

Reining in on Mortgage Brokers: The Need to Enforce Existing Regulations

NANCY FUNKHOUSER*

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I. INTRODUCTION

“Everybody drank the Kool-Aid,” said David Zugheri, co-founder of Texas-based lender First Houston Mortgage. They knew if they didn’t give the borrower the loan they wanted, the borrower “could go down the street and get that loan somewhere else.”¹

Between 2003–2007, 588 mortgage brokers licensed in Florida had criminal records that should have been an obstacle to obtaining a mortgage broker license.² While such numbers could be brushed aside as just a glitch in conducting background checks, the problem goes deeper. Particularly since Florida law at the time prohibited felons from becoming licensed mortgage brokers; revealing that these brokers should have never been able to obtain licenses in the first place.

Given such, the argument for more regulation in response to the

* Writing & Research Editor of the *University of Miami Law Review*. This note is dedicated to my family, especially my husband. I thank Professor Manning for his guidance and Jarred Leibner for editing.

1. *Liar Loans to Prolong Mortgage Crisis*, ARIZ. CENT., Aug. 18, 2008.
 2. See Rob Barry, Matthew Haggman & Jack Dolan, *Borrowers Betrayed: State Let Crooked Brokers Keep Stealing*, MIAMI HERALD, Aug. 10, 2008, at A1.

subprime crisis is dubious. Instead, the failure to enforce existing laws is the more likely culprit. The Florida laws should have prevented such criminals from obtaining broker licenses in the first place. More importantly, the laws should have established functional enforcement mechanisms to resolve discrepancies between who can hold a license and who actually did. Instead, these and many other weaknesses of the mortgage broker industry went unchecked until the current panic hit.

While many forces and players contributed to the economic crisis, this article focuses exclusively on the regulation of mortgage brokers and the failure to enforce state regulations. The issue is what would be the best legislative response to the mortgage broker's role in the modern market. This article argues for enforcing existing regulations instead of wasting time and resources by enacting more legislation. Mortgage brokers are a recent yet substantial segment of the mortgage market that are best managed by enforcing existing regulations. It first is necessary to define what exactly a mortgage broker is in order to best approach mortgage broker regulation.

The mortgage brokerage industry began in the late 1970s and has since boomed in the past three decades.³ As expanded upon in detail below, a mortgage broker is essentially a conduit between a potential borrower and a lender.⁴ The broker first compiles a borrower's profile by gathering information from the borrower.⁵ Ideally, the broker then performs the legwork for the borrower in gathering and screening potential loans.⁶ A mortgage broker faces two possible levels of regulation. First, a broker's actions may be governed by federal law under certain limited circumstances.⁷ Alternatively and more commonly, state law applies to mortgage brokering.⁸ Before the crisis struck most states

3. See Morris M. Kleiner & Richard M. Todd, *Mortgage Broker Regulations that Matter: Analyzing Earnings, Employment, and Outcomes for Consumers 2* (Nat'l Bureau of Econ. Research Working Paper No. 13684, Dec. 2007) ("[Mortgage brokers'] role in the U.S. mortgage market has mushroomed from insignificant in 1980 to predominant in recent years.").

4. See *id.* at 2.

5. See Raymond H. Brescia, *Capital in Chaos: The Subprime Mortgage Crisis and the Social Capital Response*, 56 CLEV. ST. L. REV. 271, 290 (2008).

6. See *id.*

7. See, e.g., *Watters v. Wachovia*, 550 U.S. 1 (2007) (explaining preemption analysis in this context); see also Florida Financial Services Commission, Emergency Rules 69VER08-1, 69VER08-2, and 69VER08-3 (Aug. 12, 2008) (enacted in response to "The Secure and Fair Enforcement in Mortgage Licensing Act of 2008"). Additionally, federal legislation which could possibly eliminate "yield spread premiums" is currently making its way through Congress. See H.R. 1728. The bill is called the Mortgage Reform and Anti-Predatory Lending Act, an amendment to the Truth in Lending Act, which the House of Representatives has passed but the Senate has not.

8. See, e.g., Michelle Singletary, *Color of Money: 1977 Lending Measure Not to Blame for Crisis*, MIAMI HERALD, Oct. 12, 2008 at E5 ("More than half of subprime loans were made by

already had comprehensive mortgage broker regulations on the books.⁹

Mortgage brokers still exploited the mortgage structure and contributed to the crisis despite such state regulations. Numerous factors contributed to the mortgage crisis making it a “perfect storm.”¹⁰ These factors include brokers facilitating access to mortgage products by previously untapped borrowers, mortgage products innovations that allowed brokers to pass along risk, a broader market of mortgage lenders whose loans brokers could shop, and a sky-rocketing housing market making brokers’ promises of refinancing feasible as long as prices continued ballooning.¹¹

Many players were instrumental in creating the current economic mess. Yet this article focuses exclusively on mortgage brokers’ contribution to the crisis. Part II first examines how the mortgage broker market reached its current dismal state. This is done in the context of defining a mortgage broker, tracking their growth to a position of importance in the market, and exploring the dynamics of how and why their role was solidified. Next, Part III evaluates the pre-crisis legislative responses to the mortgage broker in Arizona, California and Florida—three states notoriously hard-hit by the housing crisis. Part IV of this article finally urges states to enforce existing laws that are adequate in substance instead of imposing new duplicative regulations. Weighing potential criticisms, Part V argues that effective enforcement of existing regulations strikes the necessary balance between the need for immediate action and the long-term management of a significant component of the modern mortgage market.

