CONSUMER CREDIT, DEBT AND BANKRUPTCY

After a long period of prosperity and steady economic growth, the world's leading economies are now in crisis, and although there will be debate about its origins, the scale and seriousness of the crisis is in no doubt. There is also no doubt that excessive amounts of consumer credit, allied to a weak understanding of how globalised credit markets might react to a crisis, have played a significant part. This book, which is primarily about credit, debt and the trouble they have led to, is written by authors who have specialised in researching into overindebtedness, that is, situations in which an individual's debt burden has become overwhelming. For these authors the plight of individuals is a primary concern, but the wider issue is how credit is used and how it changes societies.

The essays in this volume, addressing topics which are fundamental to our understanding of the current crisis, range widely across the whole sector of consumer finance, including mortgages, 'credit binges', the regulation of consumer lending, insolvency, repayment plans, debt counselling and much more besides. The conclusions drawn from the book are equally wide-ranging, but above all the lesson learned from these essays is that the financialisation of contemporary life ensures that issues of the appropriate role of credit remains of critical importance in society.

Consumer Credit, Debt and Bankruptcy

Comparative and International Perspectives

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Introduction

JOHANNA NIEMI, IAIN RAMSAY, WILLIAM C WHITFORD

THIS IS A book about credit, debt and trouble. The authors of the book do research on overindebtedness, that is, on situations in which the debt burden of an individual has become overwhelming. Some of them also work closely with debtors or institutions, organizations and people who help those that are overindebted. Thus, they have seen the downside of credit. Yet the authors also see credit as a positive force in society. As Professor Jose Reinaldo Lopez put it at the conference from which the articles in this book originate, credit can and should be used as an inclusive factor that promotes inclusion of people to society. The real issue is how credit is used and how it changes societies. In an idealistic but at the same time conservative vein Udo Reifner argues that credit should be productive.

As the now-extensive research on overindebtedness shows, credit has not been productive for all debtors. During the past two decades we have seen an overall trend that has increased the income and wealth gap between the rich and the poor. While credit and debt are resources that can and do help poor and middle-class families to improve their lot, they also make the circumstances of many families much worse, even causing a regression from the middle to the lower classes. The current crisis stemming from the US housing market is a prime example of that. Ordinary people have also suffered from the economic crises over the past two decades in many other parts of the world, for example in Europe in the early 1990s and in the Asian countries in the late 1990s.

Each of these overindebtedness crises has had an impact on the regulation of consumer overindebtedness and insolvency but the impact has varied in different countries and different parts of the world. This book has resulted from a long-term commitment by the authors of this introduction and many others that a comparative study is fruitful in understanding consumer overindebtedness, the reasons for it and possible legal responses to it. This commitment has resulted in an informal network of academics and activists from around the world, many of whom met in Berlin in July 2007 as part of the meetings of the Law and Society Association. Over 30 papers on overindebtedness were presented and discussed, by approximately 50 participants. All papers included in this book were first presented at this Berlin conference. All papers took some kind of socio-legal approach to the topic, and many included the results of original empirical research.

Earlier meetings on the effects of consumer overindebtedness have tended to focus on insolvency law.[1] For the Berlin meetings and for this book a conscious and successful effort was made to expand the range of papers. The globalization of the credit markets has continued and lending by international lenders has gained new consumer markets in different parts of the world, especially Central and Eastern Europe, Latin America and Asia. At the same time, lenders have been looking for new market segments in the mature credit societies, adapting the loans to the means and possibilities of the new borrowers. Part 1 of this book contains several Chapters describing these developments in consumer credit markets in different parts of the world.

Part 2 of the book contains Chapters focusing on new attempts to regulate consumer credit markets to limit the effects of this credit expansion in creating overindebtedness. The phrase 'responsible lending' has become part of our vocabulary, as discussed in many of these papers.

Insolvency law remains an important focus of the materials. Insolvency procedures are a way to treat overindebtedness, to ameliorate some of the adverse consequences for debtors. Part 3 of the book contains articles discussing the effects of overindebtedness on insolvency filing rates and changes in insolvency procedures in many countries. Part 4 focuses on repayment plans, which is the only available insolvency procedure in many countries and in others has become an important alternative to discharge-focused insolvency procedures.

I. CHANGING CONSUMER CREDIT MARKETS

After a long period of prosperity and steady economic growth, the western hemisphere experienced in 2007 unmistakable signs of economic trouble. The seriousness of the crisis was first manifested to the general public by the crisis of the US housing market. The globalization of the credit markets suggests that the repercussions of the housing loan crisis will be felt all over the world.

Both Gregory Squires and Christopher L Peterson provide background to this crisis. Gregory Squires examines how the disparities in levels of income and property have been increasing and analyzes the impact of this development on the US credit market. Squires notes that all subprime lending is not necessarily predatory, but patterns of predatory lending can be found in this market. Squires identifies several characteristics of predatory lending, which all point in the same direction: the poor pay more.

Developments in the home mortgage market are explained by Christopher L Peterson in his comparative article. Home mortgage lending was until recently

[1] Two of the earlier meetings were also organized as part of a Law and Society Association conference held in Europe. The first was in Glasgow in 1996, and the papers were published as a special issue of *The Journal of Consumer Policy* (vol 20, pp 133–287), edited by Niemi, Kiesiläinen and Ramsay. The second meeting was held in Budapest in 2001, and the papers were included in Niemi, Kiesiläinen, Ramsay and Whitford (eds), *Consumer Bankruptcy in Global Perspective* (Oxford, Hart Publishing, 2003).

considered as the most secure form of credit, for both debtors and creditors. The market has changed as underwriting practices have relaxed, facilitated greatly by the growth of a secondary market for bundled mortgage loans. It seems, however, that the risks involved with the expansion of credit and reaching new groups of debtors have not been understood by the regulators nor anticipated by the markets. Comparatively, the markets in Germany and Japan seem to be so much behind in the development of new securitization instruments that a similar crisis as in the US is likely to be avoided.

The expansion of credit has taken different and perhaps more anticipated forms in other parts of the world. Several articles in this book illustrate the growth of the consumer credit market, its consequences to the consumers and the reactions of the regulators in countries such as Brazil, Japan, Korea, South Africa, Australia, Great Britain and Germany. Brazil provides a telling example. While the level of poverty has decreased over the last decade, outstanding credit by individuals and households has increased eight-fold and the number of credit cards is now almost four times as high as in 2000. Claudia Lima Marques and Antonio Benjamin report an increase in the debt problems experienced by the lower middle class that has gained access to credit in the 'credit explosion' during the last five years.

Debt problems are a recurrent topic in the media. Iain Ramsay takes up the picture of debtors that is painted by the media in his discussion of overindebtedness in the United Kingdom. Some of the terminology he describes is mainstream consumer credit and overindebtedness usage, like 'credit crisis' and 'irresponsible or feckless borrowing', but the more imaginative metaphors he has found, like 'credit binges' and 'wannabe WAGs', can be used to draw attention to the way debtors are commonly described as deviant, aberrant and 'the other'. Ramsay also explores whether overindebtedness should be understood as a pathology of affluence, concluding that it is both a pathology of affluence and poverty in an affluent society.

II. CONSUMER CREDIT REGULATION

After the turn of the millennium the regulation of consumer credit has been under serious policy discussions at national and regional levels in many parts of the world. These discussions are often framed along two regulation strategies: the liberalization of the credit market and the empowerment of the consumer, who is assumed to follow the rational actor model in her decision making; and the regulation of both the procedure for granting of the consumer credit and the content of the resulting contracts, with the goal of ensuring fair and secure credit contracts that protect consumers. These contrasts suggest an initial distinction between 'neo-liberal' and 'social market' approaches to regulation of consumer credit, with the UK and US within the former model and countries such as Germany representing the other. Udo Reifner argues that a neo-liberal approach favors extensive disclosures to consumers, and protection against unfair surprise in contracts. It relies primarily on the market to police credit provision but recognizes the need for responsible lending and borrowing: financial literacy is intended to achieve the latter goal. Extensive consumer credit reporting is viewed as a central part of the institutional framework of the market. Accessible bankruptcy procedures provide a 'fresh start' for consumers so that they can re-enter the credit economy. The World Bank has adopted the broad lines of this approach in its development of 'best practices' in consumer financial protection.[2]

In contrast the 'social' model is based on the image of the 'hasty and needy consumer, forced into contractual relations by social circumstances he cannot control'. Social consumer protection in credit markets includes 'usury ceilings, capped default interest rates, protection against early termination and discharge, with warnings and information on debt'.[3] Reifner also argues that consumer credit law provides a potential relational model of consumer law which recognizes the need to provide opportunities for contractual adjustment to unforeseen changes such as loss of employment. The Chapters in this Part explore the above distinctions in regulatory approaches and assumptions as they unfold in contemporary national and regional regulation.

In discourses on overindebtedness the aim of prevention is often mentioned as a goal of policies that would restrict lender behavior. Besides the national policies, which have emphasized prevention for a long time, the Council of Europe has taken an important initiative to promote a common approach to overindebtedness. The recommendation by the Council of Ministers of 2007 takes a broad approach to the prevention of debt problems. Johanna Niemi takes prevention of debt problems as the starting point in her article, which is based on a preliminary survey of national laws on enforcement, credit registration and debt adjustment laws of the European countries. The Chapter discusses the possibilities of prevention through the use of credit registration and use of default data, financial education and protection of debtors in the enforcement procedures. While promoting all these, she concludes that prevention can not replace rehabilitative procedures in a credit society.

Udo Reifner, a scholar and long-time proponent of consumer rights, approaches consumer credit in his article from a broad ethical perspective. Together with consumer protection organizations he has developed ethical principles for responsible credit. These principles are in the form of soft law, giving general guidelines for responsible credit.

[2] World Bank (2008), *Finance for All: Policies and Pitfalls in Extending Access* ch 3. See the World Bank 'Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool', August 2008, Consultative Draft. For an example of the World Bank approach to credit in emerging economies see A Kumar, *Access to Financial Services in Brazil* (Washington DC, World Bank, 2005).

[3] U Reifner (2007). 'Renting a Slave—European Contract Law in the Credit Society' in T Wilhelmsson, E Paunio and A Pohjolainen (eds), *Private Law and the Many Cultures of Europe,* (The Hague, Kluwer Law International, 2007), p 326.

The EU is committed to the creation of an integrated capital and credit market. There is also concern about overindebtedness.[4] The Consumer Credit Directive (CCD) of the European Union, adopted in 2008, is primarily a measure aimed at market integration. However, it contained in an early draft a strong 'responsible lending' requirement referring to the responsibility of the lender to consult relevant databases on the creditworthiness of the consumer before extending a credit and to ensure that credit was suitable to the needs of the consumer. The proposal was watered down before the final CCD was accepted. There were also many other issues debated, such as the scope of disclosure obligations and the rights of withdrawal and early payment. The result was a compromise between the interests of the financial institutions and the consumer organizations on almost every point. Sefa Franken discusses in her article the political process around the directive with a focus on the influence of the interest groups. While the financial sector was organized and well represented in the consultations, the consumer side seems to have a weak representation and difficulties in forming its opinion. However, as Franken notes, the financial institutions are also a non-unitary group and their silence on some central issues may mean that there are differing opinions within the group. As Franken shows, a more open legislative process would be in the interest of all EU citizens.

Susan Block-Lieb, Richard L Wiener, Jason A Contone and Michale Holtje take as their starting point the economic model of the individual consumer as a rational actor. Disclosure regulation, strengthened in the US by recent amendments to the Truth in Lending Act, and in Britain by reform of the UK Consumer Credit Act 1974, presumes a rational actor in deciding what information must be provided by a lender. Drawing on the work of behavioral economists, Block-Lieb et al present the results of a simulated empirical experiment, suggesting that the emotional value of disclosure on debtors is more significant than the effects of greater understanding of contract terms resulting from the enhanced disclosure.

Nations have reacted to debt problems in different ways, as several Chapters of this book indicate. The increase in debt problems in South Africa brought into daylight a credit market that was divided along racial and social lines. Until recently regulation basically reached only the 'upmarket' for white middle-class debtors. Michelle Kelly-Louw's article takes up the problems of debtors in the basically unregulated small-loans market, in which usury has flourished. The new consumer credit law is an ambitious attempt to regulate those loans, and includes both interest rate caps and a concept of reckless lending. Courts have the power to suspend the effect of offending credit agreements.

Souichirou Kozuka and Luke Nottage examine the growth and regulation of Japanese consumer credit, including a recently enacted responsible lending requirement, against the background of traditional justifications for regulation of

[4] The EU has initiated projects to develop a common definition of overindebtedness and to study financial exclusion. See EU Commission, *Towards a Common Operational European Definition of Overindebtedness*, DG Employment, Social Affairs and Equal Opportunities (2008).

the economy in Japan. They argue that contemporary regulation does not fit with traditional cultural explanations about the relationship of law to the economy in Japan. After considering several theories of Japanese political economy, including elite management and public choice, as well as normative theories drawn from neo-classical and behavioral economics, they conclude that reforms may represent an increasing pluralism and perhaps populism in Japanese politics.

