TO CATCH A PREDATORY LENDER

A comparative analysis examining Indian predatory lending laws in their microfinance industry to U.S. predatory lending laws in their subprime mortgage market

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I. INTRODUCTION

The statement "I have read and agree to the terms and conditions" is the most frequent lie told in the twenty-first century.[1] This sort of agreement is ubiquitous among consumer transactions and almost all consumers find themselves agreeing to something that they did not read or simply did not understand. Why should this matter? Freedom of contract governs, or is thought to govern, situations in which adults willingly bind themselves to contractual provisions.[2] Thus, if a contract is freely and voluntarily entered into, a court must enforce it.[3]

In theory, freedom of contract may seem sound, but its applicability to the real world has been called a "naïve myth."[4] One reason the doctrine is called a "naïve myth" is because it hinges on the assumption that the transaction's parties are completely informed.[5] In reality, most consumers are uninformed to some degree; particularly, many financial consumers do not understand the terms of their financial agreements.[6] Modern credit consumers can be uninformed for a variety of reasons: they are unaware that they are uninformed; they do not think that they can acquire the information to become informed; or they do not think that they can acquire such information at a reasonable cost.[7] In theory, however, if these

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1. I must attribute this quip to Professor Mark Rahdert, Charles Klein Professor of Law at Temple University's Beasley School of Law.

2. 5 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 12:3 (4th ed. WL 2012).

3. *Id.* This statement assumes that the contract is otherwise "legal" (e.g. not a contract for murder).

4. Ralph James Mooney, *The New Conceptualism in Contract Law*, 74 OR. L. REV. 1131, 1187 (1995).

5. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7–14 (2008) (explaining that the assumptions of perfectly informed parties and consumer rationality are unrealistic and potentially patently wrong in consumer credit markets).

6. *See id.* at 12 (exploring why consumers remain uninformed).

7. *See id.* at 12–14 (arguing that for many consumers, the cost of becoming informed about the meaning of their agreements would be prohibitively expensive, perhaps requiring the employment of an attorney or financial professional to explain the terms).

consumers were informed, then the market would provide safer financial products with better terms.[8]

Predatory lending is a paradigm example of the "naïve myth." Predatory loans are "exploitative high-cost loans to naïve borrowers."[9] Recently, predatory lending contributed heavily to the financial crises in India and the United States. In India, predatory lending was prevalent in the microfinance industry, whereas, in the United States, it thrived in the subprime mortgage market. This Comment will track the historical similarities between the two countries' predatory lending systems; discuss the respective issues which led to their detrimental economic effect; and review and analyze each country's new regulatory measures to combat future happenings.

In particular, this Comment will examine four approaches which India and the United States take to try to combat predatory lending in their respective systems. On a larger scale, these approaches are similar. However, they are unique to each country's problems. These four legal approaches are: (1) a two-level federal regulatory approach; (2) a series of regulations defining usable terms in lending; (3) a series of regulatory measures addressing how lenders may behave and operate; and (4) a much larger set of laws attempting to empower consumers through disclosure requirements and through providing rights of action for borrowers.

As mentioned, if both parties are fully informed, then, theoretically, they will be able to fairly deal with each other. Regulators base disclosure requirements and other consumer empowerment laws under this assumption. Yet, these requirements and laws do not adequately remedy the problem of imbalanced dealings. As this analysis will discuss in detail, disclosure requirements are only effective if those receiving the information understand the disclosures. However, common borrowers will rarely be able to understand the disclosures, which makes them a potential predatory lending victim. As a result, U.S. regulators enact "paternalistic" legislation that bans certain types of loans, caps interest rates, and enables regulatory bodies to examine more closely lender operations. Such governmental action supports the disclosure requirements and protects borrowers when—in the vast majority of scenarios—disclosure requirements alone are inadequate; these paternalistic measures should be the focus of future legislation.

This analysis will address the Indian and the U.S. regulatory regimes and compare, contrast, and comment on each country's approach to addressing predatory lending. Part II will structure a working definition of "predatory lending." Part III will discuss India's predatory lending history in the microfinance sector, its most recent socio-economic effects, and the governmental response. Part IV will track the same issues in the U.S. subprime mortgage market. Finally, Part V will discuss the four approaches to address predatory lending and compare and

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8. *Id.* at 8.

9. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1257 (2002). See Part II for a substantive discussion and definition of predatory lending.

contrast the countries' approaches and comment on their potential effectiveness. Further, it will argue that the disclosure-centric regulations do not adequately remedy the predatory lending problem and that additional non-disclosure legislation is needed. Otherwise, if regulators do not take a more hands-on approach, predatory lenders will remain as catchable as the Teumesian fox.[10]

II. "PREDATORY LENDING" DEFINED

"Predatory loans" are often said to be easier to identify than to define.[11] As a consequence, predatory lending is frequently subjected to a Justice-Stewart-type approach, such that people simply "know it when they see it."[12] Nevertheless, there are actually several approaches to defining "predatory lending." In the simplest sense, predatory loans are loans which are "bad" for the borrower.[13] They are "bad" for a myriad of reasons, such as deception in loan creation, the existence of onerous terms causing "disproportionate net harm" to the borrower, unfair practices once the lending relationship is established, or a combination of the three.[14]

Two approaches to defining "predatory lending" have emerged. The first approach consists of listing general characteristics with a few examples. The second approach defines "predatory lending" in the abstract, such as "bad loans." For this analysis, it is sufficient to understand that predatory lending is the process of strategically leveraging asymmetrical information to maximize the creditor's return in a lending relationship, while irreparably injuring the borrower's financial state. Asymmetrical information can be anything from the expertise inequality, such that the borrower is unaware of certain terms' particular effects on the lending relationship, to knowledge that the borrower has no ability to repay the loan that they are about to enter.

III. INDIA

As one of the world's largest landmasses, the Indian subcontinent has vast amounts of rural regions where farming is the predominant livelihood.[15] While

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10. In Greek mythology, the Teumesian fox was a gigantic fox, sent by the gods, that was destined never to be caught. Aaron J. Atsma, *Alopex Teumesios*, THEOI GREEK MYTHOLOGY, http://www.theoi.com/Ther/AlopexTeumesios.html (last visited Feb. 18, 2014).

11. Dustin Fisher, *Selling the Payments: Predatory Lending Goes Primetime*, 41 J. MARSHALL L. REV. 587, 593 (2008). Former Senator Phil Gramm once remarked that before predatory lending could be addressed, it had to be defined. Engel & McCoy, *supra* note 9, at 1259.

12. Engel & McCoy, *supra* note 9, at 1260 (referring to Justice Stewart's comment in *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) in which he stated, in reference to pornography that he could not define it, but "I know it when I see it")).

13. Debra Progrund Stark, *Unmasking the Predatory Loan in Sheep's Clothing: A Legislative Proposal*, 21 HARV. BLACKLETTER L.J. 129, 134 (2005).

14. Engel & McCoy, *supra* note 9, at 1260; Stark, *supra* note 13, at 134.

15. *The World Factbook: India*, CENTRAL INTELLIGENCE AGENCY, https://www.cia.gov/library/publications/the-world-factbook/geos/in.html (last updated Feb. 11, 2014).

farmer-to-farmer loans were very common for decades,[16] the Indian government encouraged, incentivized, and in some cases mandated that these rural communities received access to capital from institutional lenders in an attempt to raise India's socio-economic framework.[17] These developments spurred a large microfinance industry, but they also created a Petri dish for cultivating predatory lending.[18] After several years of unscrupulous lending, consumers and the government pushed back to address predatory lending problems. [19]

A. Historical Perspective

India's predatory lending plague dates back to the nation's late colonial period.[20] Farmers acquired loans that they were unable to repay post-harvest,[21] forcing borrowers to take out a separate loan to pay off the original.[22] Wealthier landowners typically extended such loans.[23] These landowners kept borrowers on the hook by charging high rates, purposefully miscalculating payments, and then assessing penalty interests.[24]

India's institutional lenders increased agricultural lending during the mid-twentieth century. During the 1950s, India began to nationalize its banks.[25] As a result, the Reserve Bank of India (RBI) asked the State Bank of India, a government owned corporation, to open hundreds of banks in "semi-urban areas and start agricultural lending, even if at a loss."[26] However, the State Bank of India predominantly made these agricultural loans to large agriculturalists, while wealthier individuals remained the source of loans for poor farmers.[27]

As the Indian government gained more control over banks, the government became able to implement rural-lending policies despite creditors' apprehensions to lend to poor borrowers. When India nationalized its largest banks in 1969, the RBI gained more power over lending practices and pursued policies to promote the

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16. *See infra* Part III.A.

17. *See infra* Part III.A.

18. *See infra* Part III.B.

19. *See infra* Part III.C.

20. India's "late colonial period" is the beginning of the twentieth century. *See* Mihir Shah et al., *Rural Credit in 20th Century India: Overview of History and Perspectives*, 42 ECON. & POL. WKLY. 1351, 1351 (2007) (examining the "late colonial period" and referencing economic surveys from 1929).

21. *Id.* Farmers typically used these short term loans to cover general cultivating costs. *Id.* Due to cash shortages, farmers often needed to take out long term loans to pay for their short term debt obligations; however, since the farmers paid the long term loans with harvest proceeds, they rarely had enough self-generated cash to pay off their short term debts themselves. As a result, they relied on long term loans to pay for short term debts—creating a cycle of indebtedness. *Id.*

22. *Id.*

23. *Id.*

24. Shah, *supra* note 20, at 1351–52 (2007).

25. *Id.* at 1353.

26. *Id.*

27. *Id.*

"rapid growth of agriculture [and] small industries."[28] In 1976, to further this policy, the RBI mandated that banks maintain a certain ratio of non-rural banks to rural banks so that branch banks were placed in "unprofitable"[29] areas which, in turn, would help the RBI reach its policy ends.[30] As a result, Regional Rural Banks were created.[31]

To further lending efforts and increase the amount of capital available to rural borrowers, the Indian government created a bank solely for agricultural and rural lending. In 1982, upon recommendation by the RBI, the Indian Parliament established the National Bank for Agriculture and Rural Development (NABARD) via Parliament Act No. 61 of 1981.[32] The governmental aim behind establishing NABARD was to increase the amount of credit extended to poorer, rural areas to "uplift" them.[33] To further this goal, NABARD provided "technical assistance" and aided lender liquidity to "support [and supervise] rural credit institutions and development initiatives."[34] Between NABARD and the other banks, the segment of total outstanding credit attributable to rural credit increased from 3% to 15%.[35]

B. Microfinance Operations and Procedures

The increased funding gave way to many different approaches to credit extension and administration.[36] The initial surge drew many Non-Governmental Organizations (NGOs) and nonprofits to increase credit availability.[37] Additionally, Microfinance Institutions (MFIs), banks which solely or primarily participated in microlending,[38] began to emerge. Like other lenders, MFIs made

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28. Kaushik Basu & Annemie Maertens, *The Pattern and Causes of Economic Growth in India*, 17 n.24 (Bureau for Research & Econ. Analysis of Dev., Working Paper No. 149, 2007), *available at* http://ipl.econ.duke.edu/bread/papers/working/149.pdf.

29. *See id.* at 16 (referring to remote agricultural areas as unprofitable).

30. *See* Shah et al., *supra* note 20, at 1362 (explaining that this program was a type of "social coercion" used by the central bank to obtain its policy goals).

31. *Id*.

