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# Transparency in Lending in the United States and the United Kingdom: Which Business Model Does It Best?

*Mara Hart\**

## I. THE MORTGAGE LENDING STRUCTURE IN THE UNITED STATES & THE UNITED KINGDOM

The recent downturn of the global economy, spurred in large part by an unparalleled housing crisis and credit crunch in the United States and abroad, cannot be practicably understood or explained by an examination of isolated factors. Although the impact of the economic downturn has been felt globally, many blame the meltdown of the U.S. subprime mortgage market for their individual country's woes.<sup>1</sup>

Therefore, the mortgage regulatory scheme in the United States, in terms of lending practices and housing policies, is an important place to begin an inquiry into the origins of the global crisis. In order to better understand how the lending practices in the United States may have contributed to the housing crisis, and furthermore, to hypothesize potential solutions to prevent such events from recurring, it is valuable to examine the housing and lending policies of other economies.<sup>2</sup> This paper aims to

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<sup>1</sup> Memorandum from the Bovis Homes Co. to Parliament on the U.K. Housing Market (Oct. 2008), available at <http://www.parliament.the-stationery-office.com/pa/cm200708/cmselect/cmcomloc/memo/housecredit/ucm1802.htm>.

<sup>2</sup> See, e.g., Richard Snook, *Birthplace of the Blues: The U.S. Housing Crisis*, BUILDING, Oct. 31, 2008, available at [http://www.building.co.uk.regen\\_story.asp?sectioncode=331&storycode=3126226&c=2](http://www.building.co.uk.regen_story.asp?sectioncode=331&storycode=3126226&c=2) (“[C]harting the progress of the housing downturn in the U.S., and the parallels with the UK, is an important step in understanding the prospects for economic recovery.”). But see Isabelle Job, *U.S. Housing Crisis Special Features Not Generally Present in Europe*, Credit Agricole S.A. Economic Research Department, Nov. 25, 2008, available at [http://economic-research.credit-agricole.com/medias/EN119\\_EN.pdf](http://economic-research.credit-agricole.com/medias/EN119_EN.pdf) (stating that there are risks in comparing the economies of the United States with that of Europe because of inherent

compare and contrast certain aspects of generally accepted lending practices in the United States and the United Kingdom, including recent changes in regulation that are targeted at making the lending process more transparent. The ultimate conclusion of this inquiry is that the time has arrived for the United States to look across the Atlantic for inspiration in terms of regulating mortgages.<sup>3</sup>

The framework of mortgage policy and practice in the United States is created by a complex intersection of state laws, federal agency regulations, the United States central banking system, and underlying public policy.<sup>4</sup> In the United Kingdom, the Financial Services Authority ("FSA") regulates and supervises all financial services firms, but other governmental agencies have simultaneous roles. The resulting scheme of policy and regulation is intricate, though certainly more consolidated than that of the United States.<sup>5</sup>

A background analysis of the housing and mortgage markets, the relevant regulatory bodies, and the current policies related to mortgages in both countries is essential in attempting to isolate specifically how home selling practices contributed to the overall mortgage meltdown.<sup>6</sup> The relative opaqueness of the U.K. lending market compared to the U.S. market, due to both industry structure and regulatory framework, has led to a relative resiliency to the market downturn in the United Kingdom. Therefore, this paper argues that the U.S. housing and mortgage lending market would be relatively improved by adopting U.K. mortgage brokerage and lending practices.

#### A. Comparing the Housing Markets

The mortgage industries in the United States and the United Kingdom face similar challenges, which allows us to compare the regulatory

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differences in the countries' respective markets).

<sup>3</sup> See *id.*

<sup>4</sup> See, e.g., Fair Housing Act, 42 U.S.C. § 3616a (1968); Truth In Lending Act, 15 U.S.C. § 1601 (codified, as amended, at 12 C.F.R. Part 226).

<sup>5</sup> U.S. GOV'T ACCOUNTABILITY OFFICE S. COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, REPORT TO THE CHAIRMAN ON FINANCIAL REGULATION: INDUSTRY CHANGES PROMPT NEED TO RECONSIDER U.S. REGULATORY STRUCTURE, at 67 (2004), available at <http://www.gao.gov/new.items/d0561.pdf>.

<sup>6</sup> Here, we will confine our inquiry to the mortgage lending and brokerage practices in both countries, although there are a wide variety of regulatory failures which prompted the subprime mortgage crisis and related credit crunch. In the United States, for example, many argue that the primary tipping point for the meltdown was the federal government sponsorship of mortgage lending giants Freddie Mac and Fannie Mae. See, e.g., Charles Duhigg, *Pressured to Take Risk, Fannie Reached Tipping Point*, N.Y. TIMES, Oct. 4, 2008, [http://www.nytimes.com/2008/10/05/business/05fannie.html?\\_r=1&em](http://www.nytimes.com/2008/10/05/business/05fannie.html?_r=1&em). In the United Kingdom, many point to the lack of liquidity as the main cause of the crisis. Anatole Kaletsky, *Loss of Liquidity, Not Insolvency, Caused Credit Crunch*, TIMES (London), Mar. 24, 2008, <http://business.timesonline.co.uk/tol/business/columnists/article3607495.ece>.

structures with conviction.<sup>7</sup> There has been a remarkable similarity in the evolution of house prices in both countries, charted over the past twenty years, with peak prices reaching 125% over 2000 levels in the United States, and 135% over these levels in the United Kingdom.<sup>8</sup> Additionally, such growth has accelerated since 2000, with strong economic expansion in both countries driving consistent speculation of continuation of this upward trend.<sup>9</sup> The increasing prices coupled with, until recently, relatively easy credit, has led to widespread mortgage growth in this time frame, and in many cases growth has occurred regardless of whether those receiving the mortgages could actually afford them.<sup>10</sup> In what has proven to be an unprecedented housing bubble burst, home sales began their rapid descent in the United States in early 2006, and in late 2007 in the United Kingdom.<sup>11</sup> The insulation of the U.K housing market from the downturn, as seen by this delay, is likely evidence of the effectiveness of its regulatory scheme.<sup>12</sup>

The actual nuts and bolts of the mortgage lending practices in the two countries also have similarities.<sup>13</sup> Very generally, both countries' mortgage industries rely heavily on the role of the mortgage broker to facilitate loans between lenders and borrowers.<sup>14</sup> In the United States, there were approximately 53,000 mortgage brokerage companies that employed over 418,000 employees, which originated 68% of all residential loans in the United States in 2004.<sup>15</sup> So long as the broker is adequately licensed<sup>16</sup> or certified,<sup>17</sup> the arrangement between lender and broker allows the lending

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<sup>7</sup> Henry Paulson, U.S. Treas. Sec'y, Remarks on the U.S., The World Economy and Markets before the Chatham House (July 2, 2008), available at <http://www.treas.gov/press/releases/hp1064.htm>.

<sup>8</sup> Snook, *supra* note 2.