III. CONSUMER OVERINDEBTEDNESS AND INSOLVENCIES

The increasing debt problems of households have led lawmakers all over the world to seek new solutions and, thus, insolvency procedures for consumers have become more common in different parts of the world. Consumer bankruptcy or debt adjustment schemes, leading to partial or total relief of outstanding debt, have been the traditional answer to overwhelming debt problems in Anglo-Saxon jurisdictions. These schemes have also become increasingly common in European states (see Niemi; Kilborn; Backert et al) as well as in the industrialized Asian countries (see Oh; Kozuka and Nottage).

In all insolvency systems a key question is why debtors file. The Chapter by Ronald Mann, who earlier conducted an extensive comparative study of the variation in levels of consumer credit in different countries, compares the filing rates in several jurisdictions with a view to explaining what factors impact the different bankruptcy per capita rates in these jurisdictions. His main finding is that economic reasons are most important. Debtors in the US file consumer bankruptcy more often than in the other countries he studied (Canada, UK and Japan), not because they have a lax attitude to repayment of debts, but because they have more debt. The economic explanation does not exclude legal and cultural influences on filing behavior, however. Canadians, according to Mann, seem to have a lower threshold of filing for bankruptcy when they are overindebted than debtors in comparable countries. Mann argues that one explanation is the easy accessibility of bankruptcy in Canada, with low up-front payments and the lack of an effective requirement for a judicial determination of need for bankruptcy.

The issue of who are the debtors at risk of becoming overindebted or who have already become so are taken up by Catarina Frade and Claudia Lopes, Wolfram Backert et al and Johannes Doll. Frade and Lopes frame the issue about the households with the highest risk of becoming overindebted in a new way in their article with the concept of 'financial stress'. They want to understand how overall economic variables affect how households experience financial stress across the European countries. Interestingly, they find that the prosperity of the country, as measured by GNP, the availability of credit to households and the relatively even income distribution all diminish the financial stress experienced by the non-poor households in Europe.

Wolfram Backert, Ditmar Brock, Götz Lechner and Katja Maischatz report on a study of debtors who have filed for relief under German consumer insolvency procedure. Their findings confirm the results of earlier studies that unemployment, family breakdown and loss of financial overview are the most common factors behind the overindebtedness, followed by business failure. Their study also offers support to Mann's thesis that easy accessibility of the insolvency procedure increases filing rates. A reform that made it possible to defer payment of the filing fee seems to have accelerated the rise in consumer insolvencies in Germany.

Some groups of consumers are more vulnerable to changes than others. One group that is often pointed to as most prone to debt problems are the young. Johannes Doll points out in his article that the elderly are also vulnerable to overindebtedness. In Brazil the possibility of assigning future pension payments for the payment of debt made the elderly an attractive group for the lenders and exposed them to overindebtedness in an unprecedented way.

Jason Kilborn, who looks at the European consumer insolvency systems with American eyes, distinguishes in his article about continental European countries two trends in insolvency procedures over the last 10 years. First, cumbersome accessibility criteria have been relaxed and the procedures simplified, at least to some degree. Second, there are indications that access to discharge has been made easier and special barriers abolished for debtors who have no or very little payment capacity. Kilborn agrees with Mann in advocating simplified procedures for these cases, called NINA (no income, no assets) or LILA (little income, little assets).

IV. REPAYMENT PLANS

In the past comparative research on consumer bankruptcy has emphasized the availability of a discharge of unpaid debt, whether access to the discharge is conditioned upon repayment of some of the debt, and the institutional settings of bankruptcy procedures. Today most countries sponsor repayment plans, with or without a discharge option upon conclusion, and even common law countries that traditionally have emphasized nearly unconditional access to a discharge procedure increasingly emphasize repayment plans as an alternative. It is appropriate that scholars now look at the details of repayment plans and this Part contains several papers that do so.

All repayment plans are designed to yield some partial repayment to creditors. Some plans also offer the debtor a discharge and a financial 'fresh' start after payment of some debt. Some plans have the further objective of 'rehabilitating' the debtor, through education, social assistance or other means, with the aim of enhancing his or her future ability to cope responsibly with credit. This multiplicity of goals is balanced in different ways in different national jurisdictions, and that complicates the evaluation of repayment plans. For example, if there is not an alternative of straight bankruptcy in the jurisdiction, discharge achieved through a repayment plan can probably be judged a success. But if unconditional, or straight, discharge is an alternative to a repayment plan, success is more difficult to define. Repayment might be considered a success for creditors, but it may not be the best course from the debtor's perspective if a discharge could be obtained more quickly and at lower cost by a different procedure.

Jean Braucher discusses in her article the methodology of measurement and evaluation of success with payment plans, drawing on empirical evidence from the US, Australia and Europe. An obvious measure of success would be the completion rate of confirmed plans. This, however, is not easily measured because it requires a long-term follow-up. Repayment plans typically take three or more years after filing before they are concluded. Many studies give reason to suspect that a considerable portion of plans fail. Especially in those circumstances, straight discharge might be considered a more successful option; it may provide creditors less repayment but it does provide the debtor some debt relief and at least a partial fresh start. Further, many payment plan schemes incur high administrative or legal costs, which are borne by the debtors, creditors and the taxpayers in different mix, and that has to be considered in evaluating repayment plans, especially in jurisdictions with a straight bankruptcy alternative.

The other Chapters in this Part of the book take up country examples of repayment plans. The backgrounds and contexts of these countries are different. The Australian repayment plans have been introduced in a bankruptcy system that has historically allowed immediate discharge but has had cost barriers and punitive effects for individual bankrupts. As John Duns and Rosalind Mason report, new debt agreement schemes with a repayment plan have been popular and the debtors have succeeded relatively well. However, Jean Braucher is more cautious, reminding us that the completion rates of the plans have not yet been followed long enough and that the goal of rehabilitation might have been reached in some cases more efficiently through a bankruptcy scheme.

After Korea experienced an explosion of consumer lending, followed by a realization that many of the debts could not be repaid as due by debtors, the Korean consumer insolvency law developed from a no-discharge bankruptcy law to a system that offers debtors several options. Sooegun Oh compares a workout program created by a covenant among the most important financial institutions in 2002, and a judicial rehabilitation process adopted in 2004. The workouts have come to be gradually outnumbered by the rehabilitations, which give a possibility to a more radical reduction of debts through a three- or five-year plan instead of an eight-year plan as in the workouts. Unlike the judicial rehabilitation process, however, the workouts also give protection to guarantors and to some extent against secured creditors, and consequently some debtors quite rationally still gravitate to the workout procedure.

England and Wales has now developed a variety of repayment alternatives for debtors which, when fully implemented, will provide a potentially complex array of public and private options to a debtor. These include: straight bankruptcy with the possibility of income repayments over a period not exceeding three years; a reduced fee debt relief order—effectively bankruptcy—which will be available to low-income debtors with no assets and debts of under £15,000; an administration order for individuals with debts under £15,000 which promises the possibility of a write-off of debt after five years for those individuals successfully maintaining repayments; individual voluntary arrangements permitting debt composition and repayments normally over five years; private debt management plans usually without composition but with the possibility that the government may authorize certain private plans to write off debts. This complexity is partly a result of a lack of overall planning and competing departmental responsibilities. Government policy seems to support partial repayment rather than 'straight' bankruptcy as the central mechanism for overindebted debtors although such a policy has never been presented to Parliament. Michael Green describes the evolution of the payment alternatives since the beginning of the century, highlighting the extent to which the development of the Individual Voluntary Arrangement (IVA)—now viewed as the primary consumer remedy for overindebtedness—was developed by entrepreneurial insolvency practitioners who adjusted an existing commercial device to the mass consumer market. He also draws attention to the need for regulation of this private market for debt resolution.

Finally, the Dutch consumer bankruptcy law, enacted in 1998, has the unique background of a system in which discharge and partial repayment were based on contractual agreements between a debtor and his or her creditors, with the debtor supported by municipal banks both in negotiations and through financial contributions. The old system also put a lot of emphasis on the rehabilitation by evaluating a debtor's problems and offering social services. As Nadja Jungmann and Nick Huls describe, one purpose of the new law was to facilitate such negotiations and make informal settlements more enticing for the creditors. In practice, however, the amicable old system has been partially replaced with a more standardized and bureaucratic judicial procedure, which creditors seem to prefer even though it probably offers lesser repayment than is achievable through resort to the older preferred procedure. Nonetheless, the emphasis on repayment and the socially minded financial institutions are still part of the Dutch culture, reminding the rest of the world that there is a need for social banking and responsible credit all over the world.

The financialization of contemporary life ensures that issues of the appropriate role of credit, the legitimacy of differing types of credit, and regulation of the ground rules and pathologies of consumer credit, will remain important. The Chapters in this book demonstrate that although there may be significant international pressures towards the adoption of neo-liberal approaches to regulation, there are competing voices and regulation rarely follows strictly a neo-liberal template. Different countries' regulation may reflect particular conjunctures of events, interest groups and ideology. This conclusion is of general interest to the international and comparative study of the regulation of consumer markets.

1

*Inequality and Access to Financial Services**

GREGORY D SQUIRES

Predators

If you can't maintain a certain amount
No banker's going to let you have a checking account
So when you gotta cash a check 'cause your kids need to eat
There's a check cashing place about a block up the street
When the money's tight, you don't have to wait
There's a 500 percent interest rate
That you keep rolling over on that payday loan
And if you can't afford a freezer you can rent-to-own
You gotta make those payments for you can't miss one
You can buy it three times over by the time that you're done
If you do miss a payment, they will repossess
And when your ice cream melts, it's going to make a mess
'Cause they're predators, predators, they keep devouring more and more
they're predators, predators that keep gettin' richer by preying on the poor

Rap song: Predators Music and lyric by
Clifford J. Tasner & Wil b.@2006 by
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All Rights Reserved
From the Film: In Debt We Trust: America Before the Bubble Bursts

I. INTRODUCTION

CONSUMER DEBT HAS increased dramatically in recent years, and in ways that threaten the financial security of many poor families, working households, and even some who ascended, perhaps just temporarily, into the middle class. Characterized as 'overindebtedness',[1] a 'debt

* I would like to thank Marlene Kim and Sara Pratt for many helpful comments on earlier drafts of this paper.

[1] U Reifner, 'Responsible Credit in the EU', speech delivered at Malta International Conference (21 March). <http://www.responsible-credit.net/index.php?id=1980&tr=Hv&viewid=37061> last accessed on 2 August 2006.

explosion'[2] and an 'addiction to credit'[3] the increasing reliance of consumers worldwide on credit has attracted widespread attention from policymakers, academics, community organizations and many others.[4] In the United States credit card debt alone grew from less than $10 billion in 1968 to over $800 billion in 2005. Total consumer debt reached $2.1 trillion in 2005. Among lower-income households 55 percent were in debt in 2004, a ten percent increase since 1989, with total debt held by these households increasing by 308 percent in this period.[5] Personal bankruptcies increased from less than 4 per 1,000 households in the 1950s to 52 per 1,000 in the late 1990s. More than 1.6 million filed for bankruptcy in the 12 months prior to June 2005, approximately twice the number who filed 10 years earlier.[6] In 2005 the personal savings rate dropped below zero (meaning that people spent more than they earned) for the first time since the Depression, perhaps the clearest signal of a growing financial crisis.[7] The accompanying expansion of credit, sometimes by consumer choice, sometimes in response to aggressive marketing by financial institutions, reflects restructuring of financial services in many ways.

But a more fundamental transformation shaping credit practices is a dramatic increase in economic inequality. Understanding recent restructuring of financial services, the economic and social costs that ensue, and what to do about those costs requires an understanding of those larger changes, what Lester Thurow (1986)[8] referred to 20 years ago as a 'surge in inequality.' In her recent book on educational reform Jean Anyon (2005)[9] argued that recent trends in poverty and inequality created conditions that no school reform could transcend and that macroeconomic policies shaping the broader distribution of income, wealth,

[2] E Warren, A Warren Tyagi, *The Two-Income Trap: Why Middle-Class Mothers & Fathers are Going Broke* (New York, Basic Books, 2003) 129.

[3] RD Manning, *Credit Card Nation: the Consequences of America's Addiction to Credit* (New York, Basic Books, 2000) cover.

[4] I Ramsay, 'Consumer Credit Regulation as the Third Way', <http://www.iaclaw.org/Research_papers/thirdway.pdf>; M Lee, 'Predatory Lending Goes Global: Consumer Protection in a Deregulation Network Economy' in Gregory D Squires (ed), *Why the Poor Pay More: How to Stop Predatory Lending* (Westport, CT, Praeger, 2004); I Lee, 'Global Fair Lending?' presentation at first annual International Responsible Credit conference, Brussels (28 April 2006), <http://www.responsible-credit.net/index.php?id=1980&tr-Hv&viewid=37240> last accessed on 2 August 2006.