32. *Genesis and Mission*, NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT, https://www.nabard.org/english/mission.aspx (last visited Feb. 18, 2014).

33. P.B. Reddy et al., *Women Self Help Groups in Andhra Pradesh Role of Nabard*, 2 INT'L J. SCI. RES. 88, 88 (2013).

34. C.S. Reddy & Sandeep Manak, *Self–Help Groups: A Keystone of Microfinance in India–Women Empowerment & Social Security* 5 (2005), *available at* https://wiki.wooster.edu/download/attachments/31720575/Reddy+and+Manak.pdf.

35. Basu & Maertens, *supra* note 28, at 12. Concomitantly, the amount of moneylending between individuals, such as large farmers and small farmers, fell from 75% in the 1950s to less than 25% by 1991. Shah et al., *supra* note 20, at 1355.

36. Reddy & Manak, *supra* note 34, at 6.

37. David E. Solan, *How Consumer Bankruptcy Reforms Can Help Save Microfinance in India*, 13 OR. REV. INT'L L. 317, 325 (2011).

38. Microlending is the extension of microcredit in the microfinance sector. *See* Eric Bellman & Arlene Chang, *India's Major Crisis in Microlending: Loans Involving Tiny Amounts of Money Were a Good Idea, but the Explosion of Interest Backfires*, WALL ST. J., Oct. 28, 2010, http://online.wsj.com/article/SB10001424052702304316404575580663294846100.html

loans to either individuals or small groups, including Self-Help Groups. Self-Help Groups are small groups of rural and urban people who banded together into credit and savings organizations.[39] Unlike NGOs and nonprofits, however, MFIs were for-profit institutions.[40]

When for-profit microfinance lenders emerged, they used the traditional "Grameen methodology:" locate poor borrowers; organize them to create "moral liability [for] repayment[;]. . . standardise products and systems[;] enforce discipline[;] and ensure that any breach is dealt with severely and sternly."[41] This model allowed the MFI sector to grow rapidly and generate large profits.[42] It spurred many donor-based lending institutions to move towards a "market-based model" to keep up with sector growth.[43] As a result, lenders made more money while permitting the shame-based culture of poorer Indians to self-enforce payment installment provisions.[44] However, it changed the microfinance industry's focus from meeting social goals to enabling lenders to maximize profits.

Despite this mass movement to lend to poorer individuals under a market-based—for profit—system, regulations to ensure safe lending practices did not really exist.[45] Some believed that this lack of regulation was the beauty of the system and allowed it to prosper,[46] while others believed that MFIs should be regulated like "conventional banks."[47] Regardless, the lack of regulation allowed

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(referring to microcredit as lending small amounts, which is what makes up the microfinance industry).

39. Reddy & Manak, *supra* note 34, at 6.

40. Jaideep Hardikar, *Microfinance Institutions are a Menace*, DNA INDIA (Jan. 2, 2011, 3:32 AM), http://www.dnaindia.com/money/report_microfinance–institutions–are–a–menace_1489045.

41. *Id.*

42. *Id*.

43. *Id.*

44. Solan, *supra* note 37, at 327. Indians generally feel "deep shame" when they fail to repay debt. *Id.* at 319. Solan notes that this shame, compounded by the communal nature of the loans, created peer pressure which is partly responsible for microfinance's success—repayment was self-enforcing. *Id.* at 327. *See also* Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI Sector ¶ 11.6, RESERVE BANK OF INDIA (2011), *available at* http://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=608#L11 (explaining that requiring a whole group to appear at an office to repay a loan will leverage peer pressure to repay the loan).

45. Kenny Kline & Santadarshan Sadhu, Microfinance in India: A New Regulatory Structure 1 (unpublished manuscript), *available at* http://www.centre-for-microfinance.org/wp-content/uploads/attachments/csy/1602/IIM%20Regulation%20V11.pdf (last visited Feb. 18, 2014) ("[S]ome microfinance institutions were subject to prudential requirements; however, no regulation addressed lending practices, pricing, or operations.").

46. *See, e.g.*, Sujeet Kumar, *Should the Microfinance Industry Be Regulated?*, HAUSER CENTER BLOG (Nov. 8, 2010), http://hausercenter.org/iha/2010/11/08/should-the-microfinance-industry-be-regulated/ (discussing the argument that the microfinance industry would collapse if regulated).

47. *Bring Micro-finance into Mainstream, Urges Nobel Laureate*, HINDUSTAN TIMES (India), Jan. 30, 2007.

for three overarching, negative attributes of predatory loan systems: usurious interest rates, harassing collection methods, and multiple loans to individuals.[48]

Interest rates, collection methods, and layers of loans individually and/or collectively led to a multitude of borrower suicides. Without an interest rate cap,[49] lenders charged usurious rates, sometimes exceeding 40%.[50] In addition, collection agents used deceptive and overly forceful methods, such as luring borrowers to offices to demand repayment and telling females to "sell their bodies" to get money to repay the loans.[51] Furthermore, debtors began to borrow from money-lenders to pay MFI loans.[52] In late 2010, all of this culminated in more than 200 borrowers killing themselves in the southern Indian state of Andhra Pradesh, in an attempt to escape debt and to avoid shaming their families.[53] These consequences led to a socio-political backlash against the expansion of lending.[54]

C. Regulatory Measures

As part of the backlash from the highly publicized string of suicides and other consumer complaints, the Indian Federal Government, as well as individually affected states, took regulatory measures to prevent a reoccurrence. In October 2010, the Andhra Pradesh state government issued the Micro Finance Institutions Ordinance 2010, which regulates the following: MFI registration with local authorities; interest rate disclosures; additional fees on top of interest rates; issuance of multiple loans to a single entity (individual or Self-Help Group); collection procedures; and penalties for violations.[55] Similarly, the RBI issued a circular with guidelines on Fair Practices Code for Non Banking Financial Companies and MFIs (NBFC-MFIs) and made the existing circulars on this issue applicable to NBFC-MFIs.[56] These guidelines attempt to govern the credit

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48. *Microlending Chaos: Suicides in India Due to Usurious Interest Burdens*, LEVERAGE ACADEMY, (Oct. 28, 2010, 10:38 PM) http://leverageacademy.com/blog/2010/10/28/microlending-chaos-suicides-in-india-due-to-usurious-interest-burdens/; *Muhammad Yunus Speaks at Business School*, HARV. MAG. (Apr. 20, 2012) http://harvardmagazine.com/2012/04/muhammad-yunus-speaks-at-business-school; *New Microfinance Bill will Ban Microfinance in India*, SAMN (Nov. 12, 2010) http://www.samn.eu/?q=node/191.

49. *See* Kline & Sadhu, *supra* note 45, at 5 (highlighting the recommended regulations, which include implementing an interest rate cap).

50. Lola Nayar, Madhavi Tata, & Dola Mitra, *Is it Micro Usury?*, OUTLOOK (Oct. 18, 2010), http://www.outlookindia.com/article.aspx?267394.

51. Solan, *supra* note 37, at 318.

52. Shah et al., *supra* note 20, at 1360.

53. Associated Press, *Hundreds of Suicides in India Linked to Microfinance Organizations*, BUSINESS INSIDER (Feb. 24, 2012, 8:18 AM), http://www.businessinsider.com/hundreds-of-suicides-in-india-linked-to-microfinance-organizations-2012-2.

54. Solan, *supra* note 37, at 326.

55. Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Rules, 2010, G.O. Ms. No. 356 (India).

56. Master Circular–Fair Practices Code, Reserve Bank of India, RBI/2012-13/27, DNBS (PD) CC No. 286/03.10.042/2012-13 ¶ 1, (July 2, 2012) [hereinafter Master Circular–Fair Practices Code].

extension and recovery processes.

First, the RBI circular addresses the loan acquisition process. These provisions mandate that lenders give potential borrowers a basis for "meaningful comparison" with other lenders by requiring vernacular clarity in marketing materials and full disclosure as to what factors will affect the borrower's interest rate.[57] This clarity includes "prominently" displaying the effective interest rate and the adopted grievance redress system in the lender's marketing materials and website.[58] Once a borrower applies for a loan, the lender must respond in writing—stating the loan's terms and conditions, total amount, and the penal interest amount if there is late repayment.[59]

The circular's provisions encourage lenders to put the loan's terms and conditions in writing to address the borrower's uncertainty regarding the loan's exact terms.[60] The circular mandates that the loan agreement must explicitly state in bold text whether there is a penal interest for late repayment and the amount of such interest.[61] Further, the loan agreement must inform the borrower that—aside from the principal (amount lent)—the loan only consists of "the interest charge, the processing charge and the insurance premium,"[62] and that the lender will not collect a security deposit.[63] These mandatory provisions are direct responses to complaints about lending practices that borrowers submitted to the government.[64]

Second, the RBI circular addresses the lending relationship once the borrower accepts the loan and the lender disburses the money. Lenders "should give notice" of changes to the disbursement schedule, interest rates, and charges and may only apply such changes prospectively.[65] The loan agreement terms to which the lender and borrower agreed govern all other decisions, such as the decision to recall the loan.[66] If such loan agreements provide for borrower training,[67] the training must

57. *Id.* ¶ 2(A)(i)(a–b).

58. *Id.* ¶ 2(B)(i)(e).

59. *Id.* ¶ 2(A)(ii).

60. *Id.*

61. *Id.*

62. Master Circular−Fair Practices Code, *supra* note 56, ¶ 2(B)(ii)(b)(ii).

63. *Id.* ¶ 2(B)(ii)(b)(iv).

64. *See id.* ¶ 2(A)(ii) (discussing complaints received by non-banking financial companies); *see also* RBI Master Circular – Know Your Customer (KYC) norms/Anti–Money Laundering (AML) standards/Combating of Financing of Terrorism (CFT)/Obligation of banks under PMLA, RBI/2012-13/45, DBOD. AML. BC. No. 11/12/01/001/2012-13 ¶ 2.3, (July 2, 2012) ("Every bank should develop a clear Customer Acceptance Policy laying down explicit criteria for acceptance of customers. [This includes] [d]ocumentation requirements and other information to be collected in respect of different categories of customers depending on perceived risk . . . .").

65. Master Circular−Fair Practices Code, *supra* note 56, ¶ 2(A)(iii)(a). Of note, the provision does not mandate that the loaning institutions *have* to give notice nor do the provisions state how much notice needs to be given. *Id.*

66. *Id.* ¶ 2(A)(iii)(b).

67. Training can come in many different forms. For instance, a borrowing group can receive training in managing their group, honing their income–generating activities, or basic literacy. Ranjula Bali Swain & Adel Varghese, *Being Patient with Microfinance: The Impact of Training*

be given free of charge.[68] Also, the lender's field staff must be trained to answer inquiries about the borrower's debt and to "make the borrowers fully aware of the procedure and systems related to [the] loan . . . ."[69]

Finally, the circular addresses permitted and prohibited collection methods. Generally, lenders are prohibited from using "undue harassment," such as "persistently bothering the borrowers at odd hours" or using force to get loan repayments.[70] Moreover, loan recovery can only occur at a "central designated place[,]" or if the borrower fails to show for two consecutive repayments, a field staff member may go to the borrower's residence or workplace.[71] In "sensitive areas,"[72] only the lender's employees, rather than outsourced agents, can recover loans.[73] Each institution's board of directors must set up a grievance system, and if borrowers claim overly harassing collection procedures or any other violations of the code, they can use this system to report their problems.[74] Hopefully, these codes will alleviate the root of the problems about which borrowers complain. However, a problem remains—the circular's mandates are not binding by their nature. Rather, they are mere guidelines that the RBI orders banks to adopt, hopefully in letter, but at least in spirit.[75] This disconnect between "guiding principles" and mandated practices, is the area with which the Banking Codes and Standards Board of India (BCSBI) deals.[76]

The BCSBI was established in February 2006 via a collaborative effort between the RBI and banks on the recommendation of the Committee on Procedures and Performance audit on Public Services.[77] "BCSBI is an independent and autonomous institution to monitor and ensure" that members adhere to adopted

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on Indian Self Help Groups 7–8 (Dept. of Economics, Uppsala University, Working Paper No. 22, 2010). Swain and Varghese attempt to "distill" what they observed during their visits to NABARD offices. This information is not generally available through publication. *Id.* at 7 n.6.