<sup>9</sup> *Id.*

<sup>10</sup> *See id.*

<sup>11</sup> The housing downturn in the United States was seen as early as 2005, and soon after in the United Kingdom. *See, e.g.*, Alan Greenspan, Reflections on Central Banking at a Symposium Sponsored by the Federal Reserve Bank (Aug. 26, 2005), available at <http://www.federalreserve.gov/Boarddocs/Speeches/2005/20050826/default.htm>; Grainne Gilmore, *House Sales Slow as Prices Continue to Fall*, THE TIMES, May 31, 2008.

<sup>12</sup> *See infra* part II.B. of this article for further discussion.

<sup>13</sup> Jack Guttentag, *Mortgage Brokers in the UK Versus the US*, June 2, 2008, <http://www.mtgprofessor.com/A%20-%20Mortgage%20Brokers/brokers%20in%20UK.htm>.

<sup>14</sup> *Id.*

<sup>15</sup> Access Mortgage Research & Consulting, Inc., *Study of the Mortgage Broker Business and Industry* (2008), referenced at <http://www.allbusiness.com/personal-finance/real-estate-mortgage-loans/717357-1.html>.

<sup>16</sup> *See* American Mortgage Licensing, *State Requirements for Brokers*, <http://www.amlicensing.com/state.asp>.

<sup>17</sup> *See* Financial Services Authority, *Training and Competence Sourcebook*, CP186 6.1 at 14, available at <http://www.fsa.gov.uk/pubs/cp/CP194.pdf> (stating that an examination will be required for certain mortgage activities including advised mortgage sales).

industry to function with flexibility and efficiency.<sup>18</sup> The lender provides the broker with specific loan prices and eligibility requirements, and the broker seeks customers that fit this description and are willing to pay the required price.<sup>19</sup>

This basic brokerage structure exists in both the United States and the United Kingdom, giving lenders the advantage of a broad customer base and immediate responsiveness to changes in supply and demand; when the lender wishes to cut volume, they are free to simply increase prices or tighten their eligibility standards.<sup>20</sup> Thus they are rarely forced to lay off employees, since brokers act as independent contractors. In both countries, the lender, rather than the borrower, most commonly pays brokers.<sup>21</sup>

Differences abound, however. First of all, the supply markets don't exactly translate. Land supply is abundant in the United States versus most European countries including the United Kingdom, and population density in the United States is only a fraction of that in the United Kingdom.<sup>22</sup> This creates very different supply and demand structures; some commentators note that the housing problems in the United States have stemmed from a well-documented over-supply, whereas U.K. housing problems have historically been linked to under-supply.<sup>23</sup>

The result of this supply-side difference is that the United States has a larger back stock of unsold homes, which one estimate says is over 4.7 million units, versus 700,000 in the United Kingdom.<sup>24</sup> Not surprisingly, in a time of flat economic growth and largely unavailable credit, excess inventory can only mean one thing for housing prices: steep declines.<sup>25</sup>

Secondly, although housing prices in both countries are historically high, there are differences in mortgage lending practices, fee structure for mortgage brokers, and consumer awareness policies. The main difference is that, in the United Kingdom, prices quoted by lenders directly to borrowers are the same retail prices available to borrowers through mortgage brokers.<sup>26</sup> These prices are generally public information and are

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<sup>18</sup> Jack Guttentag, *Why Fees For Mortgage Brokers Differ Between US and England*, DAILY HERALD (Aug. 2, 2008), [www.dailyherald.com/story/print/?id=224978](http://www.dailyherald.com/story/print/?id=224978).

<sup>19</sup> *Id.*

<sup>20</sup> Guttentag, *supra* note 13.

<sup>21</sup> *See id.*

<sup>22</sup> Tiffany Chaney & Paul Emrath, *U.S. vs. European Housing Markets*, NAT'L ASS'N OF HOME BUILDERS (May 5, 2006), <http://www.nahb.org/generic.aspx?genericContentID=57411&print=true>.

<sup>23</sup> Bovis, *supra* note 1.

<sup>24</sup> Snook, *supra* note 2, at 2.

<sup>25</sup> *See, e.g., The Long Hangover*, ECONOMIST (Apr. 10, 2008), available at [http://www.economist.com/world/unitedstates/displaystory.cfm?story\\_id=11016296](http://www.economist.com/world/unitedstates/displaystory.cfm?story_id=11016296) ("[T]he frailty of demand means that supply still vastly outweighs sales . . . [t]he excess of supply over demand means that the fall in house prices is accelerating.").

<sup>26</sup> Guttentag, *supra* note 13.

available on lenders' websites and through various media outlets.<sup>27</sup> All eligible borrowers theoretically have access to the same information about prices, and are assured that they can receive the advertised price from any broker that does business with the particular lender.<sup>28</sup> Armed with this information, borrowers can be assured they are on equal footing with other borrowers of the same general credit rating, and are not left wondering how their brokers are compensated.

The U.S. lender-broker arrangement is markedly different. Lenders deliver wholesale prices confidentially to those brokers with whom they do business.<sup>29</sup> These brokers add their own individually designed mark-ups to the wholesale price before quoting whole prices to borrowers, never disclosing the actual lender-originated wholesale price.<sup>30</sup> For example, a wholesale price given by a lender may be seven percent and zero points, to which the broker adds a two point markup.<sup>31</sup> The total resultant price to the borrower is seven percent and two points (i.e. each point is equal to one percent of the loan amount). This markup will traditionally be as high as the broker can get away with without losing the customer and forfeiting any fee income.<sup>32</sup>

Brokers are therefore compensated by the spread between the wholesale price quoted by the lender and the retail price that the customer is willing to pay.<sup>33</sup> This structure creates incentives to raise markups as high as the market will allow.<sup>34</sup> In addition, this pricing scheme leads many borrowers to assume, mistakenly, that the brokers are working in the borrower's best interest, attempting to snag them the lowest interest rate available for their particular credit rating.<sup>35</sup> As brokers are often compensated by the spread, this simply isn't the case. Furthermore, the problem is magnified when the borrower is "subprime."

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<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *See id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *See id.*

<sup>35</sup> *See* Federal Reserve System, Final Rule, Official Staff Commentary, 70 Fed. Reg. 147, 44522, 44525 (to be codified at 12 C.F.R. § 226) (suggesting anecdotal evidence which indicates that consumers in both the prime and subprime markets often believe, in error, that a mortgage broker is obligated to find the consumer the best and most suitable loan terms available, and stating:

Consumers who rely on brokers often are unaware, however, that a broker's interests may diverge from, and conflict with, their own interests. In particular, consumers are often unaware that a creditor pays a broker more to originate a loan with a rate higher than the rate the consumer qualifies for based on the creditor's underwriting criteria.)