[5] M Fellowes, M Mabanta, *Borrowing to Get Ahead, and Behind: The Credit Boom and Bust in Lower-Income Markets* (Washington, DC, The Brookings Institution, 2007) 1.

[6] E Warren, A Warren Tyagi, *The Two-Income Trap: Why Middle-Class Mothers & Fathers are Going Broke* (New York, Basic Books, 2003) 130; RD Manning, *Credit Card Nation: the Consequences of America's Addiction to Credit* (New York, Basic Books, 2000) 127–8. National Community Reinvestment Coalition and Woodstock Institute, 'A Lifetime of Assets' (Washington, DC and Chicago: National Community Reinvestment Coalition and Woodstock Institute, 2006) 5.

[7] S Greenhouse, 'Many Entry-Level Workers Feel Pinch of Rough Market', *The New York Times*, 4 September 2006, at A10.

[8] L Thurow, 'A Surge in Inequality' (1987) 256 *Scientific America* 30–7. This observation is perhaps better understood as a prescient prediction of the future than a commentary on the years to which he was actually referring.

[9] J Anyon, *Radical Possibilities: Public Policy, Urban Education, and a New Social Movement* (New York, Routledge, 2005).

and poverty need to be addressed as part of any meaningful educational reform effort. A similar observation applies to financial services. Coming to terms with broader questions of inequality is essential for any meaningful changes in the delivery of, and access to, financial services, at least on fair and equitable terms.

Over the past three decades, the trajectories of inequality that have most dramatically changed the face of the nation's metropolitan areas are the persistence of racial segregation, concentration of poverty coupled with increasing economic inequality, and sprawl. All of these forces, fuelled by intentional public policies and institutionalized private industry practices, have given rise to the uneven development of metropolitan areas. The following pages examine the connections between that uneven development and the evolution of financial services, particularly as they affect mortgage lending in the US. The paper concludes with directions for policies to ameliorate that uneven development and the ensuing inequality along with the associated costs, and to provide more equitable access to financial services.

II. SURGING INEQUALITY

By virtually any measure economic inequality has increased in recent decades. Between 1967 and 2005 the share of income in the US going to the top quintile of all households increased from 43.6 percent to 50.4 percent while the share going to the bottom fifth dropped from 4.0 percent to 3.4 percent. In 1967 those in the top fifth received four times as much as those in the bottom fifth. By 2005 the top group was receiving five times as much.[10] Since the mid 1970s compensation for the 100 highest paid chief executive officers increased from $1.3 million or 39 times the pay of the average worker to $37.5 million or more than 1,000 times the pay of a typical worker.[11] Further evidence that those at the very top are receiving most of the rewards was provided in 2004 when those in the top 1 percent enjoyed a 12.5 percent increase in their incomes compared to 1.5 percent for the remaining 99 percent.[12] Wealth, of course, has long been much more unequally distributed than income, and that inequality has increased over time. Between 1983 and 2001 the share of wealth held by the top five percent grew from 56.1 percent to 59.2 percent. Racial disparities yield a similar pattern with wealth being much more unequally distributed than income. While African Americans and Hispanics earn approximately two-thirds the income of whites, wealth holdings for the typical non-white family are approximately one-tenth that of the typical white family. And while these gaps close moderately when

[10] C DeNavas-Walt, BD Proctor, CH Lee, *Income, Poverty, and Health Insurance Coverage in the United States: 2053s* (Washington, DC, Government Printing Office, 2006) 60–226.

[11] P Krugman, 'For Richer', *The New York Times Magazine*, 20 October 2002, at 64.

[12] P Krugman, 'Left Behind Economics' (2006) *The New York Times*, 14 July, at A 19.

controlling for education, occupation and related socio-economic characteristics, they persist at significant levels.[13]

These inequalities have contributed to the uneven development of the nation's metropolitan areas. This is most vividly demonstrated by the concentration of poverty, racial segregation if not hypersegregation of neighborhoods, and the associated patterns of urban and suburban sprawl. These spatial developments, in turn, dramatically affect the quality of life in different neighborhoods.

The concentration of poverty in the US has been the focus of much social science research and policy analysis for several decades. Between 1970 and 2000 the number of high-poverty census tracts (those where 40 percent or more of the population is poor) grew from 1,177 to 2,510 and the number of people living in those tracts grew from 4.1 million to 7.9 million.[14] The isolation of rich and poor families is also reflected by the declining number of middle-income communities. Between 1970 and 2000 the number of middle-income neighborhoods (census tracts where the median family income is between 80 percent and 120 percent of the median family income for the metropolitan area) dropped from 58 percent to 41 percent of all metropolitan area neighborhoods. And whereas more than half of lower-income families lived in middle-income neighborhoods in 1970, only 37 percent of such families did so in 2000. The share of low-income families in low-income areas grew from 36 percent to 48 percent.[15]

Even longer-standing patterns of racial segregation persist. Nationwide the black/white index of dissimilarity did decline from .73 to .64 between 1980 and 2000. (This index varies from 0 to 1 where a score of 0 would indicate that each neighborhood had the same racial composition of the metropolitan area as a whole and a score of 1 would represent total segregation meaning every neighborhood was either all black or all white. Scores above .60 are widely viewed as reflecting high levels of segregation.) In the large metropolitan areas where the black population is most concentrated, however, segregation levels persist at high levels, reaching at or near .80 in New York, Chicago, Detroit, Milwaukee and many other metropolitan areas. Lower levels have been achieved primarily in western and southwestern communities with small black populations and far less likelihood that whites would have frequent encounters with African Americans than would be the case in metropolitan areas with large black populations if all groups were more evenly distributed throughout the community.

[13] TM Shapiro, *The Hidden Cost of Being African American: How Wealth Perpetuates Inequality* (New York, Oxford University Press, 2004); National Community Reinvestment Coalition and Woodstock Institute, 'A Lifetime of Assets' (Washington, DC and Chicago, National Community Reinvestment Coalition and Woodstock Institute, 2006).

[14] P Jargowsky, *Poverty and Place: Ghettos, Barrios, and the American City* (New York, Russell Sage Foundation, 1996). P Jargowsky, 'Stunning Progress, Hidden Problems: The Dramatic Decline of Concentrated Poverty in the 1990s' (2003) Washington, DC, The Brookings Institution.

[15] JC Booza, J Cutsinger, and G Glaster, 'Where Did They Go? The Decline of Middle-Income Neighborhoods in Metropolitan America' (2006) Washington, DC, The Brookings Institution, Metropolitan Policy Program.

For Hispanics and Asians segregation levels are much lower, approximately .4 and .5, but they have remained at that level or actually increased slightly during these years.[16]

Reflecting and reinforcing these patterns of concentrated poverty and segregation have been land use patterns characterized by the term 'sprawl.' As Anthony Downs observed: 'Suburban sprawl has been the dominant form of metropolitan-area growth in the United States for the past 50 years.'[17] To illustrate, between 1950 and 1990 metropolitan areas grew from 208,000 square miles housing 84 million people to 585,000 square miles housing 193 million. So land use grew by 181 percent while the population increased by just 128 percent. Population density declined, therefore, from 407 to 330 persons per square mile.[18]

III. COSTS OF UNEVEN DEVELOPMENT

These patterns of development embody severe social costs which have adverse consequences for entire metropolitan areas. But the costs are not evenly distributed. For many, particularly residents of low-income and minority communities, a range of opportunities are limited for reasons that go beyond the characteristics of those particular individuals. That is, there are neighborhood effects that frame the opportunity structure for access to virtually all goods and services available in the US, including financial services.[19]

Perhaps the most immediate costs result from both a skills and spatial mismatch whereby those most in need of jobs (low-income residents of central city neighborhoods) lack the skills for nearby jobs, and live the greatest distance from the suburban and ex-urban areas where job growth is concentrated. As manufacturing jobs in urban communities have disappeared[20] and professional service jobs have increased in downtown central business districts but even more so in suburban and ex-urban rings, poverty has become increasingly concentrated in inner-city neighbourhoods.[21]

[16] J Iceland, DH Weinberg, E Steinmetz, *Racial and Ethnic Residential Segregation in the United States: 1980–2000*, US Census Bureau, Series CENSR-3 (Washington, DC, US Government Printing Office, 2002); JE Farley and GD Squires, 'Fences and Neighbors: Segregation in 21st-Century America' (2005) 4 *Contexts* 33–9.

[17] A Downs, 'The Big Picture: How America's cities are Growing' (1998) 16 *Brookings Review* 8.

[18] D Rusk, *Inside Game Outside Game: Winning Strategies for Saving Urban America* (Washington, DC, The Brookings Institution Press, 1999).

[19] RJ Sampson, JD Morenoff and T Gannon-Rowley, 'Assessing 'Neighborhood Effects': Social Processes and New Directions in Research' (2002) 28 *Annual Review of Sociology* 443–78; GD Squires, CE Kubrin, *Privileged Places: Race, Residence, and the Structure of Opportunity* (Boulder, CO and London, Lynne Rienne, 2006).

[20] The share of non-agricultural workers employed in manufacturing dropped from 40 percent to 14 percent between 1979 and 2004, representing a total loss of 5.2 million manufacturing jobs. JS Hacker, *The Great Risk Shift* (New York, Oxford University Press, 2006) 80.

[21] J Kain, 'Housing Segregation, Negro Employment and Metropolitan Decentralization' (1968) 82 *The Quarterly Journal of Economics* 175–97; J Kain, 'A Pioneer's Perspective on the Spatial Mismatch Literature' (2004) 41 *Urban Studies* 7–32. WJ Wilson, *When Work Disappears: The World of the New Urban Poor* (New York, Alfred A Knopf, 1996).

But social costs emerge much earlier in life. Health care services from the very start of the life cycle are particularly unevenly distributed. For example, in the affluent and predominantly white northwest side of Washington, DC and the neighboring suburb of Bethesda, Maryland there is one pediatrician for every 400 children, compared to one for every 3,700 in the District's predominantly poor and black southeast side.[22] And in the predominantly black and Latino South-Central Los Angeles community there is one primary care physician for every 12,993 residents, compared to one for every 214 in the nearby wealthy community of Bel-Air.[23]

The quality of public schools varies dramatically in large part because funding is based primarily on local property taxes. Wealthy communities can tax themselves at a much lower rate and still have far more to spend per pupil. To illustrate, in the 2002–03 school year the city of New York (where 72 percent of the school population was black or Hispanic and 83 percent of the students were eligible for free or subsidized lunches) per-pupil expenditures were $11,627 compared to $22,311 in suburban Manhasset (where 9 percent of the school population was black or Hispanic and 5 percent qualified for subsidized meals). Similarly in Philadelphia, where 79 percent of the students were black or Hispanic and 71 percent were poor, per-pupil expenditures were $9,299 compared to $17,261 in nearby Lower Merion where 9 percent of the students were black or Hispanics and 4 percent were poor. Similar disparities prevail in most major metropolitan areas.[24]

But it is not just distressed households and poor neighborhoods that pay. Ghettos and barrios in the nation's metropolitan areas, be they in central cities or inner ring suburbs, undermine the political stability, social development, and economic growth of the entire region. Cities with large poor populations and high levels of concentrated poverty pay more for a range of public services (including education, police, health care, and fire protection), increasing taxes and reducing their ability to attract middle-class families along with the resources they bring. Metropolitan areas with particularly high levels of income inequality grow more slowly than those where income is distributed more equally.[25] In turn, the competitiveness of the nation's economy generally is undercut.[26] Uneven development is costly to all parts of many metropolitan areas and to the US overall in an increasingly global world.

[22] P Dreier, J Mollenkopf, T Swanstrom, *Place Matters: Metropolitics for the Twenty-first Century* 2nd edn (Lawrence, University Press of Kansas, 2004) 77–8.

[23] MK Brown, M Carnoy, E Currie, T Duster, DB Oppenheimer, MM Shultz and D Wellman, *White-Washing Race: The Myth of a Color-Blind Society* (Berkeley, University of California Press, 2003) 14.

[24] J Kozol, *The Shame of the Nation: The Restoration of Apartheid Schooling in America* (New York, Crown Publishers, 2005) 321–4.

[25] B Katz, 'Concentrated Poverty in New Orleans and Other American Cities' (2006) 52 *The Chronicle of Higher Education* B15; P Dreier, J Mollenkopf, T Swanstrom, *Place Matters: Metropolitics for the Twenty-first Century* 2nd edn (Lawrence, University Press of Kansas, 2004) 77–8.

[26] D Baker and H Boushey, 'Trends in the US Economy: The Evolving Role of Minorities' in JH Carr (ed), *Fair Housing, Economic Performance, and America's Future* (forthcoming).