68. Master Circular−Fair Practices Code, *supra* note 56, ¶ 2(B)(i)(d).

69. *Id.* ¶ 2(B)(i)(c)–(d).

70. *Id.* ¶ 2(A)(iv)(c).

71. *Id.* ¶ 2(B)(iii).

72. "Sensitive areas" refers to places such as a borrower's home or work where coercive methods have most often been reported. *See* Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI Sector, *supra* note 44, ¶ 11 (discussing how coercive methods are often used at homes and places of business, but that only requiring repayment at local offices can cause a burden on borrowers if they have to travel).

73. Master Circular−Fair Practices Code, *supra* note 56, ¶ 2(B)(iii).

74. *Id.* ¶ 2(A)(v).

75. *See Reserve Bank Tightens Fair Practice Code for NBFC's*, THE HINDU, (March 26, 2012), http://www.thehindu.com/business/Economy/article3248154.ece (noting that while NBFCs would have freedom in drafting this would not sacrifice the spirit underlying the guidelines).

76. *See* The Banking Codes and Standards Board of India, INDIAN BANKS' ASSOCIATION, http://www.iba.org.in/bcsbi.asp (last visited Jan. 31, 2014) [hereinafter *BCSBI*] (providing an overview to the system's establishment and function and delineating its voluntary nature).

77. *Id.*

codes.[78] Lending institutions register with BCSBI to become members.[79] Once members are "ready to implement the commitments," they are then required to adopt the Fair Practice Code, as well as other BCSBI codes, thus "binding them" to the implemented code and BCSBI's monitoring power.[80] If a bank is ineligible for membership, or if it simply does not become a member, it is still encouraged to adopt the Grievance Redressal system per the Fair Practices Code.[81] If a bank does not honor its commitment to customers and breaks the code, then, "'in extreme cases,'" the BCSBI will publicly censure and shame the bank.[82]

In addition to trying to remove the amount of asymmetrical information, the central bank addressed three major negative attributes of the lending industry that borrowers faced. The central bank set a 26% cap on microloans up to 50,000 rupees or $1,124.00.[83] This cap did not last very long, though, as many lenders complained that they were unable to keep their profit margins at a sustainable level.[84] In other words, since operating costs were so high, MFIs were unable to maintain large profits while lending under the 26% cap. In August 2012, India's central bank modified the regulation so that MFIs could exceed the 26% cap, as long as "[t]he maximum difference over funding costs [did not] exceed 10 percent for large microfinance firms and 12 percent for the rest."[85] India's central bank also set out to control the amount of loans that borrowers were permitted to have at any given time. For instance, borrowers are prohibited from borrowing from more than two MFIs.[86]

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78. THE BANKING CODES AND STANDARDS BOARD OF INDIA, http://www.bcsbi.org.in/index.html (last visited Jan. 31, 2014).

79. *BCSBI*, *supra* note 76.

80. *Id.*

81. *Id.* The Grievance Redressal System is the hiring of a code compliance officer and the implementation of help desks at branch banks to allow customers to resolve issues or file complaints regarding lender practices. *Id.*

82. *Banks which Fail to Fulfill Customer Commitment to Face Public Censure*, ECON. TIMES, (Mar. 16, 2007) http://economictimes.indiatimes.com/news/news-by-industry/banking/finance/banking/banks-which-fail-to-fulfil-customer-commitment-to-face-public-censure/articleshow/1770285.cms. This countermeasure is perhaps the impetus for joining the BCSBI. In a shame–based culture, the potential for public reprimand could be a much grimmer affair than if it occurred in the United States. The BCSBI Chairperson noted her disappointment with banks that did not join the BCSBI, seemingly in an attempt to spur them to join. *Id.*

83. Arjun Kashyap, *India cbank sets 26 pct cap on microfinance loans*, REUTERS NEWS, (May 3, 2011, 13:52 MSD), http://ru.reuters.com/article/idUKL3E7G30XF20110503.

84. *See* Kline & Sadhu, *supra* note 45, at 14 (expressing concern over margin and interest caps).

85. Ruth David, *India's RBI Eases Regulations for Non–Bank Microfinance Lenders*, BLOOMBERG (Aug. 4, 2012, 2:52 AM),http://www.bloomberg.com/news/2012–08–04/india–s–rbi–eases–regulations–for–non–bank–microfinance–lenders.html.

86. Non Banking Financial Company–Micro Finance Institutions (NBFC–MFIs) – Directions – Modifications, Reserve Bank of India, RBI/2012–13/161, DNBS (PD) CC.No.300 /03.10.038/2012-13 ¶ 4 (Aug. 3, 2012), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/CCNOI030812FM.pdf.

IV. UNITED STATES

A. Historical Perspective

Although predatory lending in the U.S. housing market predates the Great Depression,[87] for purposes of this analysis, the relevant U.S. history starts around World War II (WWII). Right before WWII, the U.S. Government commenced federal programs to spur the housing market.[88] After WWII, these programs, such as those through the Federal Housing Agency (FHA), helped returning soldiers achieve the "American dream" of homeownership.[89]

Federal agencies helped structure and effectively standardize the housing market for the better half of the twentieth century.[90] They did this, and still do, through a number of programs and regulations. For instance, the FHA provides mortgage insurance to lenders who extend loans to individuals who put very little amounts of cash down.[91] If the borrower defaults, then the FHA will pay the lender;[92] the borrower assumes the cost of such insurance.[93] Originally, this insurance was only permitted for "long-term fully amortizing fixed-rate loans."[94] The federal government mandated that creditors provide only certain types of loans. For instance, they capped interest rates and disallowed federally chartered institutions from using floating or variable rates.[95] As a consequence, the standard U.S. home mortgage loan was a thirty-year fixed-rate loan[96] and only those who qualified for an interest rate below the caps received them.[97]

This form of lending drastically changed during the 1970s and 1980s. During this time, three things began to occur: mortgage securitization, credit product

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87. *See* Fisher, *supra* note 11, at 587 (stating that non–fully amortizing loans were one of the loan types on which the pre–Great Depression housing market thrived).

88. *See The Federal Housing Administration* (*FHA)*, U.S. DEPT. OF HOUSING. AND URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory (last visited Feb. 21, 2013) (discussing the history of the Federal Housing Administration (FHA) and how the housing market and industry were flat before the FHA came into existence).

89. *Id.*; *see also* Stark, *supra* note 13, at 131−32 (discussing how home ownership and the "American dream" are intertwined).

90. Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 715 (2006).

91. *See The Federal Housing Administration* (*FHA)*, *supra* note 88 (discussing the insurance that FHA provides to lenders).

92. *Id.*

93. *See id.* (illustrating how the cost is passed on to the borrower); *see also* Willis, *supra* note 90, at 715 (discussing how FHA mortgage insurance has affected the structure of the market).

94. Willis, *supra* note 90, at 716. The transition away from this will be discussed below.

95. *Id.*

96. *See* Fisher, *supra* note 11, at 590 (referring to Alan Greenspan's confusion as to why Americans do not prefer adjusted rate mortgages (ARMs)); Willis, *supra* note 90, at 716.

97. *See* Stark, *supra* note 13, at 132 (stating that lenders were very risk averse and provided loans to those with good credit and sufficient income).

innovation, and loan extensions to borrowers previously kept out of the market.[98] Fannie Mae and Freddie Mac, government sponsored entities (GSEs), began securitizing home mortgages.[99] This process produces a constant flow of cash in the mortgage market that creates more available funds, which allows lenders to extend more loans.[100] Since this alleviates liquidity restraints, smaller institutions with less established amounts of capital could originate loans.[101]

Concurrently, the disintermediation[102] from the mid-1970s credit crunch[103] caused many rate caps to be erased or severely raised.[104] As a consequence of the credit crunch, the federal government deregulated depositories[105] and created liberal regulations,[106] which allowed lenders to use variable interest rate loans called adjusted rate mortgages (ARMs),[107] balloon payments,[108] and other

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98. Engel & McCoy, *supra* note 9, at 1273. These individuals were those who did not qualify for lower interest loans. *Id.*

99. *Id.* In short, the securitization process starts with a loan from a lending institution. The loan is then sold to an intermediary institution that bundles similar loans into "tranches" or pools. These pools are then sold to investors, typically in the form of debentures. The interest payments from the borrowers are passed through to the debenture holders and treated as the debenture's coupon payments. If a borrower prepays her loan (she paid off the remaining payments early), whether it is from a refinancing or sale, her loan is taken out of the pool, and the debenture holders subsequently receive a proportionally less amount on their future coupon payments in return for a lump sum. However, if a borrower altogether defaults on her loan, the debenture holders' principal is reduced. *See generally* Taylor D. Nadauld & Shane M. Sherlund, *The Role of the Securitization Process in the Expansion of Subprime Credit*, (Fin. and Econ. Discussion Series, Divs. Research & Stats. and Monetary Affairs, Fed. Reserve Bd., Working Paper No: 2009-28, 2009), *available at* http://www.federalreserve.gov/pubs/feds/2009/200928/200928pap.pdf (discussing securitization and subprime loans).

100. Engel & McCoy, *supra* note 9, at 1274.

101. *Id.*

102. When interest rates rise, depositors with fixed interest rates will withdraw their money from the depository and invest their money directly into money market accounts or other relatively safe liquid funds—removing the intermediary from the process—causing disintermediation. Willis, *supra* note 90, at 718 n.26.

103. *See* Willis, *supra* note 90, at 718 n.26 (describing how bank customers, withdrawing their deposits, reduced banks' lendable funds and caused a credit crunch).

104. *See id.* at 718 (explaining that fixed rate mortgages during a time period of quickly rising interest rates hurt banks earning capacity).

105. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96–221, 94 Stat. 132 (eliminating limitations on depository interest rates and authorizing interest–bearing transaction accounts).

106. *See* Alternative Mortgage Transactions Parity Act of 1982, Pub. L. No. 97–320, 96 Stat. 1469, 1545–48 (preempting and abolishing state usury laws that would restrict ability to lend at variable rates).

107. ARMs are loans that start at a fixed rate, then, after a predetermined amount of time, adjust to reflect market rates for the borrower's loan. Ruth Simon, *Paying Less for a Mortgage: How to Sidestep Rising Rates on 30–year Fixed Rate Mortgages,* WALL ST. J., Nov. 9, 2012, *available t* http://online.wsj.com/article/SB10001424052970204755404578103002877215048.html.