First, price information for the subprime market is not widely and readily available to consumers . . . [S]ubprime rates, which can vary significantly based on the individual borrower's risk profile, are not broadly advertised and are usually obtainable only after application and paying a fee. Subprime rate quotes may not even be reliable if the originator engages in a "bait and switch" strategy. Price opacity is exacerbated because the subprime consumer often does not know her own credit score. Even if she knows her score, the prevailing interest rate for someone with that score and other credit risk characteristics is not generally publicly available.<sup>36</sup>

Moreover, the payment structure between lenders and brokers differs. In the United Kingdom, payments to brokers are set by lenders and are fairly standardized and are provided in detail to borrowers at the outset. In addition, brokers must disclose to lenders exactly what the arrangements are with the lenders that they recommend, in detail.<sup>37</sup> These rates do not vary with the interest rate obtained for the loan.<sup>38</sup> Alternatively, U.S. brokers are paid based on the interest rates they can deliver to the borrower. That is, they are paid only with a commission based on this spread with no salary component.<sup>39</sup> This difference in pay structure affects the incentives of mortgage intermediaries such as brokers and appraisers, contributing to the overall lack of transparency in the U.S. market.<sup>40</sup>

Although some brokers will standardize a fee (i.e. the "yield spread premium"), the common practice among most brokers is to charge the highest rate the market will allow.<sup>41</sup> Recent regulation in the United States has focused on this facet of the pricing structure as it relates to transparency in lending. Further discussion of such regulation changes by both the Federal Reserve Board and the Housing and Urban Development Agency ("HUD") are discussed in Part II.

The structure of the pricing scheme between mortgage lenders and brokers in the United States leaves ample room and temptation for

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<sup>36</sup> See *id.*

<sup>37</sup> See Financial Services Authority Factsheet, *FSA regulation of mortgage arranging and advising – do I need to be authorised?*, [http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/mortgage\\_arranging.pdf](http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/mortgage_arranging.pdf); Moneymadeclear, *Getting Help From a Mortgage Broker*, [http://www.moneymadeclear.fsa.gov.uk/products/mortgages/help/getting\\_help\\_from\\_a\\_mortgage\\_broker.html](http://www.moneymadeclear.fsa.gov.uk/products/mortgages/help/getting_help_from_a_mortgage_broker.html) (last visited Mar. 19, 2010).

<sup>38</sup> See Guttentag, *supra* note 13.

<sup>39</sup> Itzhak Ben-David, *Financial Constraints, Inflated Home Prices, and Borrower Default During the Real-Estate Boom* (Fisher College of Business Working Paper Series 2009-03-001, 2009), 21 available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=991387](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=991387).

<sup>40</sup> See *id.* at 10 (stating that the compensation structure for mortgage brokers is such that their ultimate goal is to complete each transaction, and often at a higher price, regardless of the interests of the borrower or the bank).

<sup>41</sup> See Guttentag, *supra* note 13.

opportunistic pricing.<sup>42</sup> This structure helps to explain perhaps why the average markup of the loan price from lender to broker to borrower in the United States is nearly twice that of the United Kingdom.<sup>43</sup> Some argue that the practices of mortgage lenders and brokers in the United States have led to a breakdown in the quality of loan underwriting in the market, leading at least in part to the subprime crisis and the mortgage meltdown.<sup>44</sup> Although others contend that the mortgage brokerage system in the United States is the answer to creation of a healthy and efficient mortgage marketplace, the recent market meltdown suggests otherwise.<sup>45</sup>

Lending practices in the United Kingdom are strikingly more transparent and consumer-friendly.<sup>46</sup> Interestingly, the housing market meltdown reached the United Kingdom later than the United States, and conditions still appear to be better despite the interconnectedness of the world economy.<sup>47</sup> Economists predict a sharper recovery in the United Kingdom than the United States, citing the fact that the U.S. recovery will require jumping two large hurdles: a complete rejuvenation of the mortgage market, as well as the completion of a massive sale of the large back stock of homes currently dragging down the supply side of the housing market.<sup>48</sup>

The United Kingdom, however, does not have a similar overabundance of homes for current sale in the market, which places the U.K. housing market in a better position to recover equilibrium.<sup>49</sup> It is perhaps time for the United States to realign its mortgage lending and brokerage regulations to follow the more transparent and conservative lead of the United Kingdom.

#### B. Regulatory Framework for Mortgage Lenders and Brokers

The regulatory scheme facing mortgage lenders and brokers is considerably different in the United States and in the United Kingdom.<sup>50</sup> The following section will provide a background and overview of these

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<sup>42</sup> See Ben-David, *supra* note 39, at 20 (stating that brokers “therefore have an incentive to help potential buyers find creative solutions for their credit constraints” . . . [f]urthermore, [brokers] have the advantage of being “familiar with the techniques of and possibilities for exploiting creative funding opportunities”).

<sup>43</sup> See Guttentag, *supra* note 13.

<sup>44</sup> See *id.*

<sup>45</sup> See Jack Guttentag, *Seattle Mortgage Broker Follows U.K. Model*, CHICAGO DAILY HERALD (Aug. 10, 2008), [hereinafter Guttentag, *Seattle*].

<sup>46</sup> See *id.* (stating that the system in the United Kingdom does not leave room for opportunistic pricing by lenders and brokers the way that the system in the United States necessarily does).

<sup>47</sup> See Bovis, *supra* note 1 (stating that the crisis hit the United States in 2005, whereas the United Kingdom was not truly impacted until late in 2007).

<sup>48</sup> See Snook, *supra* note 2.

<sup>49</sup> See *id.*

<sup>50</sup> Guttentag, *Seattle*, *supra* note 45.

differences.

In 2000, Parliament passed the Financial Services and Markets Act in the United Kingdom.<sup>51</sup> This Act essentially created and gave considerable authority to the FSA, whose general duty is to instill market confidence, create public awareness, protect consumers, and reduce financial crime.<sup>52</sup> As part and parcel of these duties, the FSA was charged with regulating and supervising every person who carries on a regulated financial activity in the United Kingdom.<sup>53</sup> While the FSA is the sole financial services supervisor in the United Kingdom, there are still other governmental entities that contribute to the regulatory framework for the lending and housing market. For example, a three-part agreement lays out the simultaneous duties of the Bank of England, Her Majesty's Treasury ("HM-Treasury"), and the FSA.<sup>54</sup> The FSA, a non-governmental body, answers to both the Treasury and Parliament.<sup>55</sup>

In 2004, the FSA took over regulation of the mortgage industry, inclusive of mortgage brokers.<sup>56</sup> This consolidation of authority had the happy result of bringing all mortgage brokers in the country under one set of rules. For instance, if a consumer has a complaint against a broker, there is one agency with which to file a complaint.<sup>57</sup>

Acting under this general grant of supervisory power over the industry, the FSA put requirements in place that all brokers must pass a competency exam in order to practice, and must provide all borrowers with three specific disclosures upon commencing business with them.<sup>58</sup> The first, the Initial Disclosure Document, is provided to the borrower after the borrower's initial meeting with the broker.<sup>59</sup> This document describes the lenders to which the broker has access, and provides complete information about the broker's fee, amount payable, and how it relates to the lender.<sup>60</sup> There is no comparable document in the United States.

The second disclosure is entitled the "Key Facts Illustration," which the broker provides to the borrower once a desirable loan package has been identified, and which lays out estimates of the true cost of the loan, payment

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<sup>51</sup> Financial Services and Markets Act, 2000, c. 8, (Eng.).