IV. UNEVEN DEVELOPMENT AND FINANCIAL SERVICES

The world of financial services has hardly been immune to these forces. In many ways, restructuring of financial services both reflects and reinforces these patterns of inequality and uneven metropolitan development. A two-tiered system of financial services has emerged, one featuring conventional products distributed by banks and savings institutions primarily for middle- and upper-income, disproportionately white, suburban markets, and the other featuring high-priced, often predatory products, offered by check-cashers, payday lenders, pawnshops, and others targeted at low-income and predominantly minority communities concentrated in central cities.[27]

Perhaps the most concrete sign of these changes is the decline in branch banks and the rise in check-cashers and other fringe bankers, particularly in distressed neighbourhoods.[28] As Federal Reserve Board researchers have reported, the number of branch bank offices in low- and moderate-income areas dropped by 21 percent while they increased by 29 percent overall between 1975 and 1995.[29] As of 2005, banks remained concentrated in high-income areas. And the racial gap was even larger with more than twice as many banks per person in white as in non-white neighbourhoods.[30] Meanwhile check-cashers, which are concentrated in distressed neighborhoods, increased their numbers from 2,151 in 1986 to 22,000 in 2003.[31] And these are not just small 'Mom and Pop' businesses. They process approximately $60 billion in checks annually generating a fee income of $1 billion.[32] Often they are financed by mainstream financial service

[27] D Leonhardt, 'Two Tier Marketing' (1997) 17 March *Business Week* 82–90; J Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor* (New York, Russell Sage Foundation, 1994); H Karger, *Shortchanges: Life and debt in the fringe economy* (San Francisco, Berrett-Koehler Publishers, Inc, 2005).

[28] Fringe bankers include a variety of businesses that provide financial services usually at much higher cost than traditional banks. Examples include check-cashers, which cash personal checks for a fee. Payday lenders offer high interest loans secured by post-dated checks. Rent-to-own stores lease consumer goods and offer an opportunity to purchase those goods as well at prices dependent on how long they have been leased. Automobile title loans are small consumer loans whereby the automobile title provides collateral. Perhaps the longest-standing fringe banking institution, and one that has grown as well in recent years, is the pawn shop, where people can obtain money for material goods which they can repurchase at a specified later date, again for a fee. If they fail to return with the repurchase price, the goods become the property of the pawn shop. See J Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor*, above n 27; M Hudson, Merchants of Misery: How Corporate America Profits from Poverty (Monroe, ME, Common Courage Press, 1996); H Karger, *Shortchanges: Life and debt in the fringe economy*, above n 27.

[29] RB Avery, RW Bostic, PS Calem and GB Canner, 'Changes in the Distribution of Banking Offices' (1997) 83 *Federal Reserve Bulletin* 707–25: 55.

[30] National Community Reinvestment Coalition, 'Are Banks on the Map? An Analysis of Bank Branch Location in Working Class and Minority Neighborhoods' (Washington, DC, National Community Reinvestment Coalition, 2007a) 3.

[31] D Leonhardt, 'Two Tier Marketing' (1997) 17 March *Business Week* 84–6; A Fisher, 'The Financial Divide: An Uneven Playing Field' (San Francisco, California Reinvestment Coalition, 2005) 1.

[32] N Sawyer and K Temkin, 'Analysis of Alternative Financial Service Providers' (Washington, DC, Fannie Mae Foundation and the Urban Institute, 2004) 9.

providers like Citibank, Bank of America, and Wells Fargo.[33] It should also not be lost that a key reason why fringe bankers are able to flourish is that market opportunities were created for them by the withdrawal of mainstream financial institutions from these markets.

Traditionally these services have been concentrated in the nation's most distressed areas, though in recent years they have been expanding to working class communities as well. For example, in 1996 there were two banks for each check-casher in the central city but 10 banks for each check-cashing business elsewhere in the Milwaukee metropolitan area. In predominantly black neighborhoods there was one bank for each check-casher compared to 15 banks per check-casher in white areas.[34] In North Carolina one study found African American neighborhoods had three times as many payday lenders as white neighborhoods, even after controlling on neighborhood income, homeownership, poverty, unemployment, education and other socio-economic factors.[35] Another study found one check-casher for every 3,196 Denver residents in neighborhoods with median incomes below $30,000 compared to one for every 27,416 residents in areas where the median income was between $90,000 and $120,000.[36] The 'unbanked' (households that do not have a bank or credit union account) are also not randomly distributed. The Joint Center for Housing Studies at Harvard found in a 2004 survey that 52.4 percent of the unbanked were black and 35.3% were Hispanic even though each of these groups constitute roughly just 12 percent of the population.[37]

As with the poverty and race patterns reported above, these are not simply statistical curiosities. They reflect significant cost of living disparities as well. The California Reinvestment Coalition[38] found that users of check-cashing businesses and payday lenders spend approximately $1,000 more annually than these services would cost at a mainstream bank. The Center for Responsible Lending concluded that payday lending costs US families $4.2 billion per year in excessive fees.[39] Contrary to industry assertions that check-cashers and payday lenders basically provide a convenience that families only occasionally use when they are temporarily in need of cash, one study found that more than half of

[33] A Fisher, 'The Financial Divide: An Uneven Playing Field' (San Francisco, California Reinvestment Coalition, 2005).

[34] GD Squires and S O'Connor, 'Fringe Banking in Milwaukee: The Rise of Check-Cashing Businesses and the Emergence of a Two-Tiered Banking System' (1998) 34 *Urban Affairs Review* 131–2.

[35] U King, D Davi and K Ernst, 'Race Matters: The Concentration of Payday Lenders in African American Neighborhoods in North Carolina' (Durham, NC: Center for Responsible Lending, 2005).

[36] M Fellowes, 'From Poverty, Opportunity: Putting the Market to Work for Lower Income Families' (Washington, DC, The Brookings Institution, Metropolitan Policy Program, 2006) 26–8.

[37] National Community Reinvestment Coalition and Woodstock Institute, 'A Lifetime of Assets' (Washington, DC and Chicago, 2006) 8.

[38] A Fisher, 'The Financial Divide: An Uneven Playing Field' (San Francisco, California Reinvestment Coalition, 2005) 2.

[39] U King, L Parrish and O Tanik, 'Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year' (Durham, NC, Center for Responsible Lending, 2006) 2, 7.

those who take out payday loans participate in seven or more transactions with a lender in a typical year[40] while another found that 90 percent of payday lender clients take out five or more loans per year.[41] Families without bank accounts pay as much as $15,000 over a lifetime in fees to check-cashers and payday lenders for basic financial services.[42]

Other kinds of fringe bankers have grown as well. Rent-to-own stores grew in numbers from eight in 1986 to over 2,500 in 2003.[43] Pawn shops, long a symbol of low-income neighborhoods, doubled their numbers between 1985 and 2004 from 7,000 to 14,000, today outnumbering credit unions and banks.[44] Auto title loans, refund anticipation loans, tax preparation services, and many others are part of a growing fringe banking industry offering a range of high-priced financial services to those least able to pay.[45] In recent years, the greatest attention has been paid to the rise of subprime and predatory mortgage lending.

One of the most dramatic changes in financial services in recent years has been the explosion of mortgage products. Just one generation ago most borrowers applied for a conventional loan and were either approved or denied. Before the subprime mortgage crisis became almost daily news headlines toward the end of 2006, lenders offered dozens, if not hundreds, of products. With the advent of risk-based pricing, lenders offered an array of products priced in most cases according to the risk borrowers pose. So in addition to what was formerly a fairly standard fixed-rate 30-year loan, in recent years there have been many options including interest only, payment optional, variable rate, and many other loan types.[46] So-called 'nontraditional' mortgages accounted for more than one-third of all mortgage loans during the first nine months of 2006 compared to 2 percent just six years earlier.[47] One result has been a significant increase in high-priced, subprime mortgage loans which enable many families with blemished credit records to obtain a loan and become a homeowner who, just a few years ago, would not have been able to do so. Subprime lending has expanded exponentially in recent years. Between 1994 and 2005 the annual dollar volume of such loans grew from $35 billion to more than $600 billion. This represented

[40] Community Reinvestment Association-North Carolina, Consumer Federation of America, Consumers Union, National Community Reinvestment Coalition, National Consumer Law Center, and US Public Interest Research Group, Letter to Members of the 107th Congress, 2 October 2002.

[41] U King, L Parrish and O Tanik, 'Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year' (Durham, NC, Center for Responsible Lending, 2006).

[42] MA Stegman, M Rocha and W Davis, 'The Accessibility of Self-Service Banking Technology to Low-Income and Minority Communities: Preliminary Results from a Spatial Analysis of Automated Teller Machines in the United States', presented at the Community Development Finance Research Conference (Federal Reserve Bank of New York, 2004) 5.

[43] H Karger, *Shortchanges: Life and debt in the fringe economy* (San Francisco, Berrett-Koehler Publishers, Inc, 2005) 95.

[44] *Ibid*, 66–7.

[45] MS Barr, 'Banking the Poor' (2004) 21 *Yale Journal on Regulation* 121–237.

[46] AJ Fishbein and P Woodall, 'Exotic or Toxic? An Examination of the Non-Traditional Mortgage market for Consumers and Lenders' (2006) Washington, DC, Consumer Federation of America.

[47] K Downey, 'Mortgage-Trapped', *The Washington Post*, 14 January 2007, at F4.

an increase from 5 percent to 20 percent of home-loan originations.[48] Homeownership rates have reached record levels in recent years, which many attribute to the availability of subprime loans. But this argument has been challenged by recent research documenting that most subprime loans are for refinancing rather than purchase, and the number of families losing their homes as a result of default and foreclosure on these loans far exceeds the number who became homeowners.[49] Not unrelated has been far greater attention to unscrupulous, predatory practices in the mortgage lending market. Once again, the impact has not been randomly felt in US cities and metropolitan areas.

In part as a result of the debate over predatory lending, lenders have been required to publicly report pricing information on some loans beginning with their 2004 Home Mortgage Disclosure Act (HMDA) reports.[50] In 2006 53.7 percent of blacks, 46.6 percent of Hispanics and 17.7 percent of whites received high priced loans. In minority areas (where the population was at least 80 percent non-white) 46.6 percent obtained high-priced loans compared to 21.7 percent in white communities (where racial and ethnic minorities accounted for less than 10 percent of the population). These gaps are reduced but remain significant after controlling on various borrower characteristics (for example income, loan amount) and lender type (for example bank, mortgage company).[51] Other researchers have also found racial disparities in the share of borrowers who obtained high-priced loans and the cost of those loans after controlling on a range of socio-economic characteristics including credit scores, with racial gaps higher among upper-income than lower-income borrowers.[52]

Clearly not all subprime loans are predatory, but virtually all predatory loans are in the subprime market. While there is no official definition of a predatory loan, most observers recognize that loans with the following characteristics are likely to be problematic:

[48] RB Avery, KP Brevoort and GB Canner, 'Higher-Priced Home Lending and the 2005 HMDA Data' (2006) 84 *Federal Reserve Bulletin* 125.

[49] E Schloemer, L Wei, K Ernst and K Keest, 'Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners' (2007) Washington, DC, Center for Responsible Lending.

[50] Since 1975 most mortgage lenders have been required by HMDA to report geographic location and other information pertaining to their mortgage lending activity including the disposition of applications (eg whether they were originated or denied), the type of loan (eg purchase, refinance), and census tract in which the property is located. The law has been expanded several times and as of 2004 lenders had to identify high-priced loans where the annual percentage rate exceeded that for Treasury securities of comparable maturities by three percentage points for first lien loans and five percentage points for second lien loans. See RB Avery, GB Canner and R Cook, 'New Information Reported Under HMDA and Its Application in Fair Lending Enforcement' (2005) 91 *Federal Reserve Bulletin* 344–94.

[51] RB Avery, KP Brevoort, and GB Canner, 'The 2006 HMDA Data' (2007) 93 *Federal Reserve Bulletin*, 73-109.

[52] National Community Reinvestment Coalition, *Income is No Shield Against Racial Differences in Lending* (Washington, DC, National Community Reinvestment Coalition, 2007b); DG Bocian, KS Ernst and W Li, 'Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages' (Durham, NC, Center for Responsible Lending, 2006); Joint Center for Housing Studies of Harvard University, 'Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations' (2004) Cambridge, MA: Joint Center for Housing Studies of Harvard University.

—interest rates and fees that far exceed the risk posed by the borrower;
—loans with low initial 'teaser' rates that adjust rapidly upward within two or three years;
—high pre-payment penalties;
—loans based on the value of the property with little regard for the borrower's income and, therefore, ability to repay;
—loan flipping whereby a loan is frequently refinanced, generating fees for the lender but no financial benefit for the borrower;
—high balloon payments;
—negative amortization.