108. *See infra* Part IV Section C for an explanation on balloon payments and other types of loan mechanisms.

previously unavailable types of loans.[109] These features allowed lenders to provide loans other than the standard thirty-year fixed rate mortgage and create loans for those individuals without good credit.[110]

In addition to allowing new, more variable, loan types, federal government initiatives resulted in increased lending to low and moderate-income borrowers.[111] Prior to the GSEs creation, many believed that financial institutions aided inner cities' economic declines by "redlining"[112] lower and moderate-income areas, which were also predominantly minority neighborhoods.[113] To address practices such as redlining, Congress enacted the Community Reinvestment Act (CRA).[114] The CRA incentivized non-GSE mortgage market participants to originate or purchase loans for homes situated in "redlined" neighborhoods.[115]

Additionally, in the mid-1990s, the Department of Housing and Urban Development (HUD) began to require that the GSEs purchase more loans made to low and moderate-income individuals.[116] These loans had to constitute at least 42% of the GSEs total loan purchases.[117] In turn, these requirements, paired with the FHA's mortgage insurance, caused institutions to lend to higher credit risk borrowers without the full downside risk for lenders in the event of a default.[118] Consequently, there were more lenders willing to lend to high-risk individuals with an accompanying higher interest rate[119]—opening the door to predatory lenders in this new, subprime, mortgage market.[120]

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109. *See* Engel & McCoy, *supra* note 9, at 1275 (describing alternative loan structures that were previously unavailable); *see also* Jon Birger, *How Congress Helped Create the Subprime Mess*, CNN MONEY (Jan. 31, 2008, 9:51 AM), http://money.cnn.com/2008/01/30/real_estate congress_subprime.fortune/.

110. *See* David Reiss, *Subprime Standardization: How Rating Agencies Allow Predatory Lending to Flourish in the Secondary Mortgage Market*, 33 FLA. ST. U. L. REV. 985, 994 (2006) (explaining that the change in such legal bars, among other things, allowed for credit innovation and, as a result, loan extension to new groups of borrowers).

111. Engel & McCoy, *supra* note 9, at 1276.

112. Michelle Minton, *The Community Reinvestment Act's Harmful Legacy: How it Hampers Access to Credit*, COMPETITIVE ENTERPRISE INSTITUTE (2008) ("Lenders allegedly 'redlined' these neighborhoods—drawing a red line, both literally and figuratively, around areas with perceived undesirable characteristics and systematically refusing credit to residents, regardless of individual creditworthiness."). This practice dates back to the 1930s as an attempt by the Roosevelt Administration to stabilize the housing market. *See* REDLINING IN PHILADELPHIA, http://cml.upenn.edu/redlining/HOLC.html (last visited Nov. 8, 2012) (discussing the history of the redlining practice).

113. Minton, *supra* note 112, at 1.

114. Community Reinvestment Act of 1977, Pub. L. No. 95–128, 91 Stat. 1147; Minton, *supra* note 112, at 1.

115. *Id.*; Engel & McCoy, *supra* note 9, at 1276.

116. Engel & McCoy, *supra* note 9, at 1276.

117. *Id.*

118. *Id.* at 1277.

119. *Id.* at 1279.

120. *Id.* at 1278.

B. Operations and Procedures

The availability of new lending instruments created two general classes of housing loans—prime and subprime. Prime mortgages are loans that are "healthy."[121] Generally, these loans are akin to the "traditional" loans extended prior to the 1970s.[122] Accordingly, borrowers with prime loans predominantly have better credit than borrowers who receive subprime loans. Typically, the standard prime borrower will have a FICO credit score above 620.[123]

Subprime loans are riskier loans.[124] Subprime lending "is the extension of credit to those with lower incomes, less wealth, and riskier credit profiles than traditional 'prime' borrowers."[125] Normally, subprime lenders extend three types of loans: loans to borrowers with poorer credit histories; loans to borrowers with decent credit, but who cannot accurately document their income ("low doc" or "no doc" loans); and loans to borrowers who are refinancing, but can only get a lower interest rate for a higher loan-to-value ratio.[126] These loans have higher interest rates to account for the greater risk.[127] Predatory lending occurs in both markets, but it is more associated with, and more frequently occurs in, the subprime market.[128] Predatory lending practices generally transpire in the subprime market because of fewer, less stringent regulations and because of the type of individuals who are taking out the loans.[129] Specifically, it mainly occurs in the subprime refinancing market.[130]

Predatory lenders know where they can find borrowers.[131] For the most part,

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121. Reiss, *supra* note 110, at 993.

122. Engel & McCoy, *supra* note 9, at 1278.

123. Fisher, *supra* note 11, at 589. FICO scores are based on creditworthiness and are measured on a scale of 300-900—the higher the score, the more creditworthy the borrower. *Id.* at n.5.

124. *See* Jessica Silver–Greenberg & Tara Siegel Bernard, *Lenders Again Dealing Credit to Risky Clients*, N.Y. TIMES, Apr. 11, 2012, at A1, *available at* http://www.nytimes.com/2012/04/11/business/lenders-returning-to-the-lucrative-subprime-market.html?pagewanted=all (explaining that as lenders stabilize their own financials they are slowly reentering the subprime markets to take on more risk).

125. Reiss, *supra* note 110, at 994.

126. *Id.* at 995. Loan to value ratio is the loan's principal amount compared to the home's value. Previously, this ratio was capped at around 90%, John Pottow, *Ability to Pay*, 8 BERKELEY BUS. L.J. 175, 178 (2011), but by the 1990s these ratios were as high as 150% or greater. Reiss, *supra* note 110, at 995 n.55.

127. Engel & McCoy, *supra* note 9, at 1279.

128. *Id.* at 1279; Reiss, *supra* note 110, at 998 (stating that it is rare to find predatory lending that does not occur in the subprime market). *See generally* Fisher, *supra* note 11 (discussing predatory lenders' extension into the prime markets).

129. Reiss, *supra* note 110, at 997.

130. *Id.* at 998.

131. Stark, *supra* note 13, at 130; Gill & Warren, *supra* note 5, at 22 (explaining that consumer credit companies have vast amounts of information on each borrower that allows them to tailor products to those who are uninformed and will not be able to identify an unsafe loan).

unscrupulous lenders prey on African American and Latino neighborhoods.[132] Predatory lenders target these communities, where they know that they can get high-cost home loans, for several reasons.[133] Historically, this group of borrowers was left out of the housing credit market and, thus, they do not have experience in dealing with housing loans.[134] Lenders know that these households will not be sufficiently sophisticated to realize that the basic loan terms are overpriced.[135] Additionally, there is no ability for potential borrowers to "shop around" or compare prices because the offered loans are uniquely tailored, and, thus, they are more complex than the standard prime loan.[136]

Predatory lenders use a number of tactics to hook unsuspecting borrowers, such as leveraging trust to overcome the borrower's confusion.[137] In her article on predatory lending, Debra Stark[138] quoted an individual who entered a predatory loan because she trusted her mortgage broker.[139] This individual stated that "when you sign all those papers, it's like Greek. I'm like trusting him, figuring he wouldn't do it like that."[140] Likewise, Lauren E. Willis[141] traces the story of a widow who took out an $11,921 loan to install new windows in her house with a payment plan worth half her monthly income.[142] In one year, the lender finagled her into refinancing numerous times, such that her loan became worth $64,000 and payments totaled about 92% of her monthly income.[143] A year later, after one missed payment, the lender foreclosed on the loan.[144] Recalling the refinancing process, the widow stated that "there were a whole lot of papers with this . . .loan that I did not understand."[145] Another method predatory lenders use includes recruiting successful minority figures to advertise these loans to gain potential borrowers' trust and instill inspiration.[146]

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132. Creola Johnson, *The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, 17 GEO. J. ON POVERTY L. & POL'Y 165, 166–67 (2010).

133. A "reverse redlining" is the process of focusing on these low to moderate-income areas that were previously left out of the market. Willis, *supra* note 90, at 733.

134. Engel & McCoy, *supra* note 9, 1280; Stark, *supra* note 13, at 130–31.

135. Engel & McCoy, *supra* note 9, at 1281.

136. Willis, *supra* note 90, at 726–27. To figure out how much a loan will cost and to compare it to another loan, the consumer would need extensive forecasting skills to analyze the trade-offs in interest rates compared to fees, and accurately calculate the total cost once balloon payments and other loan structures are taken into account. In 2002, HUD even recognized this issue in one of their reports. *Id.* at 727 n.62.

137. Engel & McCoy, *supra* note 9, at 1283 (describing how charming individuals, who are trying to sell loans, make potential borrowers think that they are their friends).

138. Professor of Law at The John Marshall University.

139. Stark, *supra* note 13, at 129.

140. *Id.*

141. Associate Professor of Law at Loyola University.

142. Willis, *supra* note 90, at 734–35.

143. *Id.*

144. *Id.*

145. *Id.*

146. *See* Johnson, *supra* note 132, at 167 (discussing how Magic Johnson, a famous and

The first loans extended are usually "teaser loans" to capture the borrower into the lending scheme.[147] This loan has an "artificially low interest rate" to attract the borrower.[148] Since these teaser loans are generally ARMs,[149] they will come with the comforting promise that if (when) the rate goes up (skyrockets) the borrower can refinance her loan at a lower rate.[150] Once the interest rate increases, the borrower will likely refinance. Most frequently, the refinancing loan will be the loan containing onerous terms.[151] It is easier for the lender to pack the loan with hidden fees, penalties, and other onerous terms in refinancing loans because the borrower already has equity in her home.[152] Thus, she will not need to pay these costs in an upfront sum, like a new home buyer would, which keeps the borrower from realizing the true cost of the refinancing.[153]

The scenarios discussed above are how the problem of predatory lending starts, compounds, and perpetuates. It begins with a teaser loan which forces refinancing; the refinancing is packed with onerous terms; those terms cause the borrower to fall behind on payments; and then there is a need for a new, refinanced loan, packed with onerous terms. This "vicious cycle" perpetuates until the borrower defaults. At such time, the lender gets her house. In effect, the borrower kept paying the lender for her house but, in the end, the lender gets her house as if no payment was ever made. Bad enough in isolation, this vicious cycle has rippling effects that reach into the securitization process. When borrowers default on their loans, payments are no longer passed through to investors, which cause defaults in the secondary market.[154] These secondary market defaults cause a macroeconomic financial crisis.[155]

C. New Regulation

In July 2010, Congress enacted the Dodd-Frank Wall-Street Reform and Consumer Protection Act (Dodd-Frank Act) in response to the 2008 financial crisis which was in part caused by the massive defaults of predatory loans.[156] The Act

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successful African American basketball player, appears in commercials for "Money Now Loans" which are targeted at minority communities).

147. Fisher, *supra* note 11, at 597–98; Engel & McCoy, *supra* note 9, at 1284.

148. Fisher, *supra* note 11, at 597–98.

149. Engel & McCoy, *supra* note 9, at 1284.

150. Fisher, *supra* note 11, at 598–99.

151. Reiss, *supra* note 110, at 998.

152. *Id.*

153. *Id.* The refinancing borrower will see a lower interest rate, but because of the complex loan structure, she will not realize that the fees, penalties, and prepayment charges increase the loans' overall cost, which make it a more expensive loan than the previous one. Stark, *supra* note 13, at 139.

154. *The Fed Responds to the Financial Crisis* 494, 495–96, *available at* http://wps.prenhall.com/wps/media/objects/5398/5527631/CH14.pdf (last visited Jan. 30, 2014).