<sup>52</sup> See Financial Services and Markets Act, 2000, c. 8, § 1.2, (Eng.), available at [http://www.opsi.gov.uk/ACTS/acts2000/ukpga\\_20000008\\_en\\_2#pt1-11g1](http://www.opsi.gov.uk/ACTS/acts2000/ukpga_20000008_en_2#pt1-11g1).

<sup>53</sup> See Financial Services Authority, *Do I Need to be Authorised?*, [www.fsa.gov.uk/Pages/Doing/Do/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Do/index.shtml).

<sup>54</sup> Clive Bruilt, Financial Services Authority, *The Rationale for a Single National Financial Services Regulator*, Occasional Paper Series No. 2 (May 1999), at 8.

<sup>55</sup> Guttentag, Seattle, *supra* note 45.

<sup>56</sup> See *id.*

<sup>57</sup> *Id.*

<sup>58</sup> See *id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

schedules, and any other fees related to the loan.<sup>61</sup> Lastly, the broker provides a “Mortgage Record of Suitability,” which states the borrower’s specific traits that bear on the mortgage selection, as well as important features of the recommended loan including current and future affordability to the borrower.<sup>62</sup>

The regulatory scheme facing mortgage lenders and brokers in the United States is considerably more convoluted, while at the same time less stringent. Although mortgage brokers are regulated by more than ten federal laws, five federal enforcement agencies and at least forty-nine state regulation and licensing statutes, they have considerably more flexibility in pricing than their U.K. counterparts.<sup>63</sup>

There are several main regulatory bodies with which brokers must comply. HUD, which was created in 1965 as a cabinet-level agency to increase home ownership and increase access to affordable housing, has participated in the mortgage industry regulatory scheme to the extent that lending impacts housing policies.<sup>64</sup> Some argue that the mortgage policies of HUD have fueled the trend towards issuance of risky loans, putting its policy objectives of increasing home ownership ahead of responsible lending practices.<sup>65</sup>

In the United States, mortgage brokers are required to obtain separate licenses for every state in which they wish to operate.<sup>66</sup> Indeed, this is a key advantage to lenders to utilize brokers – their ability to seek business in other states than that in which the lender operates.<sup>67</sup> However, this requirement subjects the broker to different rules by state, leading to less than clear-cut standard industry practice with which consumers must grapple.<sup>68</sup> All brokers are subject to the federal Truth in Lending Act (“TILA”), which provides another layer of regulation on required disclosures and consumer rights.<sup>69</sup> The provisions of TILA and its recent amendments will be discussed further in Part III.

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<sup>61</sup> *See id.*

<sup>62</sup> *See id.*

<sup>63</sup> National Association of Mortgage Brokers, *The Regulation and Oversight of the Mortgage Broker Industry*, [www.namb.org](http://www.namb.org), [http://www.namb.org/Images/namb/GovernmentAffairs/Word\\_From\\_Washington/WFW%202006-11%20\(Regulation%20of%20Brokers\).pdf](http://www.namb.org/Images/namb/GovernmentAffairs/Word_From_Washington/WFW%202006-11%20(Regulation%20of%20Brokers).pdf).

<sup>64</sup> Department of Housing and Urban Development Act of 1965, 42 U.S.C. 3532-3537 (1965).

<sup>65</sup> *See id.*

<sup>66</sup> *See* Guttentag, Seattle, *supra* note 45.

<sup>67</sup> *See* Guttentag, *supra* note 13.

<sup>68</sup> *See id.*

<sup>69</sup> *See* 15 U.S.C. § 1601 (2000) (The regulations implementing the statute, which are known as “Regulation Z”, are codified at 12 CFR Part 22615 §226.1).

### C. Taxation Policies Lead to Differing Incentives

A final difference between the policies and practices of the mortgage industries in the United States and the United Kingdom is the tax code. The U.S. income tax code gives owner-occupied housing advantages such as a mortgage interest payment deduction.<sup>70</sup> In 2006, Congress estimated that the tax savings enjoyed by U.S. citizens for this deduction was \$402.7 billion over five years.<sup>71</sup> This considerable sum is borne by the government under the assumption that incentivizing home purchase is a beneficial public policy to increase home ownership.<sup>72</sup> Some argue, however, that consumers end up just buying larger homes with more amenities instead of actually making home purchase decisions that they would not have made without the tax break.<sup>73</sup>

By way of contrast, the U.K. does not have a mortgage interest deduction in place.<sup>74</sup> However, there is dissent among economists because whereas some data suggests that home ownership rates are not directly correlated with whether or not countries provide such deductions, other empirical studies suggest tax deductions significantly influence mortgage decisions.<sup>75</sup>

## II. THE SUBPRIME CRISIS & DECEPTIVE LENDING PRACTICES

### A. Background

The economic downturn and so-called housing crisis in the past few years can attribute a significant portion of their origin to two recent market phenomena: a considerable decline in housing prices and the related mortgage payment delinquencies and foreclosures.<sup>76</sup> In 2005 to 2006, the housing “bubble” which existed in the United States burst when defaults on subprime mortgages and adjustable rate mortgages began to climb at alarming rates.<sup>77</sup> The subprime share of the loan market reached about 9% in 2001, and reached 20% in both 2005 and 2006.<sup>78</sup> This widespread increase of risky mortgages increased home ownership across the United

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<sup>70</sup> Chaney & Emrath, *supra* note 22.

<sup>71</sup> *See id.*

<sup>72</sup> *See id.*

<sup>73</sup> *See id.*

<sup>74</sup> *See id.*

<sup>75</sup> Pamela J. Jackson, *Fundamental Tax Reform: Options for the Mortgage Interest Deduction*, Cong. Res. Serv. RL33025 (2005), available at <http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-7300:1>.

<sup>76</sup> Rex Nutting, *Recession Will Be Nasty and Deep, Economist Says*, MarketWatch, Aug. 23, 2006, available at <http://www.marketwatch.com/story/coming-recession-will-be-nastier-than-2001s-economist-says>.

<sup>77</sup> Federal Reserve System, Final Rule, Official Staff Commentary, 70 Fed. Reg. 147, 44522, 44524 (to be codified at 12 C.F.R. § 226), *supra* note 35.

<sup>78</sup> *See id.*

States, but the public policy benefits of this trend quickly eroded as it became evident that the risk of these loans was no distant illusion.<sup>79</sup> For example, the proportion of all subprime mortgages past-due for ninety days or more (“serious delinquency”) was about 18% in May 2008, over three times higher than the 2005 level.<sup>80</sup> Adjustable-rate subprime mortgages have performed the worst, reaching a serious delinquency rate of 27% in May 2008.<sup>81</sup> Although many factors are blamed for the depth and breadth of this crisis, chief among these factors are poor judgments made by borrowers and lenders alike.<sup>82</sup>

### B. Global Housing Boom . . . and Bust

Many observers in the United Kingdom predicted that the subprime market collapse would have a lesser impact on the housing market in the United Kingdom than was being seen in the United States.<sup>83</sup> There are several reasons for believing that the situation here is very different from that in the United States. First, subprime lending constituted a significantly smaller proportion of the total mortgage market as of 2007.<sup>84</sup> Second, U.S. borrowers have been subject to a series of rapid interest rate increases, resulting in borrowing costs rising from one to 5.25% over the short span of two years.<sup>85</sup> Contrastingly, U.K. interest rates were relatively stable over the same period of time.<sup>86</sup>

In addition, lending practices of U.S. subprime mortgage lenders added to the pain by offering low rates for initial teaser periods—typically about two years—before resetting to much higher fixed-term rates.<sup>87</sup> Third, house prices in the United States were rapidly falling as early as 2007, leaving thousands of mortgage holders with negative equity (i.e., borrowers owe more on their mortgage than the underlying property is worth) and

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<sup>79</sup> See Nutting, *supra* note 76.