This list is not meant to be exhaustive. But it indicates some of the types of characteristics of loans that have been marketed aggressively to relatively less sophisticated borrowers.

News reports, community advocacy, research, enforcement activity, and policy initiatives have all increased dramatically in recent years.[53] The costs of predatory lending can be severe. In the worst case scenario, families lose their home and their life savings that went into purchasing the home. Short of such a cataclysmic event, predatory lending costs families money they can hardly afford. According to one estimate, predatory mortgage lending costs US families $9.1 billion each year.[54] And the costs are not restricted to unfortunate individual borrowers. Many spill over into the neighborhood and metropolitan area. Subprime lending is concentrated in communities with high unemployment rates and declining housing values,[55] no doubt constituting both a cause and an effect of those neighborhood characteristics. Econometric research has found that the recent rise in subprime lending is associated with higher foreclosure rates which in turn lead to higher crime rates, reduced property values, and, consequently, lower tax revenues.[56] To illustrate, the 3,750 foreclosures that occurred in Chicago in 1997 and 1998 reduced property values by over $598 million, an average of $159,000 per foreclosure.[57]

[53] GD Squires (ed), *Why the Poor Pay More: How to Stop Predatory Lending* (Westport, CT and London, Praeger, 2004); *Housing Policy Debate*, 2004, Themed Issue: 'Market Failures and Predatory Lending', 15 (13); CJ Dodd, Statement of Christopher J Dodd at hearing of US Senate Committee on Banking, Housing, and Urban Development, 'Preserving the American Dream: Predatory Lending Practices and Home Foreclosures' (2007) (7 February) Washington, DC, US Senate Committee on Banking, Housing, and Urban Development.

[54] W Li, KS Ernst, 'The Best Value in the Subprime Market: State Predatory Lending Reforms' (Durham, NC, Center for Responsible Lending, 2006) 2.

[55] A Pennington-Cross, 'Subprime Lending in the Primary and Secondary Markets' (2002) 13 Journal of Housing Research 31–50.

[56] D Immergluck and G Smith, 'The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values' (2006) 17 *Housing Policy Debate* 57–79; D Immergluck and G Smith, 'The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime' (2006) 21 *Housing Studies* 851–66; D Immergluck and G Smith, 'Measuring the Effect of Subprime Lending on Neighborhood Foreclosures: Evidence from Chicago' (2005) 40 *Urban Affairs Review* 362–89.

[57] D Immergluck and G Smith, 'The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values' (2006) 17 *Housing Policy Debate* 57.

With the leveling off of housing prices in recent years, default rates are rising and the industry itself, and the economy generally, are starting to pay a price. The Federal Reserve reported that 2.11 percent of residential mortgage loans held by banks were delinquent at the end of 2006, the highest rate since 2002 and at least twice as high as just one year earlier. Several small lenders have failed and large investors are shying away from investments backed by subprime loans. The explosive subprime mortgage market turned many mortgage bankers and brokers into millionaires seemingly overnight, as the technology boom did for dot-com programmers in the 1990s and leveraged buyouts did for many Wall Street bankers a decade earlier. When the Dow (an index for stock values in the US) lost more than 400 points one day and over 200 points a couple of weeks later in March 2007, and lost over 800 points that summer, at least a portion of that loss was attributable to growing problems in the subprime mortgage industry. Another drop of over 200 points in November created new worries that troubles in the subprime market would continue to drive down the stock market and the economy generally.[58] But even these macroeconomic effects are harshest in depressed communities, particularly the Gulf Coast and industrial Midwest. Subprime foreclosure rates in the fourth quarter of 2006 ranged from less than 3 percent in Washington DC, Maryland, and Virginia, to over 7 percent in Mississippi and over 9 percent in Indiana, Michigan, and Ohio.[59]

Borrowers and their communities are taking great risks and paying substantial costs from recent developments in the mortgage market. That is not as true for the industry. Originators can charge higher rates and fees, thus building higher risk into their business plans Most loans are sold in the secondary market, then packaged as securities and sold to investors.[60] Some lenders, particularly in the subprime markets, have closed their doors. But the risks in home mortgages are spread across many investors. Again, when priced appropriately, originators and investors have profited from the proliferation of mortgage loans, as many households and their neighbors have suffered.[61] These dynamics, of course, reflect and reinforce broader economic inequalities.

Perhaps the most heated debate is over what, if anything, should be done about the emerging two-tiered financial services industry and uneven develop-

[58] J Creswell and V Bajaj, 'Mortgage Crisis Spirals, and Casualties Mount' (2007) 5 March, *New York Times*, C1, C4; V Bajaj and M Landler, 'Mortgage Losses Echo in Europe and Wall Street' (2007) 10 August, *New York Times*, A1, C7; MM Grynbaum, 'New Worries About Credit Drive Down Stock Markets' (2007) 20 November, *New York Times*, C1, C9.

[59] D Cho and N Henderson, 'Where the Wolf Comes Knocking' (2007) 15 March, *The Washington Post*, D1, D8.

[60] C Peterson, 'Over-Indebtedness, Predatory Lending, and the International Political Economy of Residential Home Mortgage Securitization', in J Niemi-Kiesiläinen, I Ramsay and W Whitford (eds), *Consumer Credit, Over Indebtedness and Bankruptcy: National and International Dimensions* (Oxford, Hart Publishing, 2008).

[61] AJ Fishbein, 'Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions and Effects on Regulated Financial Institutions', Testimony before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, US House of Representatives, Washington, DC (27 March 2007).

ment generally. That debate, in turn, reflects competing explanations for underlying causes of those trajectories of inequality.

V. PAST, PRESENT AND FUTURE POLICY

An individualistic bias has long dominated discussions of inequality in the US.[62] A widespread assumption is that voluntary choices made by individuals in competitive markets account for who gets what and why. But this perspective ignores the critical role of a range of public policies and institutionalized private practices that frame the context in which individual choices are made and which give rise to the inequalities noted above.

Economic inequalities, particularly those associated with the labor market, are conventionally explained in terms of human capital theory. That is, those with the most education, skills, experience, and social capital will receive the highest wages with the best benefits packages. The competitive forces of the market place, from this perspective, will minimize any racial and ethnic discrimination since any employer who pays whites more for a given level of human capital will soon be forced out of business.[63] Housing decisions, it is argued, reflect individual preferences limited by economic capacity. Families 'vote with their feet' by moving to those neighborhoods that offer them the most favorable package of amenities that they can afford.[64] Where racial disparities persist today, those inequalities reflect largely choices that minorities have made, often poor choices that reflect the absence of a work ethic, a commitment to a 'victim-focused identity,' and a general rejection of mainstream values.[65] As John McWhorter has argued, 'the black community today is the main obstacle to achieving the full integration our Civil Rights leaders sought.'[66]

But this individualistic bias ignores a range of structural forces that shape the distribution of valued goods and services.[67] In the labor market they include the

[62] WJ Wilson, *When Work Disappears: The World of the New Urban Poor* (New York, Alfred A Knopf, 1996); GD Squires, 'Demobilization of the Individualistic Bias: Housing Market Discrimination as a Contributor to Labor Market and Economic Inequality' (2007) 609 *Annals of the American Academy of Political and Social Science* 200–14.

[63] GS Becker, *Human Capital: A Theoretical and Empirical Analysis With Special Reference to Education* (New York, Columbia University Press, 1964).

[64] C Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416–24; S Thernstrom, A Thernstrom, *America In Black And White: One Nation, Indivisible* (New York, Simon & Schuster, 1997).

[65] EC Banfield, *The Unheavenly City Revisited* (Boston, Little, Brown & Co, 1968); T Sowell, *Markets and Minorities* (New York, Basic Books, 1981); T Sowell, *Civil Rights: Rhetoric or Reality?* (New York, William Morrow and Co, 1984); J McWhorter, *Losing the Race: Self-Sabotage in Black America* (New York, The Free Press, 2000); J McWhorter, *Winning the Race: Beyond the Crisis in Black America* (New York, Gotham Books, 2005).

[66] J McWhorter, *Losing the Race: Self-Sabotage in Black America* (New York, The Free Press, 2000) X.

[67] SR Friedman, 'Structure, Process, and the Labor Market' in W Darity, Jr (ed), *Labor Economics: Modern Views* (Boston, Kluwer-Nijhoff, 1984).

role of unions which generally provide higher wages and more comprehensive benefits for their members than similarly qualified non-union workers obtain, variations in state minimum wage laws, the presence or absence of living wage requirements, and unevenness in the enforcement of labor laws all contribute to economic inequality.[68] Economic restructuring (especially the shift in employment from manufacturing to both high-wage business services and low-wage personal services) has also contributed to the 'surge in inequality.'[69] Old-fashioned racial discrimination persists as a central feature of US labor markets. One recent study found that white job applicants with a felony on their record were far more successful in obtaining jobs than equally or better qualified African Americans with no criminal record.[70]

In the housing market, far more than individual choice is also involved, particularly in terms of the segregated patterns of US cities. Intimidation and violence by neighborhood 'improvement' societies, explicitly discriminatory policies that virtually excluded non-whites from FHA and other government-insured loan programs from the 1930s into the 1960s, refusal of real estate and rental agents to provide similar levels of service to white and non-white clients, the steering by agents of real estate buyers to communities based on their race and that of the neighborhoods, redlining by financial institutions, concentration of public housing complexes in inner city ghettos and barrios, and exclusionary zoning ordinances in most suburbs are among the policies and practices that have shaped the patterns of concentrated poverty, segregation, and sprawl in American metropolitan areas.[71]

If public policies and private practices have shaped the uneven development of metropolitan areas, including the uneven access to financial services, then alternative policies and practices can ameliorate those patterns. Since late 2008 a series of multi-billion dollar bailout or rescue initiatives were launched in, so far, failed efforts to stabilize financial institutions or stem growing economic crises. But other largely unexplored options should be considered. The following pages explore specific proposals to ameliorate various trajectories of inequality and provide for more equitable access to financial services.

[68] L Mishel, J Bernstein, S Allegretto, *The State of Working America 2004/2005* (Ithaca, NY, ILR, 2005); RB Freeman, JL Medoff, *What Do Unions Do?* (New York, Basic Books, 1984); R Pollin, S Luce, *The Living Wage: Building a Fair Economy* (New York, The New Press, 1998).

[69] B Bluestone, B Harrison, *The Deindustrialization of America: Plant Closings, Community Abandonment, and the Dismantling of Basic Industry* (New York, Basic Books, 1982); B Harrison, B Bluestone, *The Great U-Turn: Corporate Restructuring and the Polarizing of America* (New York, Basic Books, 1988); L Mishel, J Bernstein, S Allegretto, above n 68.

[70] D Pager, 'The Mark of a Criminal Record' (2003) 108 *American Journal of Sociology* 937–75.

[71] KT Jackson, *Crabgrass Frontier: The Suburbanization of the United States* (New York, Oxford University Press, 1985); DS Massey, N Denton, *American Apartheid: Segregation and the Making of the Underclass* (Cambridge, MA, Harvard University Press, 1993); X Briggs, *The Geography of Opportunity: Race and Housing Choice in Metropolitan America* (Washington, DC, Brookings Institution Press, 2005).

Several politically feasible tools are available to respond to the overall surge in inequality. For example, the federal minimum wage should be indexed to take into consideration cost of living increases as several states have done.[72] It had stood at $5.15 since 1997; scheduled raises were enacted in May 2007 that will bring it to $7.25 in 2009. Because of cost of living increases the purchasing power of the federal minimum wage had deteriorated by 20 percent since 1997, reaching its lowest inflation-adjusted level since 1955.[73] Living wage ordinances mandating even higher wages, generally $8 to $10 per hour, have been enacted in more than 100 localities. The objective of living wage requirements is to enable families to live independently of welfare and related public support payments. All units of government could easily incorporate such requirements in any work done by government contractors or those who receive economic development subsidies.[74] The Earned Income Tax Credit could be expanded. This initiative provides money for those working but making below poverty wages, consequently lifting many working families out of poverty. This program has widespread appeal across the political spectrum because it rewards work and helps lift many who are working out of the poverty conditions that their low wages would leave them in without this credit.[75] A more provocative proposal has been offered by former Minnesota Rep Martin Sabo, whose Income Equity Act would deny corporations tax deductions on any executive compensation exceeding 25 times the pay of the firm's lowest-paid workers.[76]

Enacting the Employee Free Choice Act, providing a national union dues check-off system, would strengthen the role of unions in the US and their positive impact on wage inequality.[77] This bill would allow workers to join a union and direct their dues to the appropriate union after 50 percent of all employees have signed a card indicating their desire to do so. This process would replace the current requirement for an election that often occurs in an intimidating environment where management warns workers of potentially adverse consequences if a union should be certified. Such a process would make it easier for

[72] J Atlas and P Dreier, 'Waging Victory' (2001) *The American Prospect Online Edition* <www.prospect.org/> last accessed 14 November 2006; N Peirce, 'Congress' Minimum Wage Vote: Prelude to a Better Politics,' <www.citistates.com> last accessed on 28 January 2007.