155. *Id.*

156. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376, pmbl. (2010) [hereinafter Dodd–Frank] (declaring the goals of the Act).

attempts to alleviate the "abusive financial services practices"[157] through two general measures. First, it attempts to reform abusive practices by banning certain types of loans and the practices used to sell them.[158] Second, it establishes the Bureau of Consumer Financial Protection (CFPB) to create rules and regulations to address more holistically the issues surrounding predatory lending.[159]

1. Dodd-Frank Act's Measures

The Dodd-Frank Act attempts to stop predatory lending by amending existing legislation. For instance, the Act amends the Truth in Lending Act (TILA)[160] so that lending institutions no longer use "yield spread premiums."[161] Yield spread premiums are incentives to lending institutions' employees to sell loans at interest rates higher than the rate for which the borrower actually qualifies.[162] Additionally, the Dodd-Frank Act amends TILA so that lenders are required to make a "good faith determination" that the borrower has the ability to repay the loan before the loan agreement is entered.[163]

Furthermore, the Act amends the Securities and Exchange Act of 1934 to limit the level of risk securities institutions can reallocate,[164] by requiring such institutions to retain at least 5% of an asset that is not a qualified mortgage.[165] In defining "qualified mortgage," the Securities and Exchange Commission, HUD, and other government agencies, must take into account the risks created by prepayment penalties,[166] balloon payments,[167] negative amortizing loans,[168] interest only payments,[169] and "other" loan features that raise the probability of borrower

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157. *Id.*

158. *See infra* Part IV.C.1.

159. *See infra* Part IV.C.2.

160. 15 U.S.C. §§ 1601–1693r (1968).

161. Dodd–Frank, 124 Stat. at 1403 (2010).

162. Yield Spread Premium Definition, INVESTOPEDIA.COM, http://www.investopedia.com/terms/y/yield_spread_premium.asp#axzz2LlQ1YsDk (last visited Jan. 30, 2014).

163. Dodd–Frank, 124 Stat. at 1411.

164. *Id.* at 941(b) (amending the Securities and Exchange Act of 1934 by adding 15G).

165. *Id.* at 941(c).

166. Penalty fees assessed for early repayment of a loan. Reiss, *supra* note 110, at 1000.. I believe that these penalties are related to the securitization process—since prepayment removes a loan from a tranche—so that banks are able to properly price the secondary market instruments.

167. A balloon payment is one large payment at the end of a loan's life which is offset by lower monthly payments. Predatory lenders make this amount higher than a borrower can afford so she defaults or refinances. *Id.*

168. Negative amortizing loans have monthly payments that are lower than the interest rate so that a borrower actually loses equity in their home as time goes on. HOUSING AND URBAN DEVELOPMENT–TREASURY REPORT 71 (2000), http://www.huduser.org/publications/pdf/treasrpt.pdf.

169. Since interest only payments do not include payments towards the principal, once the "teaser" interest–only time period is over, monthly payments increase dramatically. Interest Only ARM, Definition, INVESTOPEDIA.COM, http://www.investopedia.com/terms/i/interestonlyarm.asp#axzz2C3dN3GBP (last visited Jan. 30, 2014).

default.[170] The apparent hope is that by reducing financial institutions' ability to pass along these risks, they are less likely to make such risky loans.

2. The CFPB's Measures

The Dodd-Frank Act also set up the CFPB to promulgate rules and regulations for financial institutions offering consumer financial instruments, such as mortgages.[171] The CFPB must exercise this promulgation power with an overarching goal to create "fair, transparent, and competitive" financial products and services.[172] Additionally, the CFPB can take specific action if it suspects that a "person or service provider" is "committing or engaging in an unfair, deceptive or abusive act or practice."[173] Accordingly, it has the authority to investigate,[174] hold hearings and adjudicatory proceedings,[175] and pursue civil litigation against alleged offenders.[176] However, courts are unable to award exemplary or punitive damages for such actions.[177]

Dodd-Frank granted to the new CFPB numerous powers, including some simple tasks, such as adjusting the Home Ownership Equity Protection Act (HOEPA) triggers for inflation.[178] However, the CFPB has the much more daunting task of ensuring effective policing in the financial industry.[179] There are three areas of particular relevance with which the CFPB's rules and regulations deal to address and prevent predatory lending. First, the CFPB's rules and regulations address the issue of effective disclosure and meaningful consumer choice.[180] Second, the CFPB requires an asserted effort on the lender's behalf to (1) assure that borrowers can afford the loan and (2) ensure that, if the borrower enters the loan, fair warning is given and appropriate mitigation attempts are made to prevent foreclosure.[181] Third, the CFPB defines terms to increase lenders' understanding of acceptable lending arrangements and consumers' ability to seek

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170. Dodd–Frank, 124 Stat. at 941(b) (codified at 15 U.S.C. § 78o–11(e)(4)(C)).

171. *Id.* at Title X.

172. Julie R. Caggiano, Jennifer L. Dozier, Richard P. Hackett & Arthur B. Axelson, *Mortgage Lending Developments: A New Federal Regulator and Mortgage Reform under the Dodd–Frank Act*, 66 BUS. LAW. 457, 461 (2010-2011).

173. Dodd–Frank, 124 Stat. at 1031.

174. *Id.* 1052.

175. *Id.* 1053.

176. *Id.* 1054.

177. *Id.* 1054(b).

178. *See* Consumer Fin. Prot. Bureau, *Truth in Lending (Regulation Z)*, FED. REG. (Nov. 21, 2012), https://www.federalregister.gov/articles/2012/11/21/2012–27997/truth–in–lending–regulation–z (readjusting the triggers). *See supra* notes 250–260 and accompanying text for a fuller discussion on HOEPA and its trigger requirements.

179. Gail Hillebrand, *The Consumer Financial Protection Bureau: Title X of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010*, 8 BERKELEY BUS. L.J. 219, 220 (2011).

180. *See infra* notes 183–87 and accompanying text.

181. *See infra* notes 187–95 and accompanying text.

redress if they are victimized by predatory practices.[182]

First, the CFPB regulates disclosures so that borrowers are provided with a meaningful understanding of the loan. To accomplish this, the CFPB has enacted a requirement that consumers must receive pre-loan counseling from an "approved homeownership counseling organization."[183] This requirement is intended to increase consumers' ability to assess whether they can make the loan payments.[184] Additionally, it permits people to engage in learning about the loan rather than leaving it up to the potential borrower to read through pages of disclosures.[185] The consumer must receive this counseling after he or she received the full cost estimate by a counselor who is unaffiliated with the lending institution.[186] The counselors may be paid by the lender, but payments cannot be conditioned on loan entrance.[187]

Second, the CFPB requires that lenders assure that borrowers have the "ability to pay"[188] and that the borrowers have fair warning if that determination changes.[189] To determine whether a consumer has the ability to repay the loan, the lender must analyze the consumer's monthly payment schedule and compare it to his or her monthly income schedule.[190] Under this regime, the payment analysis will include the "juicy low introductory rates," which traditionally disillusioned a consumer's self-estimated ability to repay; hopefully, the consumer will now know whether he or she is able to pay *more* than merely the first few payments.[191]

Additionally, under proposed rules, lenders must give fair notice to borrowers concerning interest rate adjustments and possible loan default. Under the proposed amendments to TILA (Regulation Z), notice requirements mandate that whenever the ARM rate is set to increase, the servicer must give the borrower 60-120 days notice, except for the first occasion, when the servicer must give 210-240 days notice.[192] Furthermore, early intervention requirements will force servicers to make

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182. *See infra* notes 196–200 and accompanying text.

183. *High–Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X)*, CONSUMER FIN. PROT. BUREAU 306 n.179 (Jan. 10, 2013), http://files.consumerfinance.gov/f/201301_cfpb_final–rule_high–cost–mortgages.pdf.

184. *Id.* at 336.

185. *Id.* The CFPB notes that a common criticism will be that this requirement will increase the cost of extending credit and some lenders will no longer extend credit. However, according to the CFPB, there is only a minimal effect on credit supply from such regulations. *Id.* at 337.

186. *Id.* at 391.

187. *Id.* at 392. This creates an interesting and potentially dangerous dynamic. *See infra* notes 279–82 and accompanying text for full discussion on this dynamic.

188. Mandi Woodruff, *New Rule Lets Lenders Judge Whether People Can Actually Afford Mortgages*, BUSINESS INSIDER (Jan. 10, 2013, 12:54 AM), http://www.businessinsider.com/cfpb–new–ability–to–pay–mortgage–rule–2013–1.

189. *See infra* notes 192–95 and accompanying text for a discussion on warning requirements.

190. Woodruff, *supra* note 188. This calculation is the consumer debt–to–income ratio. *Id.*

191. *Id.*

192. 2*012 Truth in Lending Act (Regulation Z) Mortgage Servicing Proposal,* CONSUMER

"good faith efforts to notify delinquent borrowers of loss mitigation options" if the borrowers are thirty days late on loan payments.[193] This notification system will encourage lenders to seek options other than foreclosure.[194] As time goes on, lenders must send more educational materials concerning how to mitigate the delinquency, and eventually, materials regarding the foreclosure process.[195]

Third, the CFPB acquired authority to regulate and enforce Unfair, Deceptive, or Abusive Acts Practices (UDAAP).[196] Under this authority, the CFPB inherited the definitions for "unfair" and "deceptive," and added the definition of "abusive."[197] Defining these terms enables lenders to assess whether they are acting wrongfully and permits consumers to take legal action if the lenders act wrongfully. A practice is unfair if it (1) causes or is likely to cause substantial consumer injury, (2) is not reasonably avoidable by consumers, and (3) is not outweighed by benefits to consumer or competition.[198] Deception is "(1) a material (2) representation, omission, act, or practice that misleads, or is likely [sic] to mislead the consumer, and (3) that the consumer's misinterpretation is or would be reasonable under the circumstances."[199] Abusiveness is (1) materially interfering with a consumer's understanding of the product, or (2) taking unreasonable advantage of the consumer's lack of understanding, inability to protect his or her own interests, or reasonable reliance on the lender/lending representative.[200]

V. COMPARATIVE ANALYSIS

This analysis will focus on predatory lending and regulation in the U.S. subprime mortgage market and in the Indian microfinance lending market. Although these two markets' functions and histories are different, they are both currently the subject of new regulation. They are both the subject of new regulation

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FIN. PROTECTION BUREAU 20 (Aug. 10, 2012), http://files.consumerfinance.gov/f/201208_cfpb_tila_proposed_rules.pdf.

193. *Id.* at 5.

194. *Id.*

195. *Id.* However, lenders are not allowed to "steer" consumers into a high cost mortgage. *Consumer Financial Protection Bureau Issuing Rules to Prevent Loan Originators from Steering Consumers into Risky Mortgages,* CONSUMER FIN. PROT. BUREAU (Jan. 18, 2013), http://www.consumerfinance.gov/pressreleases/consumer–financial–protection–bureau–rules–to–prevent–loan–originators–from–steering–consumers–into–risky–mortgages/. Since mortgagors are no longer allowed to steer to high cost mortgages, it follows that these disclosures explaining non–foreclosure options also cannot steer the lender towards high cost refinancing. Although, in this author's opinion, the steering ban is meritorious, it places lenders between a rock–and–a–hard–place if refinancing at a high cost is the *only* way that the consumer will be allowed to keep their home.