<sup>80</sup> See *id.*

<sup>81</sup> See *id.*

<sup>82</sup> Joseph Stiglitz, Commentary, *How to Prevent the Next Wall Street Crisis*, CNN NEWS SERVICES, Sept. 17, 2008, available at <http://www.cnn.com/2008/POLITICS/09/17/stiglitz.crisis/index.html>.

<sup>83</sup> Jane Padgham & Robert Griffin, *UK Can Avoid U.S.-Style Mortgage Crisis*, THE INDEPENDENT, Mar. 16, 2007, available at <http://www.independent.co.uk/news/business/analysis-and-features/uk-can-avoid-U.S.style-mortgage-crisis-440480.html>.

<sup>84</sup> *Id.* (stating that “Merrill Lynch has estimated that it was worth £25bn to £30bn in 2005, but the Council of Mortgage Lending puts the figure at a much smaller £15bn to £16bn, only 5 to 6 per cent of total lending. That compares with \$830bn - about 10 per cent - in the U.S.”).

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

unable to sell their homes to pay off their debts.<sup>88</sup> In the United Kingdom, however, a long-running housing boom remained intact at that point in time.<sup>89</sup> What observers failed to appreciate, however, was that the United Kingdom was still vulnerable to the crisis in the United States because U.K. banks had huge capital obligations covering the subprime loan mess in the United States.<sup>90</sup> For example, as of February 2007, British bank HSBC had set aside \$10.5bn (£5.4bn) to cover bad loans in the United States.<sup>91</sup>

Unfortunately, the subprime meltdown in the United States had a ripple effect throughout the global economy, resulting in a wave of damage to financial institutions and investors around the world.<sup>92</sup> Because debt instruments backed by subprime mortgages were purchased worldwide, the International Monetary Fund noted that worldwide losses stemming from the U.S. crisis could reach \$945 billion.<sup>93</sup> By January, global financial institutions had announced more than \$135 billion of write-downs and losses.<sup>94</sup> In March of 2008, the largest bank in the United Kingdom, HSBC, reported a loss of \$17.2 billion due to its exposure to the U.S. housing crisis.<sup>95</sup>

The housing market downturn in the United Kingdom is wholly without precedent. In a report released in the fall of 2008, mortgage approvals for house purchases fell 75% and housing prices fell 14% over the previous two years.<sup>96</sup> Falling volumes and falling prices have in turn led to sharply reduced land values, making impracticable the continuation of many planned housing developments. The price and volume reductions in the current housing market have triggered deep concern and parliamentary response, discussed below in Part III.<sup>97</sup> Interestingly,

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<sup>88</sup> *Id.*

<sup>89</sup> Padgham & Griffin, *supra* note 83.

<sup>90</sup> See, e.g. Andrew Clark, *Barclays Sues Over Sub-Prime Losses*, THE GUARDIAN, Dec. 20, 2007, <http://www.guardian.co.uk/business/2007/dec/20/barclaysbusiness.subprimecrisis> (discussing Barclay's exposure to the US subprime losses).

<sup>91</sup> Ambrose Evans-Pritchard, *U.S. Mortgage Crisis Goes Into Meltdown*, TELEGRAPH, Feb. 27, 2007, available at <http://www.telegraph.co.uk/finance/2804846/U.S.-mortgage-crisis-goes-into-meltdown.html>.

<sup>92</sup> See Nutting, *supra* note 76.

<sup>93</sup> Findfacts Team, *IMF Says Worldwide Losses Stemming from the U.S. Subprime Mortgage Crisis Could Reach \$945 Billion*, Apr. 8, 2008, [http://www.findfacts.com/irishfinancenews/article\\_1013133.shtml](http://www.findfacts.com/irishfinancenews/article_1013133.shtml).

<sup>94</sup> Julia Werdigier, *Trading scandal diverts attention from Societe Generale's subprime losses*, INT'L HERALD TRIB., Jan. 29, 2008, available at <http://www.iht.com/articles/2008/01/29/business/loss.php>.

<sup>95</sup> See BBC News, *HSBC in \$17bn credit crisis loss*, Mar. 3, 2008, available at <http://news.bbc.co.uk/2/hi/business/7274385.stm>.

<sup>96</sup> See Bovis, *supra* note 1 (stating that the current market downturn is markedly worse than that of the late 1980s, in which mortgage approvals fell by 60% and housing prices fell by 13% in total).

<sup>97</sup> See *id.*

however, only a small portion of the housing downturn in the United Kingdom has been attributed to subprime mortgage lending practices there, or to poor regulatory oversight of mortgages; the U.S. subprime market is blamed for most of the problems.<sup>98</sup>

Expectations for recovery are nowhere in the foreseeable future, with the rate of new home construction expected to fall steeply in the coming years.<sup>99</sup> Experts at the United Kingdom's largest building society expect housing prices to continue to fall by 1% to 1.5% a month for the rest of 2008, and to continue falling at this rate in coming years.<sup>100</sup> However, the Bank of England reports that the housing market is showing signs of stabilization; the number of mortgages approved to finance house purchases was broadly unchanged as of September 2008, for the third successive month.<sup>101</sup>

### C. In the Wake of Crisis: Lawsuits and Blame

There is an abundance of litigation underway in response to the subprime crisis. One study released in early 2008 estimated that over 250 civil lawsuits had already commenced in 2007 related to subprime lending activities, a large percentage of which were class action suits brought by borrowers contending they were victims of discriminatory lending practices.<sup>102</sup>

In the United States, the Home Ownership and Equity Protection Act

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<sup>98</sup> See, e.g., Mark Landler, *Housing Woes in U.S. Spread Across Globe*, N.Y. TIMES, Apr. 14, 2008, available at <http://www.nytimes.com/2008/04/14/business/worldbusiness/14real.html?ref=business>; but see *The Bust Begins*, ECONOMIST, Apr. 8, 2008, [http://www.economist.com/world/britain/displaystory.cfm?story\\_id=11001376](http://www.economist.com/world/britain/displaystory.cfm?story_id=11001376), pointing to another possible cause:

[A] study by the International Monetary Fund found that Britain's housing market was the third most over-valued of 17 developed economies, narrowly behind Ireland and the Netherlands. House prices were almost 30% higher than could be explained by fundamental factors such as disposable income, interest rates and working-age population . . . The reality was that the market was lifted artificially high by a tide of cheap credit.

