliates. She also addressed continuing ambiguities regarding prescreening, and liabilities of creditors and others under the FCRA. The required prescreening disclosures do not apply to oral or telephone solicitations.

Regarding enforcement, the FTC had filed a suit against a financial institution for alleged FCRA violations. The suit alleged common central mortgage brokers and others in violation of the FCRA. The suit alleged that the FCRA may be interpreted to include credit reporting activities. The suit alleged that the FCRA may be interpreted to include credit reporting activities.

XIII. High Cost Mortgage Legislation, Regulation and Litigation

Beniss K. Koren provided an update on the high cost mortgage legislation. He indicated that there is a high level of noncompliance with the Home Ownership Equity Protection Act (HOEPA). The NAR believes that the requirements are complex and very difficult to meet. Mr. Koren also stated that the requirement of regulatory enforcement in this area is unclear whether this is due to examiner ignorance or merely a temporary regulatory focus on other issues such as Fair Lending.

Mr. Koren described several common errors that should be avoided by creditors and lenders, including the correct back-dating of section 32 disclosures. Numerous problems can be encountered because the disclosures in some cases must be given before the information required to be disclosed is known.

Mr. Koren’s written materials also cover such issues as the TILA-recovery of attorney's fees, the non-Bank Act class action issues, e.g., Newmont v. United Companies Financial Corp. However, the lack of reported decisions may reflect a propensity of lenders to settle their cases, since the HOEPA requirements are so easily violated that the plaintiff’s burden of proving that the fee can be easily met, outside the class action context.

XIV. State Law Issues and Developments

Lawrence A. Young discussed hot topics state law issues developing. The known best of the latter cases is Westfall v. Chase Lincoln First Bank, N.A. holding that the mortgage payoff statement fee is an extra fee not included in the original transaction and therefore not required to be disclosed. These are basic contract law issues, and so long as the fees are reasonable there should be no problems treating the fee as payment for an additional service. However, if such a fee is very large it could be characterized as a disguised prepayment penalty not authorized in the loan documents or disclosed to the consumer. A fee for releasing the mortgage may look more like a prepayment fee and therefore be more troublesome for the lender.

Mr. Young also discussed fraud and deceptive acts and practices litigation. He noted Law v. Gallup Auto Sales, Inc., holding that the National Highway Traffic Safety Administration regulations exempting older cars from the federal odometer law exceeded the statutory authority of the NHTSA and is invalid. The Tenth Circuit joined several other circuits that have reached this conclusion.

Mr. Young’s written materials also cover such issues as the TILA-recovery of attorney's fees, the non-Bank Act class action issues, e.g., Newmont v. United Companies Financial Corp. However, the lack of reported decisions may reflect a propensity of lenders to settle their cases, since the HOEPA requirements are so easily violated that the plaintiff’s burden of proving that the fee can be easily met, outside the class action context.

1. 110 F.3d 1066 (2d Cir. 1997).
2. See also Act of May 1, 1966, as amended, 74 Stat. 136 (1962).
3. 110 F.3d 1066 (2d Cir. 1997).
6. 107 F.3d 1377 (8th Cir. 1997).
7. 110 F.3d 1066 (2d Cir. 1997).
8. 110 F.3d 1066 (2d Cir. 1997).
9. 110 F.3d 1066 (2d Cir. 1997).
10. 110 F.3d 1066 (2d Cir. 1997).
11. 110 F.3d 1066 (2d Cir. 1997).
12. 110 F.3d 1066 (2d Cir. 1997).
14. 110 F.3d 1066 (2d Cir. 1997).
16. 110 F.3d 1066 (2d Cir. 1997).
18. 110 F.3d 1066 (2d Cir. 1997).
QUARTERLY REPORT

In some operations, credit insurance is the creditor’s largest single profit line, and may even exceed the overall net profit of the operation. This creates great pressure for the sale of such ancillary products. Credit insurance is considered by some to be the Number One consumer fraud, and the use of hidden camera and microphone by investigating agencies and plaintiffs’ lawyers is apparently common. These circumstances suggest a need for extreme caution by lenders and dealers with regard to credit insurance products and practices.

XVI. Yield Spread Premiums and Discounts in Auto Finance

David McCrea noted that litigation involving yield spread premiums and secondary-market discounts has increased dramatically, though it is increasingly clear to most everyone that yield spread premiums and secondary market discounts need not be disclosed to the consumer unless explicitly imposed on the consumer.