196. Jean Braucher, *Form and Substance in Consumer Financial Protection*, ARIZ. LEGAL STUD., Mar. 2013, at 1, 14–15.

197. *Id.*

198. *Id.* at 18–19.

199. *Id.* at 19. Inadequately disclosing material terms or misrepresenting loan terms constitutes a deceptive practice. *Id.*

200. *Id.*

because, in the past five years, both markets have been subjected to mass news media for their roles in their respective nation's economic downturns. Therefore, they are well-suited for comparison because they illustrate recent attempts to remediate predatory lending.

In addition to the issues' contemporaneousness, the two countries regulations provide many different and interesting grounds for comparison. First, both regulatory systems use two different national government bodies to regulate and address predatory lending issues. In India, the central bank and the BCSBI pass rules and regulation, whereas in the United States, Congress and the newly formed CFPB similarly address predatory lending through new laws and rules. Second, both regulatory systems attempt to stop predatory lending by defining terms which lenders are allowed to use. The two systems do this by placing interest rate caps or listing loan payment types which are not permissible. Third, India and the United States place restrictions on lender operations so that certain incentive systems or interactions with consumers are not used to facilitate predatory lending. Fourth, both national systems attempt to empower consumers to even the playing field and provide consumers with meaningful tools to decide for themselves whether they should enter a particular loan.

A. Two Level Approach to Regulation

India's and the United States's federal governments each address predatory lending through federal legislation and specialized non-political entities. India's central bank issues guidelines which banks must adopt;[201] this is India's federal level legislation. These guidelines structure the lending relationship by requiring notices and disclosures and by defining appropriate recovery methods.[202]

Once the bank adopts the guidelines, the BCSBI "monitors" the banks' adherence to the adopted code.[203] Even though the BCSBI receives funding from India's central bank, the BCSBI is independent from it.[204] The BCSBI's primary responsibility is to ensure that the banks under its jurisdiction do not breach their fair practices code and, if they do, to appropriately sanction them.[205] Sanctions include publishing the bank's name in the annual report or otherwise publicizing the bank's breach, dictating certain future action for the bank to take, and issuing a "warning or reprimand" to the bank.[206] Although the BCSBI requires banks to have

201. Master Circular–Fair Practices Code, *supra* note 56, ¶ 1.

202. *Id.*

203. *BCSBI*, *supra* note 76.

204. Banking Codes and Standards Board of India, *About Us – Background*, THE BANKING CODES AND STANDARDS BOARD OF INDIA, http://www.bcsbi.org.in/Abt_Background.html (last visited Feb. 13, 2014).

205. *Id.*

206. Banking Codes and Standards Board of India, *The Banking Code Rules*, BOSTON U. CENTER FOR FIN. L. & POL'Y ¶ 15.2, http://www.bu.edu/bucflp/files/2012/01/Banking-Code-Rules.pdf [hereinafter *The Banking Code Rules*].

a grievance system, the BCSBI does not hear complaints through that system.[207]

The U.S. Congress and the newly created CFPB are the United States' two levels which address predatory lending. Congress passes legislation regulating areas such as permitted loan types, disclosure and notice requirements, and creditor incentive systems.[208] These legislative packages tend to be more macro-focused by creating general requirements. On the other hand, the CFPB creates more detail-oriented rules for creditor-borrower relations, which are then treated as amendments to the larger legislative packages.[209] The CFPB is technically a part of the Federal Reserve (the Fed), which funds the CFPB, but the Fed does not have authority over the CFPB.[210]

The CFPB has its own grievance system, which allows for consumer complaints to be filed with it directly, unlike the BCSBI, which requires consumers to exhaust a bank's grievance system and then turn to the judiciary system on their own.[211] The CFPB brings an action in court if a creditor violates a rule, whereas the BCSBI has an independent sanctioning system in which it can issue sanctions in-house without judicial decree.[212] Additionally, since a bank must voluntarily join BCSBI, the BCSBI does not have the binding authority which the CFPB has in the United States.[213] This difference might be attributable to the complexities of the two systems; since India just decided to regulate their microfinance market, the United States is in a much later regulatory iteration than India. Having a regulatory entity with legislative power which is solely dedicated to consumer finance will allow the United States to adapt new predatory lending attempts, while India relies on general promises to be honest and fair in the lending process.

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207. Reserve Bank of India, *The Banking Ombudsman Scheme*, RESERVE BANK OF INDIA CENTRAL OFFICE MUMBAI ¶ 8(1)(s) (2006), http://rbidocs.rbi.org.in/rdocs/Content/PDFs/67933.pdf (listing the grounds for submitting a complaint to the Banking Ombudsman). The Banking Ombudsman is a judiciary body to hear complaints relating to the Indian banking system. *Id.* pmbl.

208. *See supra* notes Part IV.C. for a discussion of the federal legislation addressing predatory lending in the mortgage market.

209. *See generally Bureau of Consumer Financial Protection (C.F.P.B.)*, *Times Topics*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/organizations/c/consumer_financial_protection_bureau/index.html (last updated Dec. 30, 2013) (providing a chronology of events and recent news articles on the CFPB's actions).

210. *See* Dodd-Frank, *supra* note 156, § 1011 (establishing the CFPB within the Federal Reserve system and noting its status as an independent bureau).

211. *See* Consumer Fin. Prot. Bureau, *Submit a Complaint*, CONSUMER FIN. PROT. BUREAU, http://www.consumerfinance.gov/complaint/ (last visited Jan. 13, 2013) (allowing consumers to file complaints online); *see also BCSBI*, *supra* note 76 (listing the order of operations for grievance redressal systems).

212. *The Banking Code Rules*, *supra* note 206, ¶ 15.2.

213. *See id.* at ch. 1 (discussing member eligibility, application, and obligations); *see also* Consumer Fin. Prot. Bureau, *Creating the Consumer Bureau*, CONSUMER FIN. PROT. BUREAU, http://www.consumerfinance.gov/the-bureau/creatingthebureau/ (last visited Jan. 31, 2014) (explaining the reasons for the bureau's creation and its basic powers).

B. Defining Terms

Another way in which India and the United States try to curb predatory lending is through paternalism. Both regulatory systems take paternalistic measures by defining the loaning instruments' characteristics or defining precisely what the loaning instruments may not contain.[214] In general, most cultures regulate lending in some way.[215] However, each approach is unique in that it tries to address the particular issues at hand. Particularly, although there are similarities between the U.S. and Indian approaches, there are explainable differences.

Both India and the United States cap interest rates, but the two countries cap them differently. Prior to the most recent regulations, India did not cap interest rates.[216] Their first imposed cap was fixed at 26%, but after lenders complained, the central bank set a variable rate cap.[217] Since India wants to encourage lending without over-exposing borrowers to abuse, the interest rate cap is between 10% and 12% above lending costs.[218] In contrast, the United States's interest rates differ from state to state, with some imposing a flat interest rate cap and others imposing either a separate flat usury rate, a usury rate set at a certain percentage point above the federal interest rate, or separate rates for consumers and non-consumers.[219] Mortgage rates, however, are preempted by federal law.[220] In essence, federal law acts as the floor, while state law can provide more stringent consumer protection laws.[221] So, under federal law, ARMs must have a built-in interest rate cap so that the consumer knows the most they can be charged under the loaning instrument.[222] Individual states regulate these interest rate caps.[223]

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214. *See e.g.,* Master Circular–Fair Practices Code, supra note 56, ¶ 2(B)(ii)(b)(ii). India only allows a loan to consist of the money lent, the interest charge, the processing charge, and the insurance premium. *Id.*

215. For instance, in Islam, all interest rates are viewed as usurious and, therefore, are banned. Tarek El Diwany, *Silent Culprit of our Decline*, ISLAMIC FINANCE (2008), http://www.islamic-finance.com/item151_f.htm.

216. Kashyap, *supra* note 83.

217. *See id.* (explaining the 26% interest cap and statements from financial professionals regarding the cap).

218. *See* David, *supra* note 85 (discussing the relaxing of regulations on non-bank microfinance companies).

219. *See State Interest Rates and Usury Limits,* 'LECTRIC LAW LIBRARY, http://www.lectlaw.com/files/ban02.htm (last visited Jan. 18, 2013) (listing each states' interest rate caps and/or usury rates). If a bank chartered in state A lends in state B, the interest rate cap in state A applies which allows the bank to charge at a rate higher than that allowed in state B. Marquette Nat. Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 313–14 (1978).

220. 12 U.S.C.A. § 1735f–7 (West 2013). *See*, *e.g.*, *Exceptions to the Usury Law*, WASH. ST. DEPARTMENT OF FIN. INSTITUTIONS, http://www.dfi.wa.gov/consumers/interest_rates_exception.htm (last updated July 26, 2011) (listing the loaning instruments which are exempt from state usury laws). Interest rates are unique in regulation because Dodd–Frank lifted the preemption on all state consumer protection laws. Pottow, *supra* note 126, at 203.

221. Pottow, *supra* note 126, at 203.

222. 12 U.S.C.A. § 3806 (West 2013).

223. Comptroller of the Currency Adm'r of Nat'l Banks, *Other Consumer Protection Laws*

Another paternalistic approach to stop predatory lending is limiting the types of loan instruments. A main issue in the United States is the use of lending instruments which prevent the borrower from paying off the principal,[224] or lower the borrower's equity in her home as time progresses;[225] further, loan instruments contained other features, such as balloon payments, which limit the likelihood that the borrower will pay off the loan. Consequently, the CFPB passed rules which ban interest-only payments, negative amortizing loans, and certain balloon payments from "qualified mortgages."[226] A qualified mortgage is one which the consumer is expected to be able to repay.[227] In India, different complex loan types like these were not an issue. Rather, lenders were able to keep borrowers on the hook by burdening them with multiple loans.[228] Accordingly, the Indian central bank mandated that a consumer may not borrow from more than two MFIs at any given time.[229]

Although only time will tell whether banning loans and capping rates will prevent another crisis in each country, there are a few commentaries on how these new regulations will fare and whether they are appropriate. First, many critics see the new U.S. regulations as a condescending message to borrowers that they are too unintelligent to protect themselves.[230] Second, critics assume that both the U.S. and Indian regulations will limit the amount of credit that lenders would be willing to extend to consumers because they will no longer be as profitable.[231] Yet, in

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and Regulations, COMPTROLLER'S HANDBOOK 4 (Aug. 2009), http://www.occ.gov/publications/publications–by–type/comptrollers–handbook/other.pdf.

224. These are "Interest Only Loans." *See supra* note 169 and accompanying text.

225. These are "Negative Amortizing Loans." *See supra* note 168 and accompanying text.

226. Bureau of Consumer Fin. Prot., *Protecting Consumers from Irresponsible Mortgage Lending*, CONSUMER FIN. PROT. BUREAU 3 (Jan. 10, 2013), http://files.consumerfinance.gov/f/201301_cfpb_ability-to-repay-factsheet.pdf.

227. Mark Zandi, *Defining a 'Qualified' Mortgage*, WASH. POST (Aug. 24, 2012), http://www.washingtonpost.com/realestate/defining-a-qualified-mortgage/2012/08/23/a6fdb85e-e7fb-11e1-a3d2-2a05679928ef_story.html. Under new regulations, the lender must make sure that the borrower has the ability to repay. Dodd–Frank, *supra* note 156, § 1411. Therefore, if the mortgage possesses a feature which is banned from a qualified mortgage, then it is not a qualified mortgage, and, consequently, the borrower is deemed likely unable to repay it and the lender is exposed to liability under the Dodd–Frank Act.

