Learning from Financial History: An Academic Never Forgets

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Learning from financial history: An academic never forgets

By David Reiss, J.D., Brooklyn Law School

There is a lot of debate in the Senate regarding the appropriate structure and jurisdiction of the Consumer Financial Protection Bureau. But much of the criticism of the CFPB is merely tactical.

Given that it is impossible to kill off the bureau in the current political environment, powerful financial industry interests are seeking to sufficiently hamstring it so as to make it completely ineffective.

Thus, debates over Elizabeth Warren’s qualifications and the structure of the leadership of the CFPB were more about this tactical goal than the actual issues themselves.

The bust that followed the boom ended subprime lending for the current credit cycle. Most subprime lenders have gone out of business or merged with other financial institutions.

The remaining financial institutions have tightened their underwriting so that they no longer lend to those with subprime credit profiles, and they have pulled back from complex and abusive mortgage products like the one described above.

But subprime lending will return once the credit cycle turns, and it needs to be better regulated in the future.

There is a lot of fear-mongering surrounding law firm Mayer Brown, are sensitive to the need to balance consumer protection with a healthy business environment for financial institutions.

Those with short-term memories have been dominating our debate over the future of the Consumer Financial Protection Bureau. They argue that the financial industry has learned its lesson and point to a more rational marketplace today. But the bureau was designed to regulate the subprime mortgage market and other consumer credit markets through the credit cycle.

A strong agency should be built today to deal with the inevitable irrational exuberance of lenders and consumers once the cycle rises from its current depths to the heights of tomorrow.

The CFPB will seek to reduce the confusion that consumers face with their mortgages by improving mandatory disclosures of the terms of credit.

It is a truism to say that politicians have short memories, and they share that characteristic with Wall Street. That they have forgotten the rapacious practices of the mortgage industry from the subprime boom of the early 2000s is to be expected. Luckily, academics have longer memories.

One of my most striking memories from the height of the boom involves a particular type of mortgage marketed by a national lender. The mortgage came with a two-year teaser cap on loan payments (not on the interest rate — on the payments!) combined with a three-year prepayment penalty period.

This, of course, can create a perfect storm for a borrower, particularly for an unsophisticated one.

For once the artificially low payments of the two-year teaser period end, the borrower might find it difficult to make her payments on the loan. But if she tries to refinance from the high-interest product to a more appropriate one at that point, she will be forced to pay a prepayment penalty, thereby ensuring that the lender wins — one way or another.

The Consumer Financial Protection Bureau, with representatives of various financial industries claiming that the agency will be the end of them with endless regulations covering the smallest details of the smallest transactions.

But it is clear that the CFPB is focusing on big issues, like the servicing of residential mortgages, a secretive sector of the mortgage industry that has been rife with consumer abuse. The bureau has also made it clear that it will seek to reduce the confusion that consumers face with their mortgages by improving mandatory disclosures of the terms of credit.

The CFPB is also taking on the confusing fees that consumers pay to their banks and credit card companies — fees that are very unpopular with just about everybody.

Critics of the agency also seek to define it as anti-business, but its leadership is filled with many people who have worked many years in the finance industry. For example, Raj Date of Deutsche Bank and Capital One and Pat McCoy, a former banking partner at law firm Mayer Brown, are sensitive to the
Mortgages
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Lewis v. BAC Home Loans Servicing LP et al., No. 11-CV-413, complaint filed (E.D.N.C. Aug. 6, 2011).

Laurie Lewis also says BAC Home Loans Servicing LP, a subsidiary of Bank of America, and AFR Mortgage Inc. have not posted a $20,000 payment to her mortgage account. She says in her suit, filed in the U.S. District Court for the Eastern District of North Carolina, that the companies have breached their duty to act in good faith.

The suit says Lewis then sent the money to BAC in December 2010 but the company has not posted the payment to her account. BAC has not returned the money to the plaintiff and neither it nor AFR has stopped the foreclosure proceedings, according to the suit.

In addition Lewis says that after she sent the check to BAC the balance due on her mortgage increased. She says the defendants have not explained the increase despite her written request for information.

In the complaint Lewis says she refinanced the mortgage on her Durham, N.C., home in 2009 with defendant AFR Mortgage. AFR and BAC are the servicers for the loan, according to the suit.

Lewis says she was at least 60 days delinquent on her payments when the defendant companies placed her home into foreclosure in 2010. The suit says that since that time Lewis has submitted application paperwork for a loan modification to BAC and AFR at least six times.

She has also spoken to representatives of both companies numerous times but neither defendant has acted on her modification request, according to the complaint.

Lewis also says she sent a check for $20,000 to AFR in order to bring her loan current but the company returned the check to her several weeks later.

The suit says BAC and AFR have not acted in good faith toward the plaintiff because they have not evaluated the modification request, have not posted the $20,000 payment and have increased the loan balance despite holding on to the payment.

Lewis also says BAC is obligated to evaluate the mortgage for a modification since its parent, Bank of America, contracted with the government in 2009 to participate in the Home Affordable Modification Program. HAMP participants must take action on modification requests, the suit says.

Lewis is asking the District Court to award her unspecified damages and costs. As of press time neither defendant had responded to the suit. WJ

Attorney: Plaintiff: Sandra Polin, Raleigh, N.C.
Related Court Document: Complaint: 2011 WL 3801833
See Document Section A (P. 19) for the complaint.