The danger for lenders in these cases comes from the volatile combination of emotional arguments made to a local jury by an articulate and persuasive lawyer; juror prejudice against lenders; alleged violations of complex and technical statutes and regulations; vague deceptive trade practices laws; and punitive damages. The “Willie Ed Johnson case” is now widely recognized as an aberration that the new adverse action requirements require an adverse action notice if credit is not granted on the requested terms. The impact is not clear when loan terms are adverse to the borrower, and the courts have generally demonstrated that they have a hunching curve in this area of law with no apparent statutory provision.

Mr. Swartz also discussed the impact of the new FCRA amendments. The new adverse action requirements require an adverse action notice if credit is not granted on the requested terms. The impact is not clear when loan terms are adverse to the borrower, and the courts have generally demonstrated that they have a hunching curve in this area of law with no apparent statutory provision.

Credit Commissioner states that this requires an adverse action notice. A memo of September 30, 1997, from the National Automobile Dealers Association indicates that a dealer’s substitution of other collateral for higher interest subprime loans, or a decision not to forward the application to a prime lender, on the basis of the consumer’s credit report, is also adverse action that requires an adverse action notice. If this theory becomes widely accepted, it could result in a flood of frivolous applications being forwarded to prime lenders, in order to avoid triggering an adverse action notice.

Mr. Swartz also discussed the February 11, 1998, FTC letter on FCRA section 604, prohibiting dealers from obtaining customer credit reports during sales negotiations with the consumer. He noted the possibility that consumer defenses and allegations against the dealer on such issues will be raised against the lender in litigation, though the lender plays no part in the violation. Subprime letters are thus susceptible to fraud by both dealers and subprime letters even if they have the borrower sign an agreement to commit the making of misrepresentative statements. This represents a conflict of interest against the lender. Obviously a lender should not deal with such dealers, though such fraud is difficult to prove and the competitive marketplace makes this a difficult decision.

There seems to be little political or public awareness of the need to allow legitimate lenders to serve subprime borrowers and avoid prosecution on the basis of accepted practices. Too many of these isolated abuses by a single bad actor are used as the basis for a punitive response that can impair the functioning of an entire market segment. The same critics who object to the high cost of subprime credit will often then argue that costly and punitive measures are not a matter of public-policy concern, because the costs can be passed on to the public at large. Thus do well-intentioned public policies raise the cost of consumer credit, or ultimately work to the benefit of illegal loan sharks as legitimate lenders are driven from the market.

Current litigation techniques seem quite sufficient to deal with the bad actors, without embracing unsound theories that further drive up the cost of subprime credit or reduce its availability. Hopefully the states and U.S. Congress will be cautious before adding further to the costs and risks of serving subprime borrowers, so that legitimate and responsible-cost lenders will not be driven from this important market segment.

XVII. Subprime Auto Finance

James M. Swartz presented the perspective of an in-house lender for a prime consumer lender who has made the transition to the subprime lending market. He offered examples of how to avoid liability while purchasing subprime automobile paper. He discussed the problem of consumer down payments being misrepresented by dealers, e.g., to make it appear the lender’s loan-to-value ratio requirements are met, when in fact they are not. One variation is where the dealer holds the down payment check (or multiple checks) until a future date, or sells the check for a discount to a check cashing service, so the down payment does not represent an actual cash down payment but rather in another credit obligation. Falsehoods are sometimes told to cover the down payment, but some dealers coach their customers to help deceive the secondary-market buyer unless specifically imposed on the consumer.

Mr. Swartz also discussed the February 11, 1998, FTC letter on FCRA section 604, prohibiting dealers from obtaining customer credit reports during sales negotiations with the consumer. He noted the possibility that consumer defenses and allegations against the dealer on such issues will be raised against the lender in litigation, though the lender plays no part in the violation. Subprime letters are thus susceptible to fraud by both dealers and subprime letters even if they have the borrower sign an agreement to commit the making of misrepresentative statements. This represents a conflict of interest against the lender. Obviously a lender should not deal with such dealers, though such fraud is difficult to prove and the competitive marketplace makes this a difficult decision. Mr. Swartz also discussed the impact of the new FCRA amendments. The new adverse action requirements require an adverse action notice if credit is not granted on the requested terms. The impact is not clear when loan terms are adverse to the borrower, and the courts have generally demonstrated that they have a hunching curve in this area of law with no apparent statutory provision.