228. *Microfinance Institutions' Business Model Faulty: PM Panel*, DECCAN HERALD (Jan. 5, 2013), *available at* http://www.deccanherald.com/content/126540/microfinance–institutions–business–model–faulty.html.

229. Non Banking Financial Company–Micro Finance Institutions Modifications, *supra* note 86, ¶ 4.

230. *See* Michael Patrick Leahy, *Warren: Consumers Too Simple–Minded to Understand Credit*, BREITBART (Oct. 10, 2012), http://www.breitbart.com/Big-Government/2012/10/10/Elizabeth-Warren-Consumers-Too-Simple-Minded-to-Understand-Credit (commenting on Elizabeth Warren's co-authored piece which recommends the creation of a federal consumer finance agency).

231. *See* Joseph L. Barloon, Anand S. Raman & Darren M. Welch, *Consumer Protection Provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES 1, 13 (July 9, 2010), *available at*

India, since the microfinance sector was built on the ideology that these loans would help achieve social goals, these sorts of profit-reducing laws are not "inconsistent" with the overall goals of the system.[232] Finally, regardless of whether these laws indicate an overreaching government or a looming credit crunch, the ultimate question is whether it will stop predatory lending. In the long history of lending, creditors have always found ways to adapt to regulation, and it is likely that they will continue to do so.[233] Therefore, it seems as though paternalistic regulations are a quick fix—not a cure to the problem.

C. Lender Operation Limitations

The third approach that India and the United States take to stop predatory lending is limiting lender operations. Again, the Indian system's relative simplicity renders its problems and subsequent legislation less technical in nature. Yet, despite the differing problems and solutions, the regulatory responses demonstrate both countries' regulators' willingness to enter lenders' business models and operations and to tell them precisely how they may act. This willingness displays something more than simply a government's hand in business. Instead, it demonstrates that regulators recognize how deeply rooted the problem is, as opposed to dismissing the problem as simply a few rogue, unethical lenders or by merely treating the symptoms through policing the end result—the loans themselves.

In India, a chief public concern is how lenders recover loans from borrowers.[234] In particular, the legislature wanted to remedy what was displayed in a series of highly publicized instances, which included physically threatening, suggesting prostitution, and embarrassing borrowers at their work places.[235] To address this issue, the Reserve Bank issued specific rules on when, where, and how

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http://www.skadden.com/newsletters/FSR_A_Consumer_Protection_Provisions_in_DoddFrank.pdf (stating that lenders will refrain from lending so that they are not exposed to subjective laws regulating what are "fair" loans); Ilya Somin, *Posner on Consumer Financial Protection Paternalism*, THE VOLOKH CONSPIRACY (July 29, 2009, 1:50 AM), http://www.volokh.com/2009/07/29/posner-on-consumer-financial-protection-paternalism/ (discussing the limits of behavioral economics and critiquing the role of government in deciding for consumers); *Microfinance Institutions' Business Model Faulty: PM Panel*, *supra* note 228 (commenting that interest rate caps will hurt lenders' ability to make profit in the expensive process of providing credit in remote rural areas).

232. *See Microfinance Institutions' Business Model Faulty: PM Panel*, *supra* note 228.

233. *See* LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES 28 (4th ed. 2011) (explaining how from the start of U.S. banking regulation state banks found innovative ways to avoid new regulations).

234. *See supra* Part III.B.

235. *See* Yoolim Lee & Ruth David, *Suicides in India Revealing How Men Made a Mess of Microcredit*, BLOOMBERG (Dec. 28, 2010, 5:00 PM), http://www.bloomberg.com/news/2010–12–28/suicides–among–borrowers–in–india–show–how–men–made–a–mess–of–microcredit.html (telling several different stories of microfinance borrowers whose plight was exacerbated in part by harassing collection methods).

to collect loans from borrowers.[236] If a borrower believes that the lender is acting abusively or in a harassing manner, the borrower can file a complaint through the grievance system discussed in Section II.A.[237]

While India's borrowers accuse creditors of physical coercion, in the United States, debtors accuse creditors of using institutional incentives and tantalizing sales methods to accomplish their predatory ends. The institutional incentive system occurred inside the creditor business model via yield-spread premiums.[238] These sales premiums awarded mortgage salesmen and women for selling a loan at a rate higher than what the borrower actually qualified for.[239] Consistent with the paternalistic approach, Dodd-Frank allowed a blanket ban on this incentive system, if the CFPB deemed it necessary; as of yet, the CFPB has not done so.[240] Furthermore, tantalizing sales methods lured borrowers into the lending relationship.[241] Through "teaser rates," lenders offered borrowers loans at very low rates and then would raise rates once the lending relationship had formed.[242] This bait, hook, and switch method is also outright banned in Dodd-Frank.[243]

D. Consumer Empowerment

A large part of the regulation, which addresses lending relationships and tries to even the playing field on which lenders and borrowers interact, attempts to empower consumers.[244] Regulators equip consumers in a myriad of ways. For one, regulators require disclosure of certain terms, conditions, and other issues that may

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236. Master Circular–Fair Practices Code, *supra* note 56, ¶ 2(B)(iii).

237. See *supra* note 211–213 for a more detailed explanation of the two nations' grievance systems.

238. *See* Nicole M. Olvera, *Why the CFPB Should Reconsider Dodd–Frank's Prohibition on Yield Spread Premiums*, 16 N.C. BANKING INST. 323, 335 (2002) (discussing the criticisms of yield spread premiums).

239. *Id.*

240. Barry Grey, *US Consumer Financial Board Issues Pro-Bank Mortgage Rules*, WORLD SOCIALIST WEB SITE (Jan. 12, 2013), http://www.wsws.org/en/articles/2013/01/12/mort–j12.html. It is possible that the ban will be worked into a cap on points and fees rather than a general ban on compensation methods. Robert Feinberg, *Consumer Financial Protection Bureau Announces Qualified Mortgage Rule—Part II*, MONEY NEWS (Jan. 25, 2013, 12:34 AM), http://www.moneynews.com/Robert–Feinberg/CFPB–qualified–mortgages–DoddFrank/2013/01/16/id/471741.

241. *See Bureau of Consumer Financial Protection (C.F.P.B.)*, *supra* note 209.

242. *Id.*; *see also Consumer Financial Protection Bureau Unveils New Mortgage Protection Plan*, THE OREGONIAN (Jan. 10, 2013, 10:09 AM), *available at* http://www.oregonlive.com/business/index.ssf/2013/01/consumer_financial_protection_1.html ("The rules limit features like teaser rates that adjust upwards . . . .").

243. *See Bureau of Consumer Financial Protection (C.F.P.B.)*, *supra* note 209; *Consumer Financial Protection Bureau Unveils New Mortgage Protection Plan*, *supra* note 242.

244. *See* Cliff Rosenthal, *Working Together to Empower Consumers*, CONSUMER FINANCIAL PROTECTION BUREAU (July 5, 2012), http://www.consumerfinance.gov/blog/working–together–to–empower–consumers/ (stating that a key goal of the CFPB is to empower consumers so that they understand their financial decisions' effects).

arise once the lending relationship is created.[245] Similarly, once the lending relationship is formed, regulators require that lenders give borrowers notice if, for instance, something in the lending relationship is set to change.[246] Additionally, consumers often receive the right to bring a cause of action, in some form, against the lender if the lender acts improperly. This analysis will primarily focus on the similarities and effects—actual and potential—of disclosure requirements in the United States and India. It will then briefly address some of the civil remedies afforded by each system.

1. Disclosures

Disclosure requirements are a "paradigm for remedying abusive lending practices."[247] Theoretically, if a lender provides information, consumers can scrutinize the loaning instrument, notice any unfairness or mistakes within it, and in turn, ensure their financial welfare and safety.[248] Both the Indian and U.S. systems embrace this belief to certain extents. However, the Indian system puts more confidence in disclosure regulation's ability to create a fairer lending market. This might be the case because Indian microfinance regulation is still in its infancy and regulators are hesitant to require much more than lending relationship transparency.[249]

In spirit, the Indian disclosure requirements are similar to the U.S. disclosures required under the Truth in Lending Act (TILA) and the Home Ownership Equity Protection Act (HOEPA), which are both amended by Dodd-Frank and subsequent CFPB rules and regulations.[250] There are some differences, though. Prior to Dodd-Frank, Congress passed a series of legislative acts, including the TILA and its amendment, HOEPA, which required certain disclosures for some types of loans.[251] These acts had "triggers," or specific loan features, which activated the regulation for that loan.[252] Once triggered, the act required certain disclosures.[253]

Prior to the Dodd-Frank amendments, if a loan's annual percentage rate

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245. *See* Engel & McCoy, *supra* note 9, at 1305.

246. *See supra* Part IV.C.2.

247. Engel & McCoy, *supra* note 9, at 1305.

248. *See* Paula Fitzgerald Bone, *Toward a General Model of Consumer Empowerment and Welfare in Financial Markets with an Application to Mortgage Servicers*, 42 J. CONSUMER AFF. 165, 172 (2008) (discussing the beneficial effects arising from information disclosures in the lending relationship).

249. Before the 2010 microfinance crisis, the Indian central bank was hesitant to regulate the microfinance sector at all, so it is understandable that they would ease into the process. *See* Vinod Kothari and Neha Gupta, *Micro Credit in India: Overview of Regulatory Scenario*, VINOD KOTHARI CONSULTANTS, http://india–financing.com/Micro_Credit_in_India–Overview_of_the_Regulatory_Scenario.pdf (last visited Feb. 17, 2014).

250. *See High-Cost Mortgage and Homeownership Counseling Amendments*, *supra* note 183, at 1.

251. Pottow, *supra* note 126, at 180–83; Stark, *supra* note 13, at 144.

252. *See* Pottow, *supra* note 126, at 181–82; Stark, *supra* note 13, at 144.

253. *See* Stark, *supra* note 13, at 144.

exceeded a comparable U.S. Treasury security's yield by 8% or if its fees exceeded "8% of the loan total or $400 (adjusted for inflation), whichever is greater," then TILA and HOEPA disclosure requirements were triggered.[254] On the other hand, India's Fair Practices Code, which lists disclosure requirements, does not set triggers; consequently, the regulations do not specify a certain class of loans to which they apply.[255] The United States's trigger requirements have received criticism from advocates and academics alike.[256] The chief complaint is that the trigger requirements are too high and allow subprime lenders to avoid disclosures by merely pricing under the trigger.[257] Thus, the purpose of the legislation is defeated. In this context, India's regulations are a step in the right direction compared to the United States's requirements.[258] These triggers are still in effect in the United States—albeit lower[259]—and the CFPB has the power to adjust them.[260]

The Indian and U.S. systems are similar with regard to the information required to be disclosed. As discussed *supra* in Part III, unlike the United States, India does not ban certain loan types outright.[261] Rather, it merely requires that the terms and conditions be in writing,[262] the existence of penal interest for late repayment be in bold text,[263] and the interest rate and total loan amount be clearly stated.[264] Requiring lenders to go one step further, Indian regulations also mandate that lenders disclose to borrowers what factors will affect their interest rates.[265] Although U.S. regulations require lenders to disclose the interest rate, terms, conditions, fees, and potential penalties, there is no requirement that lenders explain exactly what will affect a borrower's interest rate. Nonetheless, due to more complex loaning instruments, U.S. disclosure requirements offer borrowers

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254. Reiss, *supra* 110, at 1026. "Similar U.S. Treasury security" means a similar maturity time period, so that if the housing loan is for 30 years, the relevant Treasury maturity is 30 years. *Id.* at n.265.