<sup>99</sup> *Id.*

<sup>100</sup> Hillary Osbourne, *Credit Crunch: Nationwide predicts House Price Falls Into 2010*, GUARDIAN, Nov. 10, 2008.

<sup>101</sup> FinFacts, *U.K. House Prices Fell at the Fastest Rate in At Least 25 Years in October*, Nov. 6, 2008, [http://www.finfacts.ie/irishfinancenews/article\\_1015190.shtml](http://www.finfacts.ie/irishfinancenews/article_1015190.shtml).

<sup>102</sup> *Subprime Lawsuits On Pace To Top S&L Cases*, THE BOSTON GLOBE, Feb. 15, 2008, available at [http://www.boston.com/business/articles/2008/02/15/subprime\\_lawsuits\\_on\\_pace\\_to\\_top\\_sl\\_cases/](http://www.boston.com/business/articles/2008/02/15/subprime_lawsuits_on_pace_to_top_sl_cases/).

("HOEPA") is specifically designed to combat predatory lending.<sup>103</sup> This act has been in place since 1994, but it has recently been infused with tougher requirements for specific loans.<sup>104</sup> Other federal agencies have taken actions, sometimes jointly, under various federal consumer protection laws, to bring actions against mortgage lenders and brokers who may have engaged in unfair or deceptive lending practices. For example, The Federal Trade Commission ("FTC") has played a prominent enforcement role, filing 19 complaints and reaching multimillion dollar settlements.<sup>105</sup> In addition, the Departments of Justice ("DOJ") and HUD have entered into predatory lending-related settlements using laws such as the Fair Housing Act and the Real Estate Settlement Procedures Act.<sup>106</sup>

Federal banking regulators, including the Federal Reserve Board, report little evidence of predatory lending by the institutions they supervise.<sup>107</sup> However, on September 23, 2008, government officials reported that the Federal Bureau of Investigation was looking into the possibility of fraud by mortgage financing companies Fannie Mae and Freddie Mac.<sup>108</sup> States have also strengthened regulation of lenders and brokers. As of January 2004, twenty-five states had passed laws to address the problems of predatory lending, utilizing such measures as restricting terms or provisions of certain high-cost loans, or instituting more stringent licensing requirements.<sup>109</sup>

In the United Kingdom, lawsuits arising from the housing crisis have also commenced and multiplied recently.<sup>110</sup> In a landmark case, a homeowner who was charged 9,000 British pounds in early repayment fees

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<sup>103</sup> U.S. Gov't Accountability Office, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, GAO-04-280, Jan. 30, 2004, available at <http://www.gao.gov/products/GAO-04-280>.

<sup>104</sup> The Home Ownership and Equity Protection Act of 1994 (HOEPA or the Act) amended TILA by adding Section 129 of TILA, 15 U.S.C. § 1639, and has been implemented by Sections 226.31 and 226.32 of Regulation Z. 12 C.F.R. §§ 226.31 and 226.32. HOEPA was implemented to specifically curb the predatory lending practices of certain sub-prime lenders. Generally, the Act provides added protections to borrowers who obtain more high-cost loans in the sub-prime market.

<sup>105</sup> U.S. Gov't Accountability Office, *Consumer Protection*, *supra* note 103.

<sup>106</sup> *See id.*

<sup>107</sup> *See id.*

<sup>108</sup> Kelli Arena, *FBI Probing Bailout Firms*, CNN, Sept. 24, 2008, available at [http://money.cnn.com/2008/09/23/news/companies/fbi\\_finance/index.htm](http://money.cnn.com/2008/09/23/news/companies/fbi_finance/index.htm).

<sup>109</sup> U.S. Gov't Accountability Office Senate Committee on Banking, Housing, and Urban Affairs, Report to the Chairman and Ranking Minority Member, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, (Jan. 2004), available at <http://www.gao.gov/new.items/d04280.pdf>.

<sup>110</sup> *See* Anand Doobay, *United Kingdom: What The Increase In International Crime Means For The Insurance Market*, Peters & Peters, MONDAQ July 31, 2009, available at <http://www.mondaq.com/article.asp?articleid=83712>.

for her mortgage brought the case to the High Court.<sup>111</sup> The outcome of this case will likely affect thousands of borrowers who similarly face exorbitant prepayment fees, of which they were not aware when they signed for their mortgages.<sup>112</sup> There exists a fundamental question at the base of the case: Who has responsibility for non-disclosed or inadequately-disclosed terms on a mortgage, the unsophisticated borrower or the business-minded lender?<sup>113</sup> The plaintiff in the case stated that the mortgage lender did not point out the prepayment penalty when she signed her mortgage.<sup>114</sup>

The FSA addresses these practices on its website, but the question has not been litigated in the High Court as of yet. The FSA states that “[m]ost major lenders have opted either to charge a fee that cannot be varied during the lifetime of the mortgage, or to remove the fee altogether. . . The fee should only vary for valid reasons *clearly explained at the outset*” (emphasis added).<sup>115</sup>

The FSA has also launched a “Campaign Against Mortgage Fraud,” increasing their supervisory focus on enforcement in the industry.<sup>116</sup> A new Enforcement Division works to ban intermediaries who have been implicated in mortgage fraud, whether by individuals or groups.<sup>117</sup> As of 2008, the FSA has banned twenty mortgage brokers and other involved in submitting false applications.<sup>118</sup> Perpetrators face not only bans but heavy fines and the possibility of forced disgorgement of ill-gotten gains.<sup>119</sup>

### III. CURRENT LANDSCAPE OF RESPONSIBLE LENDING PRACTICES

The response to the market meltdown in both countries has been extensive. Amendments to regulations already in place have been the route taken by U.S. governmental agencies, whereas transparency policies are already in place in the United Kingdom. There, they have focused more on liquidity and the credit portion of the crisis, rather than revamp their lending policies.<sup>120</sup> In the following section, we examine the changes in the United

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<sup>111</sup> Martin Shipton, *Mortgage Fees Face Test in Landmark Welch Case*, WESTERN MAIL, July 9, 2008, available at <http://www.walesonline.co.uk/news/wales-news/2008/07/09/mortgage-fees-face-test-in-landmark-welsh-case-91466-21308096/>.

<sup>112</sup> *Id.*

<sup>113</sup> *See id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> Financial Services Authority, *Campaign Against Mortgage Fraud*, [http://www.fsa.gov.uk/smallfirms/your\\_firm\\_type/mortgage/fraud/campaign.shtml](http://www.fsa.gov.uk/smallfirms/your_firm_type/mortgage/fraud/campaign.shtml) (last visited Nov. 22, 2008).

<sup>117</sup> *See id.*

<sup>118</sup> *See id.*

<sup>119</sup> *See id.*

<sup>120</sup> RICS Economics, 2009 Housing Forecast, *Transactions to Edge Up but Prices to Remain Depressed* (Dec. 2008), available at <http://www.docstoc.com/docs/9880623/2009->

States in response to the crisis and contrast these efforts with the response in the United Kingdom.