On February 11, 1998, the FTC issued a letter on FCRA section 604, prohibiting lenders from obtaining customer credit reports during sales negotiations with the consumer. Mr. Swartz noted the possibility that consumer defenses and allegations against the dealer on such issues will be raised against the lender in litigation, though the lender plays no part in the violation. Subprime letters are thus susceptible to fraud by both dealers and subprime letters even if they have the borrower sign an agreement to commit the making of misrepresentative statements. This represents a conflict of interest against the lender. Obviously a lender should not deal with such dealers, though such fraud is difficult to prove and the competitive marketplace makes this a difficult decision.

Mr. Swartz also discussed the February 11, 1998, FTC letter on FCRA section 604, prohibiting dealers from obtaining customer credit reports during sales negotiations with the consumer. He noted the possibility that consumer defenses and allegations against the dealer on such issues will be raised against the lender in litigation, though the lender plays no part in the violation. Subprime letters are thus susceptible to fraud by both dealers and subprime letters even if they have the borrower sign an agreement to commit the making of misrepresentative statements. This represents a conflict of interest against the lender. Obviously a lender should not deal with such dealers, though such fraud is difficult to prove and the competitive marketplace makes this a difficult decision.

Mr. Swartz also discussed the February 11, 1998, FTC letter on FCRA section 604, prohibiting dealers from obtaining customer credit reports during sales negotiations with the consumer. He noted the possibility that consumer defenses and allegations against the dealer on such issues will be raised against the lender in litigation, though the lender plays no part in the violation. Subprime letters are thus susceptible to fraud by both dealers and subprime letters even if they have the borrower sign an agreement to commit the making of misrepresentative statements. This represents a conflict of interest against the lender. Obviously a lender should not deal with such dealers, though such fraud is difficult to prove and the competitive marketplace makes this a difficult decision.

Mr. Swartz also discussed the February 11, 1998, FTC letter on FCRA section 604, prohibiting dealers from obtaining customer credit reports during sales negotiations with the consumer. He noted the possibility that consumer defenses and allegations against the dealer on such issues will be raised against the lender in litigation, though the lender plays no part in the violation. Subprime letters are thus susceptible to fraud by both dealers and subprime letters even if they have the borrower sign an agreement to commit the making of misrepresentative statements. This represents a conflict of interest against the lender. Obviously a lender should not deal with such dealers, though such fraud is difficult to prove and the competitive marketplace makes this a difficult decision.

There seems to be little political or public awareness of the need to allow legitimate lenders to serve subprime borrowers and avoid prosecution on the basis of accepted practices. Too many of these isolated abuses by a single bad actor are used as the basis for a punitive response that can impair the functioning of an entire market segment. The same critics who object to the high cost of subprime credit will often then argue that costly and punitive measures are not a matter of public-policy concern, because the costs can be passed on to the public at large. Thus do well-intentioned public policies raise the cost of consumer credit, or ultimately work to the benefit of illegal loan sharks as legitimate lenders are driven from the market.

Current litigation techniques seem quite sufficient to deal with the bad actors, without embracing unsound theories that further drive up the cost of subprime credit or reduce its availability. Hopefully the states and U.S. Congress will be cautious before adding further to the costs and risks of serving subprime borrowers, so that legitimate and responsible-cost lenders will not be driven from this important market segment.

XVIII. Manufactured Housing Finance

Marc Lifsit noted the size and importance of manufactured housing industry. There are over 7,000 manufactured housing dealers selling manufactured homes produced by 88 major manufacturers (the largest has only an 18.5% market share). Sixty-five percent of sales are in the south. In 1997 manufactured homes comprised 32.4% of new single family homes sold. In 1996 the national average sales price was $28,200 for single section homes, $47,300 for multi-section homes. Most manufactured housing lending is conducted by finance companies (roughly 86% of the market), there are 20 major manufactured housing lenders, with the top two together accounting for approximately 50% of the market. Less than one percent of manufactured home loans are made under the FHA Title 1 program, down from 20% not long ago. Most manufactured housing falls into one of four categories: the traditional manufactured home (formerly called mobile homes), built on a chassis to the standards of the Federal Building Code, the modular homes, not built on a chassis and subject to local building codes, recreational vehicles (treated as a vehicle rather than a home); and travel trailers, also not subject to manufactured housing rules. The cost of constructing manufactured housing is approximately $27 per square foot, while the cost of a modular home is $22 per square foot, compared to over $56 per square foot for conventional construction.