255. Master Circular–Fair Practices Code, *supra* note 56 (containing no provision which defines the types of loans to which the disclosure requirements apply).

256. Stark, *supra* note 13, at 144.

257. *Id.*

258. Dodd-Frank transferred power to the CFPB to adjust the TILA and HOEPA trigger amounts. Additionally, Dodd-Frank widened the acts' scope to include any loan secured by a dwelling. Christopher K. Seide, *Consumer Financial Protection Post Dodd–Frank: Solutions to Protect Consumers Against Wrongful Foreclosure Practices and Predatory Subprime Auto Lending*, 3 U. PUERTO RICO BUS. L.J. 219, 240–41 (2012). Yet, they only lowered the trigger to 6.5% above the similar Treasury security. Dodd–Frank, *supra* note 156, § 1431. While 1.5% is a large amount, there is still room for evading the regulations by clever loan structuring.

259. Dodd-Frank, *supra* note 156, § 1431.

260. *See Truth in Lending (Regulation Z)*, *supra* note 178. It is unclear whether it will adjust them down or, simply, cover all loans. Logically, the lower the triggers, the more loans will be covered and, consequently, there will be increased administrative costs for regulators and lenders. In a down economy with tightened budgets, it seems imprudent to lower triggers now.

261. *See supra* Part III.C.

262. Master Circular–Fair Practices Code, *supra* note 56 ¶ 2(A)(ii).

263. *Id.* ¶ 2(B)(ii)(b)(ii).

264. *Id.* ¶ 2(B)(i)(e).

265. *Id.* ¶¶ 2(A)(i)(a)–(b).

much more detail, including balloon payment amounts and, if applicable, credit insurance premiums or debt cancellation coverage.[266]

HOEPA requires lenders to disclose certain terms and possible consequences of the loan. These terms and consequences include statements informing the potential borrower that: she is not required to complete the transaction; whether the interest is fixed or variable; the maximum possible interest rate under the loan; and the total amount of the loan.[267] Additionally, the lender must inform the potential borrower that the borrower could lose her home if she defaults.[268] These are similar in spirit to what the Indian regulations require—disclosure to borrowers about the cost and consequences of their loan.[269] However, there is one assumption on which the effectiveness of these disclosures relies—consumers understand the disclosure materials.

Currently, most borrowers, particularly those subject to predatory lending, find disclosures "incomprehensible."[270] As Kathleen C. Engel[271] and Patricia A. McCoy[272] posit: how can regulators expect lower class individuals to be financially literate when these individuals may not have the ability to read or write in the first place?[273] Moreover, disclosure requirements alone are insufficient because they do not require that the loan be fair and repayable.[274] Under Dodd-Frank, U.S. lenders are required to make a good faith effort to ensure that borrowers will be able to repay the loan.[275] On the contrary, Indian regulations, at best, will allow a borrower to understand whether he will be able to make the first few payments. The United States had disclosure requirements prior to the housing market crash, yet it did not stop predatory lending—something more is required.

Disclosure requirements, on their own, are incapable of stopping predatory lending, and they inappropriately shift the spotlight from lender to borrower. Disclosure requirements attempt to guarantee that the borrower is able to detect a predatory or otherwise bad loan[276]—changing the impetus towards arming the borrower.[277] If the borrower is unable to be armed, in that he does not understand what the informational brochure is conveying, then there is no protection for

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266. *See* Eugene J. Kelley, Jr., John L. Ropiequet & Anna-Katrina S. Christakis, *An Overview of HOEPA, Old and New*, 59 CONSUMER FIN. L. Q. REP. 203, 205 (2005).

267. *Id.*

268. *Id.*

269. See *supra* notes 56–63 for a listing of general Indian disclosure requirements.

270. Engel & McCoy, *supra* note 9, at 1309.

271. Associate Dean for Intellectual Life and Professor of Law at Suffolk University.

272. Connecticut Mutual Professor of Law at University of Connecticut and former Assistant Director for Mortgage Markets for the Consumer Financial Protection Bureau.

273. Engel & McCoy, *supra* note 9, at 1309–10; *see also* Shah et al., *supra* note 20, at 1360 ("[Microfinance] borrowers are often illiterate . . . .").

274. Fisher, *supra* note 11, at 606.

275. Pottow, *supra* note 126, at 176; Dodd–Frank, *supra* note 156, § 1411.

276. *See* Fisher, *supra* note 11, at 606–07 (stating that disclosures are meant to put borrowers and lenders on even playing grounds).

277. Engel and McCoy, *supra* note 9, at 1310–11.

him.[278] Consequently, there needs to be something more than merely providing a description of the loan which the borrower is about to enter. If regulations in both India and the United States are going to adequately arm borrowers, they can only do so through actual education, not mere disclosures.

The CFPB has addressed this concern and now requires that lenders provide counseling to potential borrowers.[279] Additionally, lenders have the option to pay counselors' costs.[280] This raises two issues.[281] First, despite the ability for counseling to communicate more accurately and perhaps more effectively the actual risks involved in entering the lending agreement, it is still not enough. It is difficult to imagine a low-income borrower walking out of a counseling session with a real appreciation of a high cost loan and what it definitely and potentially will entail. Second, by allowing a lender to pay the counselor, an incentive system has been created, and there is a real risk for a conflict of interest. Even though the counselor cannot be paid contingent to the consumer entering the loan, it is only reasonable to assume that a lender will hire and fire a counseling organization based upon results, while still adhering to the law. This may create a race-to-the-bottom effect in which counseling organizations effectively sell their services by gaining a reputation for getting borrowers to enter into loans.[282]

As a consequence, if regulators are serious about stopping predatory lending, they will need to actually monitor lenders' actions and lending instruments—not leave it up to borrowers. This need to monitor is why other forms of regulation, discussed elsewhere in this section, are needed. When disclosures are inevitably not enough, specialized rule makers, term limitations, and lender operational limits act as a back stop by limiting how far lenders can go. However, regulators need to actually umpire the lending game when the items that lenders put on paper—rates, fees, incentive structure, etc.—do not tell the whole story.

2. Ability for Consumer Action

In addition to providing consumers with information, both India and the United States attempt to empower consumers by allowing them to take action

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278. *See id.* ("Such reliance [on educating consumers] is nothing more than *caveat emptor* served up with an informational brochure or loan counseling.").

279. *See* 12 C.F.R. §§ 1024.20, 1026.36(k) (2014).

280. 12 C.F.R. § 1026.34 (a)(5)(v).

281. *Id.*

282. This can be accomplished in the same manner in which predatory loans were originated. As Creola Johnson discusses in *The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, lending counselors will now attempt to relate to consumers by explaining to them what can happen, but spinning it as "everybody has been in your spot before" or otherwise explaining the terms in a lender–favorable manner. Johnson, *supra* note 132, at 167. Further, this sort of "independent" party for a fee approach is partially what may have caused the financial crash since mortgagors were incentivized to place high ratings on subprime–backed securities. Chris Isidore, *S&P Vows to Fight Suit, but Open to Settlement*, CNN MONEY (Feb. 12, 2013, 11:19 AM), http://money.cnn.com/2013/02/12/news/companies/sandp-lawsuit/.

against abusive lenders. As discussed above, both the United States (via CFPB) and India (via the interbank grievance system) allow consumers to file complaints if they believe that a lender is acting improperly.[283] There are many differences which can be drawn between the two systems; yet, most of these distinctions could likely be attributed to each state's legal system—not their concentration on predatory lending practices.

Nonetheless, there is one distinction in regulations which stands out as affecting consumers' ability to gain relief. Under the CFPB's control of UDAAP, the Bureau and preceding governmental entities have defined terms such as "abusive," "deceptive," and "unfair."[284] India's Fair Practice Code, however, simply places a ban on "undue harassment" and gives examples such as attempting to collect payments at "odd hours."[285]

There are two sides to this definitional coin. On one side, a more precise approach like the U.S. strategy will provide more guidance for judiciaries to determine whether an act was abusive, deceptive, or unfair. On the other side, a less constrained approach like India's, which defines through examples, might allow a more equitable ruling in which a judiciary could be more outcome-determinative. Considering that predatory lenders are adaptive and that this area is subject to an "I know it when I see it" approach, the less constrained definition might work. Conversely, the example-based regulation may allow for overly narrow readings, and the spirit of the law will be trumped by its letter. However, in the United States, by clearly listing the exact components of a type of predatory lending—abusive, deceptive, unfair—the judiciary will be able to draw the distinction between unethical business practices and illegal business practices. In my opinion, the precise approach will prove more effective.

VI. CONCLUSION

Recently, in India and the United States, highly sophisticated lenders leveraged their asymmetrical information to maximize their returns while irreparably injuring borrowers' financial state. In India, lenders did this in their microfinance industry by preying on poor rural regions, burdening individuals with un-payable debts, and harassing these individuals to gain repayment. In the United States, lenders used the subprime mortgage market to seek out low-income individuals and convince them to enter into loans which they did not understand and could not repay. In India and the United States, predatory lending allowed

283. *See supra* notes 17–24 and accompanying text for a discussion on grievance redress systems.

284. Braucher, *supra* note 196, at 18–21.

285. Master Circular–Fair Practices Code, *supra* note 56, ¶ 2(A)(iv)(c); *see also* India Disclosures, *Fair Practices Code of Goldman Sachs (India) Capital Markets Private Limited*, GOLDMAN SACHS, http://www.goldmansachs.com/worldwide/india/disclosures–docs/fairpractice–cap–mrkts.pdf (displaying Goldman Sachs' adoption of the fair practices code which lists that it will refrain from undue harassment, such as trying to collect at odd hours) (last visited Feb. 17, 2014).

lenders to profit, while the poor borrowers and the economies as a whole crumbled.

Against this backdrop, Indian and U.S. regulators addressed predatory lending via new rules and regulation. Although there are several differences in each country's problems and solutions, there are many similarities. First, both countries address predatory lending with two levels of national government regulators. Second, both countries use paternalistic measures to define what kinds of loans are strictly forbidden and what kinds are tolerated. Third, each regulatory regime digs into lender operations and mandates which lender procedures can and cannot be used. Fourth, both systems try to empower consumers so that they are not left completely vulnerable to predatory lending. The primary means for empowering consumers is information disclosure, so that borrowers are able to understand the loans that they are about to enter into and to decide for themselves whether they are in their best interest or not.

These disclosure requirements represent an attempt to cure the "naïve myth," which assumes that both parties to a transaction are informed. Yet, no amount of disclosure or counseling will put consumers on a completely equal footing with lenders. Therefore, regulators must resort to other, more hands-on methods to curb predatory lending. These methods include the other three approaches discussed above as well as more scrupulous oversight. In an ideal world, both the lender and the consumer would be highly sophisticated and could enter into market transactions knowing exactly what those transactions entail. However, we do not live in that ideal world; so, regulation is necessary to protect less than fully-informed borrowers from bad loans, deceitful lenders, and, because of the widespread effects of predatory lending, society as a whole. The only question now is whether India and the United States will prevent predatory lending or whether, as in the past, these lenders will find more ways around regulations and slip through regulators' grasp, remaining uncaught.