#### A. HUD Changes and 11th Circuit Decision

In 2007, a group of borrowers appealed a lower court decision to deny their class action suit against a mortgage lender, Premiere Mortgage Company, alleging that the lender's payment of yield spread premiums ("YSPs") to mortgage brokers in exchange for delivering interest rates above "par rate" violated the recently-enacted Real Estate Settlement Procedures Act ("RESPA").<sup>121</sup> The 11th Circuit affirmed the lower court finding, in that YSPs did not violate the RESPA.<sup>122</sup> The Court held that brokers were providing a real service to lenders for which they were owed compensation, and the total amount of such compensation was reasonable in light of the services that these brokers provided.<sup>123</sup> This holding, which was the first time the Court directly addressed the widespread use of YSPs to compensate brokers, seems to assure this particular structure of lender-broker payments a long, fruitful life.

YSPs are points paid by lenders for loans carrying interest rates above the par rate.<sup>124</sup> Although YSPs provide a useful option to some borrowers (i.e., those with little cash may pay a higher YSP to obtain a no-cost mortgage in which the settlement costs are paid by the lender), they overall increase costs to all borrowers.<sup>125</sup> The position taken by HUD, which administers RESPA, is that although the Act prohibits referral fees, YSPs are considered legal so long as they are reasonably related to the value of services provided to the borrower by the broker.<sup>126</sup> This position, affirmed by the 11th Circuit in *Culpepper*, leads to the widespread acceptability of YSPs and reveals, once again, the reluctance of the United States to standardize mortgage pricing as in the United Kingdom.<sup>127</sup>

In November of 2008, HUD issued a long list of additional mortgage reforms that essentially requires lenders and mortgage brokers to provide lenders with a standard Good Faith Estimate ("GFE") which will clearly disclose key loan terms and closing costs.<sup>128</sup> These final rules address a

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<sup>121</sup> *Culpepper v. Irwin Mortgage Corp.*, 491 F.3d 1260, 1263 (11<sup>th</sup> Cir. 2007).

<sup>122</sup> *See id.*

<sup>123</sup> *See id.* at 1273–74.

<sup>124</sup> *See* Jack Guttentag, *HUD and Yield Spread Premiums*, Oct. 3, 2001, available at [http://www.mtgprofessor.com/A%20-%20Mortgage%20Brokers/hud\\_and\\_yield\\_spread\\_premiums.htm](http://www.mtgprofessor.com/A%20-%20Mortgage%20Brokers/hud_and_yield_spread_premiums.htm).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *See id.*

<sup>128</sup> Press release, Brian Sullivan, *HUD Issues New Mortgage Rules to help Consumers Shop for Lower Cost Home Loans*, HUD No. 08-175, Nov. 12, 2008, <http://www.hud.gov/news/release.cfm?content=pr08-175.cfm>.

slew of comment letters received by HUD in response to their proposed changes to RESPA, including a four-page GFE.<sup>129</sup> The new rules require a much shorter and simpler GFE, which will tell borrowers the following information: loan term, interest rate (i.e., fixed or variable), pre-payment penalties, balloon payments, and total closing costs.<sup>130</sup> These upfront disclosures will go into effect January 1, 2010.<sup>131</sup> Some argue that these new rules will be the end of mortgage brokerage, as industry trade groups bemoan the increase in cost and clumsiness of the new rules.<sup>132</sup>

#### B. Federal Reserve Board Releases Amendments to Regulation

In July of 2008, the Federal Reserve Board approved a final rule for home mortgage loans to better protect consumers and promote responsible lending.<sup>133</sup> Lenders initiated over 550,000 foreclosures in the first quarter of 2008, about half of which were on subprime mortgages.<sup>134</sup> The sharp increase in delinquencies and foreclosures in the housing market since 2006 prompted the Federal Reserve Board to take new action by implementing a finalized set of rules amending Regulation Z (also known as Truth in Lending Act).<sup>135</sup> The new rules affect mortgage lenders of any size and took effect October 1, 2009, with the exception of the new escrow requirement which will be phased in during 2010.<sup>136</sup>

These highly anticipated changes strive to place more and better information in the hands of potential borrowers earlier in the process, facilitating more responsible and informed lending and borrowing. In finalizing the changes, the Federal Reserve Board took into account comments from across the entire industry including community banks, consumer banking trade associations, and mortgage banking trade associations.<sup>137</sup> Under the new amendments, *all* mortgage lenders could be impacted.<sup>138</sup> Four of the recent rules apply specifically to “high-priced loans,” which have been newly redefined as first-lien mortgages with an APR of 1.5% above the Federal Reserve Board’s “average prime offer rate,” as well as subordinated loans that are 3.5% over this rate (this updates the previous definition of “high-priced loans” which were tied to the

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<sup>129</sup> See *id.*

<sup>130</sup> See *id.*

<sup>131</sup> *Id.*

<sup>132</sup> See Jack Guttentag, *Reform May Mean End of Mortgage Broker Deception is Near*, DAILY HERALD, Sept. 6, 2008, <http://www.dailyherald.com/story/print/?id=232905>.

<sup>133</sup> Press Release, Federal Reserve Board, July 14, 2008, <http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm>.

<sup>134</sup> See, e.g., Federal Register, Part III, Federal Reserve System, 12 CFR Part 226, Truth in Lending, Final Rule, Sections 226.4, 226.5, 226.17, 226.18, 226.30.

<sup>135</sup> Sullivan, *supra* note 128.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> See *id.*

treasury rate).<sup>139</sup> Three other rules address all closed-end mortgages secured by a principal dwelling.<sup>140</sup>

The new rules purport to focus on transparency and verification, but emphasize such changes for loans traditionally considered subprime, with less concern for prime loans.<sup>141</sup> Here again, perhaps the focus of the regulatory changes should be on restructuring the lender-broker relationship. Changes apply to two loan categories: “high-priced loans” and closed-end loans secured by a principal dwelling.<sup>142</sup> If lending institutions write any loans that qualify as “high-priced” on or after October 1, 2009, more information pertinent to repayment ability will have to be considered beyond just the value of the underlying home.<sup>143</sup> In addition, evaluation of a borrower’s financial position must now include verification of the applicant’s income and existing assets, prepayment penalties will no longer be allowed if the monthly payment amount can potentially change within the first four years of repayment, and creditors will have to establish escrow accounts to reserve for property taxes and homeowner’s insurance payments.<sup>144</sup>

For closed-end loans secured by a principal dwelling, changes are less groundbreaking. For example, creditors and mortgage brokers are prohibited from coercing appraisers into misstating home values.<sup>145</sup> In addition, new regulations for loan servicing require lenders to credit payments to a consumer’s account as of the date received, and prohibit “pyramiding” late fees (pyramiding occurs when consumers make full and timely payments but are still assessed late fees on previously accrued and unpaid late fees.)<sup>146</sup> Lenders must also provide timely and accurate payoff statements if requested; and creditors must now deliver early mortgage loan disclosures to consumers no later than three business days after application, and before any fee is paid, other than a fee for obtaining the consumer’s credit history.<sup>147</sup> Under current fee structures, borrowers are often deterred from looking elsewhere after paying significant application or origination fees.<sup>148</sup>