[73] Economic Policy Institute, 'Minimum Wage: Facts at a Glance' (2006) <http://www.epi.org/content.cfm/issueguides_minwage_minwagefacts> last accessed 28 August 2006.

[74] P Dreier, 'Community Organizing for What: Progressive Politics and Movement Building in America' in Marion Orr (ed), *Transforming the City: Community Organizing and the Challenge of Political Change* (Lawrence, University Press of Kansas, 2007); L Mishel, J Bernstein, S Allegretto, *The State of Working America 2004/2005* (Ithaca, NY, ILR, 2005); G LeRoy, *The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation* (San Francisco, Berrett-Koehler Publishers, 2005).

[75] Internal Revenue Service, 2008, <http://www.irs.gov/individuals/article/0,,id=96406,00.html> last accessed 4 March 2008; Center on Budget and Policy Priorities, 2008, 'The Earned Income Tax Credit,' <http://www.cbpp.org/pubs/eitc.htm> last accessed 4 March 2008.

[76] N Peirce, 'Congress' Minimum Wage Vote: Prelude to a Better Politics' (2007) <www.citistates.com> 28 January.

[77] T Kochan and B Shulman, 'A New Social Contract: Restoring Dignity and Balance to the Economy' (Washington, DC, Economic Policy Institute, 2007).

those who want union representation to have that protection. Some but not all states do allow this. Making it a national law would bring the US into conformity with several other industrialized countries that permit this option.[78] The share of the work force that is unionized has declined in recent years but this reflects primarily stepped up anti-union activity by employers and the failure of the Federal government to enforce the National Labor Relations Act as intended when it was enacted.[79] In fact, in 2005 more than half of all non-union workers would have voted for union representation if they had the opportunity, up from approximately one-third of such workers in the mid-1990s.[80]

Expansion of several housing and land use policies would also reduce various trajectories of inequality. Inclusionary zoning laws that require developers to set aside a specific share of housing units to meet affordable housing objectives have now been implemented in dozens of cities. Tax-based revenue sharing, whereby a portion of the increasing property tax revenues in prosperous neighborhoods is used to invest in housing and other community development initiatives in distressed areas, has been implemented in Minnesota.[81] Mobility programs have enabled thousands of families to leave ghettos and barrios for more prosperous outlying urban and suburban communities where they found safer communities, better schools, and better job prospects.[82]

In addition to policies aimed at ameliorating economic inequality generally, other policies directed specifically at financial service providers are also required. More comprehensive financial literacy programs for consumers is widely recognized as a step in this direction.[83] Community development finance institutions (CDFIs), which receive incentives including grants and other assistance from the federal government to provide financial services to traditionally underserved neighborhoods, appear to be doing just that. CDFIs include community development banks, community development credit unions,

[78] P Hall-Jones, 'Paying Your Dues' (2006) Public Services International <www.world-psi.org/Template.cfm?Section=Home&CONTENTID=10560&TEMPLATE=/ContentManagement/ContentDisplay.cfm> last accessed 28 August 2006.

[79] H Shaiken, 'Unions, The Economy, and Employee Free Choice' (Washington, DC, Economic Policy Institute, 2007).

[80] RB Freeman, 'Do Workers Still Want Unions? More Than Ever' (Washington, DC, Economic Policy Institute, 2007) 2.

[81] M Orfield, *American Metropolitics: The New Suburban Reality* (Washington, DC, The Brookings Institution Press, 2002); D Rusk, *Inside Game Outside Game: Winning Strategies for Saving Urban America* (Washington, DC, The Brookings Institution Press, 1999).

[82] LS Rubinowitz, JE Rosenbaum, *Crossing the Class and Color Lines: From Public Housing to White Suburbia* (Chicago, University of Chicago Press, 2000); J Goering, JD Feins, *Choosing a Better Life: Evaluating the Moving to Opportunity Social Experiment* (Washington, DC, The Urban Institute Press, 2003); A Polikoff, *Waiting for Gautreaux: A Story of Segregation, Housing, and the Black Ghetto* (Evanston, IL, Northwestern University Press, 2006).

[83] H Karger, *Shortchanges: Life and Debt in the Fringe Economy* (San Francisco, Berrett-Koehler Publishers, Inc, 2005); D Duncan, 'Statement of Douglas Duncan, Senior Vice President for Research and Business Development and Chief Economist, Mortgage Bankers Association, Before the Subcommittee on Financial Institutions and Consumer Credit of the House of Representatives Committee on Financial Services' (2006) (13 June).

microenterprise lenders, community development corporations and community development venture capital funds. Again, such initiatives should be expanded.

But more aggressive efforts to redirect the activities of mainstream financial institutions is essential to complement the efforts of alternative services and what consumers can accomplish via education. The advent of electronic banking makes it much more cost-effective for mainstream institutions to reach out to the unbanked and basically out-compete fringe bankers. Carefully targeted financial incentives would encourage more banks to do so.[84]

The Community Reinvestment Act (CRA), which requires mortgage lenders to ascertain and be responsive to the credit needs of their entire service areas including low- and moderate-income communities, should be strengthened, rather than weakened as has been the case in recent years. Currently the statute only applies to federally chartered depository institutions (for example, banks and thrifts), but most of the subprime lending is originated by independent mortgage bankers and brokers not covered by the CRA. This statute should be expanded to cover those lenders along with credit unions, insurers, and others engaged in mortgage lending. The Community Reinvestment Modernization Act, introduced by Eddie Bernice Johnson (D-Texas) would accomplish this objective.[85] The Home Mortgage Disclosure Act (HMDA), which facilitates enforcement of CRA, should be expanded as well. It should require pricing information on all loans, not just so-called high-priced loans, along with information on the credit rating of applicants, and characteristics of the property (square feet, number of rooms), to permit more comprehensive analyses of differences in denial rates and services to various groups and communities.[86]

A strong national predatory lending law should be enacted. As of spring 2007, 36 states and the District of Columbia have such laws, leaving consumers in other states less protected.[87] While there is variation across these statutes they generally require lenders to charge interest rates and fees that are commensurate with the risk borrowers pose, limit prepayment penalties, verify income of

[84] MS Barr, 'Banking the Poor' (2004) 21 *Yale Journal on Regulation* 121–237.

[85] R Marsico, *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act* (Durham, NC, Carolina Academic Press 2005).

[86] J Taylor, 'Statement of John Taylor, President and Chief Executive Officer of the National Community Reinvestment Coalition, Before the Subcommittee on Financial Institutions and Consumer Credit of the House of Representatives Committee on Financial Services' (2006) (13 June).

[87] Mortgage Bankers Association, 'Suitability—Don't Turn Back the Clock on Fair Lending and Homeownership Gains', MBA Policy Paper Series, Policy Paper 2007-1 (Washington, DC, Mortgage Bankers Association, 2007) 11; SL Antonakes, 'Testimony of Steven L Antonakes, Massachusetts Commissioner of Banks on Behalf of State Bank Supervisors on Subprime and Predatory Lending; New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Financial Institutions' before the Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit US House of Representatives Washington, DC (2007) (27 March) 12. In addition, 17 local laws have been enacted. G Ho and A Pennington-Cross, 'The Impact of Local Predatory Lending Laws on the Flow of Subprime Credit' (2006) 60 *Journal of Urban Economics* 210–28.

borrowers to maximize the likelihood they will be able to afford the loan, offer products that offer a financial benefit to borrowers, and take other steps to assure access to credit on fair and equitable grounds. No doubt, more aggressive enforcement of fair housing and fair lending laws would also increase fair access to credit and banking services generally.[88]

Under the Home Ownership Equity Protection Act the Federal Reserve Board could and should issue regulations that would be responsive to many of the problematic practices that are taking place in today's mortgage market. But federal legislation may well be required for a more comprehensive remedy that would apply to all products and protect all borrowers. Lenders should be required to document a borrower's ability to repay and underwrite loan applications accordingly. They should escrow for taxes and insurance so borrowers are not deceived by what appears to be low monthly payments, only to be hit by unaffordable property tax and homeowner's insurance bills after the loan is closed. Prepayment penalties that trap borrowers into high-cost loans should be prohibited. Lenders should be liable for the practices of the brokers with whom they do business. In addition, investors who purchase predatory loans, thus providing material incentives for such lending, should be liable for these abusive practices. Several bills have, in fact, been introduced in Congress that would address these and related issues.[89]

A more fundamental change would be to place a duty of suitability on lenders requiring them to recommend loan products that are most appropriate for borrowers given their financial situation (reducing the likelihood of default and foreclosure) similar to rules that currently apply to securities brokers and financial planners. This, in essence, would shift at least some of the burden from individual consumers and complainants to lenders themselves to assure compliance with fair lending and anti-predatory lending rules. Some states are already moving in this direction by prohibiting those loan products and services that do not provide a net tangible benefit to the borrowers. Again, pending legislative proposals in Congress would address these issues.[90]

Ideas alone, of course, do not translate into action. Identifying appropriate political actors and developing a political strategy for implementing progressive ideas is equally if not more challenging as developing a policy agenda. Generally this requires mounting an organizing effort to encourage (if not require) those with the power and authority to act to do so. In the area of financial services,

[88] SL Ross, J Yinger, *The Color of Credit: Mortgage Discrimination, Research Methodology, and Fair-Lending Enforcement* (Cambridge, MA: MIT Press, 2002).

[89] M Eakes, 'Statement of Martin Eakes Before the Federal Reserve Board On Homeownership and Equity Protection Act' (2007) Washington, DC, Board of Governors of the Federal Reserve System (June).

[90] S Covington, 'Predatory Lending's New Frontier' (2005) September *Mortgage Banking*; PA McCoy, 'A Behavioral Analysis of Predatory Lending' (2005) 38 *Akron Law Review* 725–39; KC Engel and PA McCoy, 'A Tale of Three Markets: The Law and Economics of Predatory Lending' (2002) 80 *Texas Law Review* 1281–4.

many of the problematic practices have been outlawed, but the regulators are often as much a problem as the financial service providers themselves.[91]

In recent years several community groups and a number of national membership organizations and networks have effectively challenged and changed the behavior of the financial services industry. Groups like the Association of Community Organizations for Reform Now (ACORN), the National Community Reinvestment Coalition (NCRC), the National Training and Information Center (NTIC), the National Fair Housing Alliance (NFHA) and others have secured access to financial services for markets that have long been underserved or exploited by the industry.[92] For example, ACORN estimated that between 1995 and 2004 it generated more than $6 billion for low-income communities through its CRA organizing efforts and another $6 billion from its anti-predatory lending campaigns. Adding its work to create living wage ordinances, develop affordable housing, and reform various public services ACORN pegs its return to low-income communities at more than $15 billion.[93] Using leverage provided by the federal Community Reinvestment Act (basically a federal ban on redlining) NCRC estimates that more than $4.7 trillion in new loans have been secured for low-income and minority markets since the statute was enacted in 1977 largely in response to community organizing efforts.[94] Under authority provided by the federal Fair Housing Act, the National Fair Housing Alliance estimated that non-profit advocacy groups generated $225 million for plaintiffs since 1990.[95]

But future advances will likely require even stronger coalitions. And there are a number of logical partners, some of whom are already working with these community organizations. Organized labor, church groups, members of the local media, some elected officials (for example, mayors whose cities are losing tax revenues from predatory lending), foundations, and many others can collaborate in effective efforts to extend recent successes in democratizing access to financial services.[96]

The credit squeeze and related financial crises that many families (poor, working-class and even middle-income) face are inextricably linked to broader

[91] C Bradford and G Cincotta, 'The Legacy, The Promise, and the Unfinished Agenda' in GD Squires (ed), *From Redlining to Reinvestment: Community Responses to Urban Disinvestment* (Philadelphia, Temple University Press, 1992).

[92] GD Squires (ed), *Organizing Access to Capital: Advocacy and the Democratization of Financial Institutions* (Philadelphia, Temple University Press, 2003).

[93] L Ranghelli, 'The Monetary Impact of ACORN Campaigns: A Ten-Year Retrospective' (1995–2004) (2006) <www.acorn.org> last accessed 31 January.

[94] National Community Reinvestment Coalition, '30th Anniversary: The Community Reinvestment Act' (Washington, DC, National Community Reinvestment Coalition, 2007); EB Johnson and L Gutierrez, Dear Colleague letter, 'Support the Community Reinvestment Act (CRA) Modernization Act in the 111th Congress,' 19 November 2008; e-mail message from J Taylor to NCRC Listserve (ncrclist@ncrc.org), 19 November 2008.

[95] National Fair Housing Alliance, '$225,000,000 and Counting' (Washington, DC, National Fair Housing Alliance, 2006).