Mr. Lifsit described the New Colony Village project in Maryland, a manufactured housing project on 52 acres accommodating 420 units. This is zoned and taxed as a mobile home park, providing significant cost advantages. The homes are sold to consumers with long-term leases on the land. What is unusual is that the original financing was provided to guarantee the survivability of an upscale single family housing addition, with homes that appear to have been built on-site. Yet the homes are constructed from units built on chassis, stacked in various combinations to create the appearance of on-site construction (some are stacked vertically to create Cathedral ceilings). Mr. Lifsit showed a film that reveals the impressive beauty of this development. This may represent a real breakthrough in affordable housing for the crowded eastern U.S. It does, however, create unique legal issues relating to the relation between real and personal property law.
XIV. Enforcement, Arbitration, Debt Collection, and Bankruptcy Issues

Alan Kaplan and Michael Young provided an update on the Fair Debt Collection Practices Act (FDCPA), with an emphasis on recent developments including such issues as the scope of the FDCPA, the liability of creditors collecting their own debts, sufficiency of creditors collecting on their own debts, sufficiency of the validation of debt and “best effort” notice, the statute of limitations, the bona fide error defense, the “least sophisticated consumer” test, and the burdens of state law issues, including state law provisions in the Texas Debt Collection Act. He also discussed the problems associated with bankruptcy reaffirmations and the effects of bankruptcy discharge on the lender’s “in rem lien rights.”

Michael Dunagan covered the impact of the “Rash” decision. He questioned the common perception that bankruptcy Chapter 13 is always preferable to Chapter 7 as a public policy matter. He also questioned whether Rash is the panacea that some creditors first thought it was. He noted that subprime credit is likely to be affected differently than prime credit. Mr. Dunagan noted that subprime lending is asset-based lending at its purest, in that the consumer’s credit history typically does not justify the loan; only the collateral can justify the loan. Yet the standard price guides for vehicles do not reflect the reality of market pricing in the subprime used car market, where a high cost of doing business may require a proportionate pricing structure, with a very wide gap between wholesale and retail prices.

Even after Rash, some bankruptcy courts significantly reduce the collateral value by deducting (from an already low guidebook retail price) for high mileage or poor condition, yielding a “value” close to wholesale (or close to midway between wholesale and guidebook retail) value.

Thus as a practical matter, Rash has had very little effect in some bankruptcy courts, in terms of protecting secured creditors from artificially low valuations (and commensurate cram-downs in Chapter 13 cases). The impact of this phenomenon is especially severe in subprime lending cases, where the cram-down value of the collateral is all-important and the court is least likely to recognize the consumer’s true replacement cost. The delays inherent in Chapter 13 cases will likely mean still further losses, due to a decline in the value of the collateral, which is likely to be more severe in the case of subprime loans. These problems are exacerbated by the willingness of some bankruptcy courts to modify subprime contract interest rates by reducing the rate to a prime credit level.

William L. Norton III provided an update on recent bankruptcy cases. He began by citing In re Keaton, which deals with the proper treatment of “attorney fees.” Not the amount or award, but the proper grammatical treatment. The court concluded that “attorney fees” is the proper term.

Mr. Norton also described the current, competing bankruptcy reform efforts. The current Congressional efforts incorporate a “needs” test for Chapter 7 (but not Chapter 13) bankruptcy, in marked contrast to the proposals of the National Bankruptcy Review Commission (which did not address this issue). The current Congressional proposals would also preclude avoidance of preferential transfers under §547, which would protect creditors from actions by the trustee to recover small pre-petition payments.

[Bankruptcy reform issues are also discussed in a symposium elsewhere in this issue.]


MISSION STATEMENT OF THE CONFERENCE ON CONSUMER FINANCE LAW

The general purposes of the Conference are to encourage study and research in the field of consumer finance law; to make available information on the history, changes and current status of the laws and regulations relating to consumer finance law; to promote, through education, the sound development of consumer finance law; to stimulate, by discussion and publication, the improvement of legal procedures affecting consumer finance law; and to afford a forum at which interested lawyers may meet and exchange opinions. For purposes of this statement, consumer finance law shall be deemed to include laws affecting finance companies, consumer banks, banks, retailers, credit insurance companies, and other similar industries of related nature.