There are several inadequacies to these amendments passed by the Federal Reserve Board. Notably, these amendments to Regulation Z do not address the market practices that differentiate the United States from the

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<sup>139</sup> *See id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *See id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

United Kingdom.<sup>149</sup> No mention is made of increased standardization of broker fees or enhanced disclosure of wholesale loan prices.<sup>150</sup> In fact, the Federal Reserve Board withdrew its proposal to “require servicers to deliver a fee schedule to consumers upon request; and its proposal to prohibit creditors from paying a mortgage broker more than the consumer had agreed in advance that the broker would receive.”<sup>151</sup> Instead, the Federal Reserve Board focused on increasing disclosures to consumers about their own repayment obligations and the true nature of the interest rate they face.<sup>152</sup> Although tightening up mortgage loan disclosures in the United States could assist some borrowers to better understand the costs and terms of their loans, some argue that such efforts may have an immaterial impact on decreasing the incidence of predatory lending.<sup>153</sup>

Secondly, the inherent complexity of mortgage terms is an inevitable source or opportunity for exploiting the unsuspecting borrower.<sup>154</sup> Some argue that even a relatively clear and transparent system of disclosures still not help borrowers who lack sophistication about financial matters, are not highly educated, or suffer physical or mental infirmities.<sup>155</sup> However, it is clear from looking at the state of the housing market in the United Kingdom, with their relatively transparent system, that there is room for improvement in the United States. Although a good start, the amendments focus too narrowly on the subprime market, or the newly defined “high-priced loan” market. The Federal Reserve Board was perhaps overly concerned with the cost burden of compliance for these new disclosure requirements and thus wished to exclude the prime market:

The Board stated in connection with the proposal a general principle that new regulations should be applied as broadly as needed to protect consumers from actual or potential injury, but not so broadly that the costs, including the always-present risk of unintended consequences, would clearly outweigh the benefits. Consistent with this principle, the Board believes, as it stated in connection with the proposal, that the stricter regulations of § 226.35 should cover the subprime market and generally exclude the prime market.<sup>156</sup>

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<sup>149</sup> See *id.*

<sup>150</sup> See Truth in Lending Final Rule, 12 C.F.R. § 226 (July 30, 2008).

<sup>151</sup> *Id.* at 44523.

<sup>152</sup> See Truth in Lending Final Rule, 12 C.F.R. § 226 (July 30, 2008).

<sup>153</sup> U.S. Gov’t Accountability Office Senate Committee on Banking, Housing, and Urban Affairs, Report to the Chairman and Ranking Minority Member, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, at 102, (Jan. 2004) available at <http://www.gao.gov/new.items/d04280.pdf>.

<sup>154</sup> See *id.*

<sup>155</sup> See *Id.*

<sup>156</sup> See Federal Reserve System, Final Rule, Official Staff Commentary, 70 Fed. Reg. 147, 44522, 44524 (to be codified at 12 C.F.R. § 226) *supra* note 35.

In light of such changes, it does not seem that the mortgage brokerage system in the United States will receive the overhaul it needs once the rules of amended Regulation Z come into effect. The increased transparency in subprime lending is a step in the right direction, but does not solve many of the issues with the mortgage brokerage scheme in the current market.

### C. United Kingdom: Responses to Market Meltdown

The split of responsibilities between the Treasury, Bank of England and FSA implemented by Gordon Brown in 1997 spread the supervisory responsibility of the mortgage industry to more entities, but arguably laid the foundations of a weaker regulatory framework by making it tougher for authorities to act nimbly and take timely action in the face of crisis.<sup>157</sup> In light of the recent crisis, some changes have been instituted at the FSA.<sup>158</sup> Changes include further tightening of their regulatory focus in response to the world financial crisis.<sup>159</sup> There is very little commentary related to tightening of disclosure requirements or mortgage broker practices, however, there is further evidence that the United Kingdom already has a strong and opaque regulatory scheme in place to oversee the mortgage market.

## IV. CONCLUSION

Whatever the best model for selling practices may be, it is clear that mortgage brokers in this post-subprime meltdown world must evolve with the times; regulation of the industry in the United States must keep pace with the times.<sup>160</sup> Improved regulation of their selling practices may be just the ticket.<sup>161</sup> The U.K. model, which takes a harder line at lending regulation and requirements, is more effective than that of the United States in controlling brokers and informing borrowers.<sup>162</sup> Regardless of the exact

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<sup>157</sup> See *The Politics of Printing Money*, THE TIMES, Mar. 6, 2009, [http://www.timesonline.co.uk/tol/comment/leading\\_article/article5854306.ece](http://www.timesonline.co.uk/tol/comment/leading_article/article5854306.ece) (describing that the tripartite system of financial responsibility did not help to stave off the comprehensive failure of policy, regulation and institutions in the United Kingdom in recent years).

<sup>158</sup> Mark Kleinman, *FSA Chairman Lord Turner Expects the City to Recover From Financial Crisis*, TELEGRAPH, Oct. 19, 2008, <http://www.telegraph.co.uk/finance/financetopics/financialcrisis/3224976/FSA-chairman-Lord-Turner-expects-the-City-to-recover-from-financial-crisis.html>.

<sup>159</sup> See *id.*

<sup>160</sup> Dousing the Fire, THE ECONOMIST, May 14, 2008, available at [http://www.economist.com/finance/displaystory.cfm?story\\_id=10855889](http://www.economist.com/finance/displaystory.cfm?story_id=10855889) (“The PWG—which comprises America’s Treasury, the Federal Reserve, the Securities and Exchange Commission and the Commodity Futures Trading Commission—concludes that, as Hank Paulson, the treasury secretary, put it, “regulation needs to catch up with innovation.”).

<sup>161</sup> See *id.*

<sup>162</sup> *Id.*

structure that emerges, increased exposure will compel lenders to maintain tighter control over credit quality.<sup>163</sup>

Although an onslaught of regulatory reform has occurred in the United States in the past year in response to the subprime crisis and the mortgage meltdown, the eventual impact of such changes in regulation may still come up short in solving the real problems of the current mortgage brokerage system. While the value of mortgage brokers is undisputed, the standardization of their fees and the pricing structure in the place in the United Kingdom is a more responsible and honest approach to mortgage pricing. The impact of the U.S. crisis has been felt globally, but the more immediate recovery prospects predicted in the United Kingdom versus that in the United States is just one indication of the inherent flaws in the regulatory scheme in the United States. Increasing the requirements for transparency through standardization of retail and wholesale price disclosures of mortgages, like the system in the U.K, would undoubtedly prove beneficial in the United States as well.

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<sup>163</sup> Matthew Lind, Jeff Babcock, Michael Zeltkevic & Piyush Tantia, *The Future of Wholesale Lending: The Wholesale Lending Channel Is Under Stress From a Variety of Forces* *Today* (Oct. 2008), available at [http://findarticles.com/p/articles/mi\\_hb5246/is\\_1\\_69/ai\\_n30963377/pg\\_2?tag=content;coll](http://findarticles.com/p/articles/mi_hb5246/is_1_69/ai_n30963377/pg_2?tag=content;coll).