[96] P Dreier, 'The Future of Community Reinvestment: Challenges and Opportunities in a Changing Environment' (2003) 69 *Journal of the American Planning Association* 341–53.

forces of uneven development that have taken hold since Thurow noted the surge in inequality. The public policies and private practices that have generated these outcomes are no secret. Neither are at least some of the remedies. Over 100 years ago Frederick Douglass provided what remains one of the critical lessons for today when he stated:

> If there is no struggle, there is no progress.
> Those who profess to favor freedom and yet deprecate agitation
> Are men who want crops without plowing the ground.
> They want rain without thunder and lightning.
> They want the ocean without the awful roar of its waters.
> Power concedes nothing without a demand.
> It never did, and it never will.

August 4, 1857, West India Emancipation,
Speech delivered at Canandaigua,
New York.[97]

[97] JW Blassingame (ed), *The Frederick Douglass Papers* (New Haven, Yale University Press, 1985) 204.

2

The Political Economy of Consumer Credit Securitization: Comparing Predatory Lending in Home Finance in the US, UK, Germany and Japan

CHRISTOPHER L PETERSON*

THE UNITED STATES' home mortgage market is in a state of upheaval. The American media is currently saturated with troubling news of foreclosure and financial desperation faced by families and neighborhoods all around the country.[1] Nationally, over two million American families are in the process of losing their homes to foreclosure—economic refugees rivaling in numbers what might be produced by a small civil war.[2] One rating agency predicts that between 40 and 50 percent of all subprime mortgages originated since 2006 will end in foreclosure.[3] Ethnic minority families in particular are disproportionately losing their homes.[4] As the volume of foreclosures has increased, it has put downward pressure on home prices, contributing to the first decline in the national median price for previously owned homes since the Great Depression of the 1930s.[5] Some cities in the industrial mid-west have been particularly hard hit, with foreclosures leaving thousands of homes abandoned; currently, foreclosure and other economic pressures have left an estimated 10,000 of Cleveland, Ohio's 84,000 single-family homes sitting vacant and rapidly deteriorating into urban

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[1] See, eg, M Whitehouse, '"Subprime" Aftermath: Losing the Family Home', *Wall Street Journal* (New York, 30 May 2007) A1 (part I of 'Bomb: Inside the "Subprime" Mortgage Debacle—Three Part Series').

[2] Editorial, 'Coming to Grips with the Subprime Meltdown: California Should Follow the Lead of Other States With Stronger Mortgage Protections', *Sacramento Bee* (1 April 2007) E6.

[3] G Bailey, V Barberio, and G Costello, 'Revised Loss Expectations for 2006 and 2007 Subprime Vintage Collateral', <www.fitchratings.com> accessed 25 March 2008, 2.

[4] Editorial, 'Discrimination Hits Home: The Debacle Over Poorly Regulated Subprime Mortgages Disproportionately Affects Minorities', *Houston Chronicle* (29 June 2007) B10.

[5] ——, 'Banks Collect Houses Amid Subprime Fallout', *International Herald Tribune* (Paris, 3 July 2007) 10.

blight.[6] After years of record profits, the once reputable investment bank Bear Sterns collapsed from subprime mortgage losses, inducing the Federal Reserve Board of Governors to orchestrate a transfer of the firm's assets to another investment bank and its potential liabilities to the US treasury.[7] Congress has been conducting hearings demanding answers from the mortgage industry and from federal banking regulators. Scholars, pundits, politicians, and bankers have all cast about looking for an explanation. The most common account references the collapse of a 'bubble' in housing prices. But, more thoughtful commentators have asked how the bubble formed in the first place, and why a collapse in housing prices has been associated with the inability of consumers to make monthly payments on homes not listed for sale.

Several American legal scholars, including Pat McCoy, Kathleen Engle, Kurt Eggert, Julia Patterson-Forrester and I, have explored how the secondary market in assignment of home mortgages influences the origination practices and underwriting standards of home mortgage lenders. In this Chapter I will suggest that the interaction of American law and the structured finance of home mortgage origination—often called securitization—is one of the most important causes of residential mortgage overindebtedness. This essay builds on my previous research on structured finance of predatory home mortgages by comparing the law and business practices of securitization in the United States to that found in three influential countries from around the world: the United Kingdom, Germany, and Japan. Moreover, this Chapter inquires whether the recent US meltdown in securitized home mortgages may hold lessons for international legal and business scholars. Indeed, this discussion is both timely and important because international financiers continue to advocate the use of American-style securitization in commercial and residential lending markets around the world. A comparative discussion of home mortgage securitization may paint a cautionary picture with lessons on how to avoid the instability and tragedies currently occurring in the United States.

Accordingly, this essay first provides a brief introduction to the business practices of, and law governing, residential mortgage securitization in the United States. Part II surveys the growing use of securitization in markets around the world, focusing on the United Kingdom, Germany, and Japan. Part III inquires whether securitization may create structural economic incentives that promote consumer overindebtedness as well as predatory lending. Part IV looks at the political economy of residential mortgage securitization and argues that securitization will tend to empower opponents of consumer protection law and then offers tentative policy recommendations. Part V provides concluding remarks.

[6] E Eckholm, 'Foreclosures Force Suburbs to Fight Blight', *New York Times* (3 March 2007) A1 ('Many of the houses are filled with smelly trash and mattresses used by vagrants. They have been stripped of aluminum siding, appliances, pipes and anything else that scavengers can sell to scrap dealers.').

[7] AR Sorkin, 'In Sweeping Move, Fed Backs Buyout and Wall St. Loans', *New York Times* (17 March 2008) A1.

I. SUBPRIME HOME MORTGAGE SECURITIZATION IN THE UNITED STATES

Securitization, also referred to as structured finance, is a financing technique that allows capital markets to take direct ownership of revenue streams by pooling assets, and then reselling them to investors.[8] In countries with law amenable to structured finance, virtually any income-producing asset can be securitized. In the United States securitization is used to finance everything from physician and hospital accounts, oil exploration, lawsuit settlement proceeds, entire business ventures, music royalties, or even baseball stadiums.[9] But, among the most commonly securitized assets both world-wide and in the United States are consumer loans, especially residential home mortgages.

The business structure of residential mortgage securitization in the United States has evolved into a complex web of relationships between different business entities that provide a variety of lending and investment-related services. In the US, there are two basic home mortgage securitization markets: one public (or at least quasi-public) and the other private. Generally speaking, most of the public home mortgage securitization market runs through one of two 'Government Sponsored Enterprises' (GSEs) created by Congress. These companies, Fannie Mae and Freddie Mac, purchase home mortgages that meet relatively strict underwriting guidelines from private mortgage loan originators. The status of Fannie Mae and Freddie Mac is somewhat ambiguous since Congress has not passed legislation explicitly guaranteeing payment on bonds or securities issued by the GSEs. Yet, the capital markets generally regard the two companies as 'too big to fail,' treating the debt as virtually guaranteed by the US government on the theory that Congress would not allow the companies to collapse. Fannie Mae and Freddie Mac hold some mortgages in their own portfolios, but many others they pool into investment vehicles and sell as securities to investors. The enormous volume of loans securitized by Fannie and Freddie give the companies both economies of scale and risk-spreading advantages that most private companies cannot match. Moreover, because of the implicit federal guarantee on Fannie and Freddie loans, the GSEs can find investors for their securities without incurring transaction costs from rating agencies or credit enhancements.[10]

[8] A Davidson *et al*, *Securitization: Structuring and Investment Analysis 3* (Hoboken, John Wiley, 2003).

[9] See, eg, GR Salathe, 'Reducing Health Care Costs through Hospital Accounts Receivable Securitization' (1994) 80 *Virginia Law Review* 549; CE Harrell *et al*, 'Securitization of Oil, Gas, and Other Natural Resource Assets: Emerging Financing Techniques' (1997) 52 *Business Lawyer* 885; CA Baker and JP Forrester, 'Home Run! A Case Study of Financing the New Stadium for the St. Louis Cardinals' (2004) 10(2) *Journal of Structured Finance* 69; Sam Adler, 'David Bowie $55 Million Haul: Using a Musician's Assets to Structure a Bond Offering' (1997) 13 *Entertainment Law and Finance* 1.

[10] Credit enhancements are agreements that shift risks away from investors. Commonly they take the form of third party guarantees from an insurance company on losses from mortgage defaults and

On the other hand, the GSEs have been reluctant to offer high loan-to-value loans and have been unwilling to purchase loans made to borrowers with questionable credit histories. Loans sold into capital markets from these public sources tend to be relatively homogenous, fifteen- or thirty-year mortgages, frequently with fixed interest rates, and no prepayment penalties. Fannie and Freddie refuse to purchase loans from private mortgage originators unless they use standardized contracts with terms generally seen as fair to both parties. Both GSEs have strict automated underwriting standards, use widely accepted financial models, require standardized documentation, and pay similar prices for all the loans they purchase.[11] As a result, Fannie and Freddie tend to exert a stabilizing force on the 'prime' mortgage market, acting as gatekeepers that weed out loans with predatory terms or risky underwriting. Some commentators also argue that the GSEs' mortgage pools tend to combine lower and some moderate risk borrowers together, with the same loan pricing, creating a modest subsidy to some moderate risk borrowers.[12] Mortgages packaged by Fannie Mae and Freddie Mac have performed relatively well throughout the recent mortgage market problems in the United States.[13]

In contrast, the private secondary home mortgage market lacks uniform underwriting guidelines. This has freed originators to make loans with a great variety of pricing and prepayment terms, and also to reach much deeper into higher risk borrower populations. In recent years, the US 'subprime' market, which generally refers to loans that do not qualify for assignment to the GSEs, has relied heavily on loans with introductory teaser interest rates that adjust upwards, high prepayment penalties, and high (as well as misleading) closing costs. A significant percentage of subprime borrowers—as much as a third by one estimate—actually qualify for prime mortgages but have nevertheless been steered or enticed into the private subprime market.[14] The structure of the secondary market for subprime mortgages reflects the variety in origination practices. Factors such as the type of assets involved, the anticipated preferences of potential investors, the size and growth plans of the originator involved, and the liability risks associated with the transaction can all lead to different securitization strategies. Nevertheless, Figure 2.1 provides a schematic that attempts to

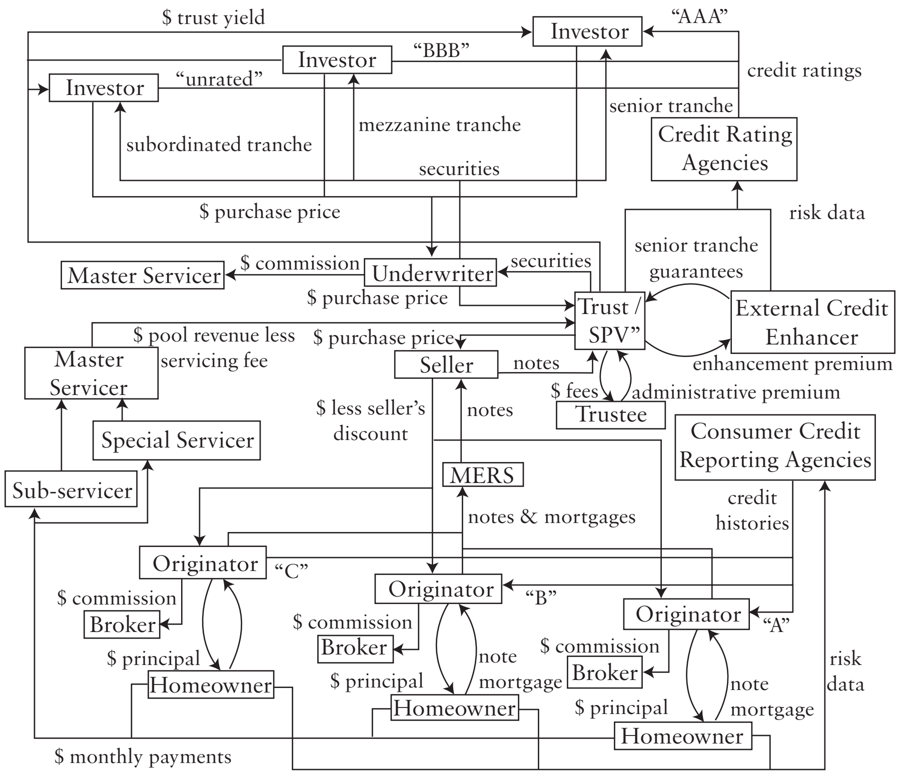
prepayments. T Frankel, *Securitization: Structured Financing, Financial Asset Pools, and Asset-Backed Securities* (Boston, Little, Brown & Co., 1991) Chapter 9.

[11] AK Bhattacharya, FJ Fabozzi and SE Chang, 'Overview of the Mortgage Market' in FJ Fabozzi, ed., *The Handbook of Mortgage-Backed Securities* 5th edn (New York, McGraw-Hill, 2001) 3, 22; R Mann, 'Searching for Negotiability in Payment and Credit Systems' (1997) 44 *UCLA Law Review* 951, 971; H Greely, 'Contracts as Commodities: The Influence of Secondary Purchasers on the Form of Contracts' (1989) 42 *Vanderbilt Law Review* 133, 169–70.

[12] R Green and S Wachter, 'The American Mortgage in Historical and International Context' (2005) 19 *Journal of Economic Perspectives* 93, 109.

[13] J Tyson, '2 Mortgage Lenders are Heroes After Subprime Fallout, *Int'l Herald Tribune* (Paris, 6 June 2007) 16 (detailing success of Fannie Mae and Freddie Mac in weathering housing price downturn).

[14] D Getter, 'Consumer Credit Risk and Pricing' (2006) 40 *Journal of Consumer Affairs* 41, 50.



Source: Christopher L Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2208 (2007).

Figure 2.1

illustrate the flow of capital and information in a typical American subprime home mortgage lending securitization conduit.

A typical subprime home mortgage securitization conduit begins with a mortgage broker—essentially a loan salesperson—identifying a homeowner willing to pledge a home in exchange for a loan. American brokers use a variety of marketing techniques including direct mail, telephone solicitation, door-to-door solicitation, email, and radio, Internet, or television advertising. Along with the broker, a mortgage lending company obtains information on the consumer from one or more of the three national credit-reporting agencies.[15] Once the originator is satisfied that the borrower meets its underwriting guidelines, the

[15] The United States has an active market in personal credit history information. There are three large companies that attempt to maintain comprehensive credit histories of every adult American. These companies are Equifax, Experian, and Trans Union. J Carton-Good, *All About Mortgages: Insider Tips to Finance or Refinance Your Home* 3rd edn (New York, Dearborn Trade Publishing, 2004) 33–5.

loan is funded at a real estate closing meeting. Then, in a typical conduit, the originator will quickly transfer the loan to a subsidiary of an investment banking firm.[16] This subsidiary, which is alternatively called the securitization sponsor, or seller, then transfers the loan and hundreds of others like it into a pool of loans.[17] This pool of loans will become a business entity, called a special purpose vehicle (SPV). The SPV can take the legal identity of a corporation, a partnership, or a limited liability company, but most often is a trust.[18] Aside from the mortgages, the SPV has no other assets, employees, or function beyond the act of owning the loans. Under the agreement transferring the loans into the pool, the SPV agrees to sell pieces of itself to investors. In a typical transaction, an underwriter purchases all the 'securities'—here meaning derivative income streams drawn from payments on the underlying mortgages—issued by the pool. Usually employing one or more placement agents who work on commission, the underwriter then sells securities to a variety of investors with different portfolio needs. In designing the SPV and its investment tranches, the seller typically works closely with one of three credit rating companies that in exchange for a fee rate the credit risk of each tranche.[19] A 'tranche' is a specified part of the income generated by monthly payments made on loans included in the pool of mortgages. The credit rating agency investigates the credit risk of the underlying mortgages as well as the risks posed from pooling the mortgages together. Credit ratings on each tranche are essential, since they obviate the need for each individual investor to do due diligence on the underlying mortgages in the pool.[20] The rating agency will typically require some form of credit enhancement on some tranches to assign them higher investment ratings.

The seller also arranges to sell the rights to service the loan pool to a company which will correspond with consumers, receive monthly payments, monitor collateral, and when necessary foreclose on homes. Sometimes the originator retains servicing rights, which has the advantage of maintaining a business relationship with homeowners. But often servicing is done by a company specializing in this activity. Increasingly, American pooling and servicing agreements allow for several different servicing companies with different debt collection roles. A master servicer may have management responsibility for the entire loan pool. The master servicer may subcontract to subservicers with a loan type or

[16] K Eggert, 'Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine' (2002) 35 *Creighton Law Review* 503, 538.

[17] Sometimes the loan will be held in an SPV that is a wholly owned subsidiary of the originator or the underwriter while awaiting assignment into an independent SPV that will issue securities. See, eg, S Schwarcz, 'The Alchemy of Asset Securitization' (1994) 1 *Stanford Journal of Law Business and Finance* 133, 142 (describing advantages of 'two tier' securitization conduit structures).

[18] C Hill, 'Securitization: A Low-Cost Sweetener for Lemons' (1996) 74 *Washington University Law Quarterly* 1061, 1067 n 25, 1098 n 162.

[19] The credit rating agencies most actively involved in securitization ratings are Standard and Poor's Ratings Group, Moody's Investors Service, Inc., and Fitch ICBA, Duff & Phelps, Inc. Steven L Schwartz, *Structured Finance: A Guide to the Principals of Asset Securitization*, Adam D Ford ed, 3rd edn (New York, PLI Press, 2002 and Supplement 2007) § 8.9.

[20] Schwarcz, 'The Alchemy of Asset Securitization', above n 17, at 136.

geographic specialty.[21] The pooling and servicing agreement may also allow for a special servicer that focuses exclusively on loans that fall into default or have some other characteristics making repayment unlikely. Some servicing agreements require servicers to purchase subordinated tranches issued from the mortgage pool in order to preserve the incentive to aggressively collect on the loans.[22] Servicing rights also change hands often, in some cases several times a year for the same loan. If, for instance, a servicing company is not meeting collection goals or is charging the trust too much, the trustee may contract with a new servicer. In addition to one or more servicers, many American securitization structures use a document custodian, most frequently a company called Mortgage Electronic Registration System, Inc. (MERS), to record the mortgage with a county recording system and to track ownership and servicing rights for the pool.[23]

In the United States the most important legal question in securitizing home mortgages is whether the SPV acquired bankruptcy remote assets through a 'true sale.' The loans held by an SPV are bankruptcy remote when the insolvency of loan originators cannot affect the legal status of the securitized loans. To induce investment in the SPV's securities, rating agencies and investors must be assured that the insolvency of loan originators—a frequent occurrence in the US[24]—will not cause the SPV's assets to be treated as part of the originator's estate. Otherwise the securities will be unmarketable. A rather complex and evolving jurisprudence has developed in the US on the finer points of when a sale is a 'true sale,' making the assets bankruptcy remote.[25] Bankruptcy judges must weigh the claims of the originator's creditors, sometimes including fraud victims, against the rights of the SPV and its investors.

II. CONSUMER CREDIT SECURITIZATION IN COMPARATIVE PERSPECTIVE

Securitization deals that cross national borders create both legal and monetary challenges for all of the parties involved. Legally, cross-border securitization is now generally governed by the United Nations Commission on International

[21] J Kravitt, *Securitization of Financial Assets* (New York, Aspen Law & Business, 1997) § 16.05[A][6].

[22] A subordinated tranche—sometimes called the 'first loss piece'—is pool security that is designed to absorb losses from default or prepayment before higher priority tranches. Subordinated tranches generally are unrated or receive low ratings by credit rating agencies. R Levine and P Moreo, 'An Investors' Guide to B Pieces' in F Fabozzi (ed), *Trends in Commercial Mortgage-Backed Securities* (Hoboken, John Wiley, 1998) 172, 180.

[23] R Arnold, 'Is There Life on MERS' (July/August 1997) 11 *Property and Probate* 32, 35.

[24] Mary Ann Milbourn, 'O.C. Lenders in Subprime Market Disappearing: Irvine's Option One is Latest Casualty', *Orange County Register* (4 December 2007). <http://www.beaconeconomics.com/people/oress/OCRegister120407.pdf> accessed 9 January 2008.

[25] See generally S Schwarcz, *Structured Finance: A Guide to Asset Securitization* 3rd edn (New York, Practicing Law Institute, 2007) Chapter 4.

Trade Law's Convention on the Assignment of Receivables in International Trade.[26] The goal of the treaty was to promote commerce by increasing the availability of capital through international capital market investment. While a complete account of the treaty is beyond the scope of this Chapter, its core legislative compromise is to defer to the local priority laws of the jurisdiction where the party assigning receivables is located, rather than the jurisdiction of debtors obligated to pay or of investors entitled to receive the obligations in question. While this provision does nothing to clarify the local laws of the assignor's state, it does give the parties some certainty in knowing what laws will apply ahead of time.

Even where choice-of-law provisions are clear, cross-border securitization deals must address the risks posed by fluctuation in the value of currency. This is because investors may be investing in loans or other assets that are payable in the currency of a different country. This makes the investment in asset-backed securities much more speculative because changes in currency exchange rates are so difficult to predict. Without a mechanism for separating currency risk from the credit risk on the assets themselves, a large investment in home mortgage loan securities could be functionally wiped out by macroeconomic changes unrelated to the loans themselves. Securitizers generally address this risk by hedging against currency fluctuation with a 'swap counterparty.'[27] This third party agrees, for a fee, to buy at some point in the future a yet-to-be-determined amount of the currency of the investors' countries. In a typical securitization currency hedge, the parties agree in advance on a set exchange rate for the two currencies involved. Then, on scheduled settlement dates, investors can call on the swap counterparty to deliver enough value to offset any losses incurred due to unfavorable shifts in currency exchange rates.[28] The credit rating of the securities will then depend in part on the credit risk of the swap counterparty. Sometimes the swap counterparty's promise will be enhanced with a third-party guarantee or a cash collateral account held in trust (both of which create additional transaction costs). Of course, it should go without saying that in securities composed of loans payable in highly unstable currencies it may be difficult or impossible to find a swap counterparty willing to absorb the currency risk.

Given these additional hurdles in securitizing assets across international borders, it should not be surprising to find that in many jurisdictions around the

[26] Convention on the Assignment of Receivables in International Trade, reprinted in Resolution 56/81, General Assembly of the United Nations (New York, 12 December 2001), United Nations Document A/RES/56/81 (January 15, 2002). For a more thorough discussion of the UNCITRAL Receivables Convention's treatment of priority and location, see R Broude and B Markell, 'The Priority Provisions of the UNCITRAL Convention on the Assignment of Receivables in International Trade' (2002) 11 *International Insolvency Review* 121.

[27] S Schwarcz, B Markell, and L Broome, *Securitization, Structured Finance, and Capital Markets* (Newark, Lexis/Nexis, 2004) 196.

[28] J Marshall and K Kapner, *The Swaps Market* 32 2nd edn (Miami, Kolb Publishing Co, 1993). The building societies were funded by retail deposits, much as the American savings and loan institutions in the same period.

world purely domestic securitization is more prevalent than cross-border transactions. The remainder of this Part summarizes the business and legal climate for consumer credit, including especially residential mortgage loan securitization, in the United Kingdom, Germany, and Japan.

A. United Kingdom

Along with the United States, the United Kingdom's securitization market is the oldest and most developed in the world. In the 1980s, securitization first allowed competitors to challenge the domination of building societies in the UK real estate mortgage market.[29] With strong political allies, including the Bank of England, regulatory, accounting, and legal hurdles to securitization have been cleared away.[30] The result has been steady growth in both the volume and variety of securitized assets.

As is true elsewhere, in the UK the key legal issue for investors in mortgage-backed securities is whether 'the mortgage . . . [originator] has no recourse to an institution that sells the mortgages on if it runs into problems.'[31] Unlike securitization in the United States, where a true sale is generally recognized as a prerequisite to securitization, some structured finance conduits in the UK rely on the originator of the assets merely granting a security interest to the SPV that later issues securities. This structure has proven especially useful in the securitizations of entire business ventures. Capital markets have accepted this legal form because UK law does not prevent the SPV's seizure of the securitized assets in the event of the originator's insolvency.

Although UK financiers have produced many creative commercial and consumer securitization structures, the vast majority of securitizations in the country have involved residential mortgages, which tend to show similar structural patterns to those in the US. Also similar to the US, the UK has active securitization markets in both prime and subprime home mortgages. While mortgages in many European countries are originated exclusively through bank branches, in the UK intermediary mortgage brokers similar to those in the United States are rapidly gaining market share.[32] These brokers have increasingly used non-standardized underwriting and offered a variety of different repayment terms.[33]

[29] M Pryke and C Whitehead, 'An Overview of Mortgage Backed Securitization in the UK' (1994) 9 *Housing Studies* 101–39; M Pryke and T Freeman, 'Mortgage Backed Securitization in the United Kingdom: The Background' (1994) 5 *Housing Policy Debate* 307, 307–8.

[30] A Bowen, 'Housing and the Macroeconomy in the United Kingdom' (1994) 5 *Housing Policy Debate* 241, 249–50.

[31] *Ibid*, 250.

[32] European countries where mortgages are originated primarily through bank branches include 'Denmark, Germany, Spain, France, Italy, Austria, Poland, and Portugal.' Commission (EC) Mortgage Funding Expert Group, 'Report of the Mortgage Funding Expert Group' 6 (Brussels) 22 December 2006 (hereinafter Mortgage Funding Expert Group).

[33] *Ibid*.