II. HOW WE GOT HERE

A. Defining a “Mortgage Broker”

Defining a mortgage broker is the critical first step in evaluating the proper regulatory response. The American Bar Association defines a mortgage broker as “[a]n individual or company who brings borrowers and lenders together for the purpose of loaning money. The mortgage broker might also negotiate with the lender to help the borrower get a better deal on the mortgage loan.”¹² While there are both commercial

independent mortgage companies not subject to comprehensive federal supervision”) (citation omitted).

9. See Chris Casacchia, *New Arizona Law Imposes Regulations on Loan Officers*, PHOENIX BUS. J., July 14, 2008, at 1 (“At least 30 other states have loan officer licensing requirements.”).

10. See Brescia, *supra* note 5, at 311.

11. See *id.*

12. ABA Section of Real Property, Trust and Estate Law, *Real Estate FAQs, (VI) Glossary of Commonly Used Terms*, <http://www.abanet.org/rppt/public/realestate/glossary.html>.

and residential mortgage brokers,¹³ this article focuses on the latter.

The concept of a mortgage broker is a recent innovation. In the mid-1970's, savings and loans, commercial banks and mortgage bankers were the predominant originators and holders of single-family mortgages.¹⁴ "In the past, applying for a loan and the pricing of a loan were done primarily at a local bank, often selling only its own products."¹⁵ The shift away from savings and loans to mortgage brokers began in the 1980's.¹⁶ "Interest rate volatility, widespread bank failures and capital market and information technology innovations in the 1980s moved the mortgage industry away from federally regulated banks and savings and loans to more specialized arenas."¹⁷ As a result, mortgage brokers have now come to dominate the loan origination market. The Federal Reserve Bank of Minneapolis estimates two-thirds of mortgage loan transactions in 2006 occurred through third-party mortgage brokers.¹⁸ The originations are also concentrated in a few thousand firms.¹⁹

Additionally, technological advances made it possible for much of the mortgage lending process to be "outsourced" to mortgage brokers.²⁰ Internet sites requiring only borrowers' basic information quickly matched borrowers with brokers,²¹ thus triggering the brokers' roles in the transaction. The sales and underwriting functions of mortgages were therefore bifurcated, thus enabling mortgage brokers to act as independent contractors with respect to multiple lenders.²²

Simply put, "mortgage brokers are intermediaries matching potential mortgage borrowers and lenders and assist them in completing the

13. See Fact Sheet About NAMB and the Mortgage Broker Industry, NAMB, http://www.namb.org/namb/Fact_Sheet.asp?SnID=1247328637.

14. See generally U.S. Department of Housing & Urban Development, Regarding Lender Payments to Mortgage Brokers, available at <http://www.hud.gov/offices/hsg/sfh/res/resp0222.cfm> (last visited Jan. 17, 2009).

15. J. Alex Heroy, *Other People's Money: How a Time-Gap in Credit Reporting May Lead to Fraud*, 12 N.C. BANKING INST. 321, 325 (March 2008) (citation omitted).

16. See generally U.S. Department of Housing & Urban Development, Regarding Lender Payments to Mortgage Brokers, available at <http://www.hud.gov/offices/hsg/sfh/res/resp0222.cfm> (last visited Jan. 17, 2009).

17. Christopher W. Backley et al., *License to Deal: Regulation in the Mortgage Broker Industry*, Fed. Reserve Bank of Minneapolis, July 2006, http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2257.

18. *Id.*

19. Amany El Anshasy et al., *Mortgage Brokers and the Subprime Mortgage Market 1* (May 2004) (unpublished discussion draft, on file with CiteSeer) (citation omitted).

20. Kleiner & Todd, *supra* note 3, at 6.

21. See Alex Veiga, *Sites Conjure Up Mortgage Quotes, Play Up Privacy*, ARIZ. CENT., Aug. 27, 2008 (discussing several web sites that allow potential borrowers to compare various lenders' loans by merely entering basic personal information such as the loan amount, the property value, and the locality in which the property is located).

22. See Kleiner & Todd, *supra* note 3, at 6.

loan origination process.”²³

A detailed application process, financial and credit worthiness investigation, and extensive disclosure requirements must be completed in order for a wholesale lender to evaluate a consumer’s home loan request. The broker simplifies this process for the borrower and the wholesale lender, by conducting this research, counseling consumers on their loan package choices, and enabling them to select the right loan for their home buying needs. The mortgage loan process can be arduous, costly, and seemingly impossible to the consumer. The broker works as the liaison between the borrower and the lender to create a cost effective and efficient loan process.

As an independent contractor, the broker allows wholesaler lenders to cut origination costs by providing such services as preparing the borrower’s loan package, loan application, funding process, and counseling the borrower.²⁴

Mortgage brokers thus should play a pivotal informational role between lenders and borrowers.²⁵ A mortgage broker plays the important role of ultimately identifying mortgage products appropriate for the borrower and counsels them accordingly.²⁶ Assuming mortgage brokers actually do their job in properly gathering and verifying borrower information—a lofty assumption, their role is beneficial to consumers and lenders alike. “By reducing the information asymmetry and confirming that a borrower has the economic resources to repay a credit obligation, mortgage brokers have helped to expand an emerging market that was initially difficult for banks to access.”²⁷ Mortgage brokers thus expand the market of potential loans, aspiring borrowers, and prospective lenders by streamlining an otherwise muddled system.

In this respect, mortgage brokers should make the process more efficient for both borrowers and lenders. They consolidate information for borrowers and provide a convenient way to evaluate available home loans.²⁸ As opposed to traditional one-stop lenders, mortgage brokers are more likely to match borrowers with loans that are specifically tailored

23. Kleiner & Todd, *supra* note 3, at 3.

24. Kleiner & Todd, *supra* note 3, at 5 (citation omitted).

25. See Brescia, *supra* note 5, at 302 (“The mortgage broker therefore sits at a critical juncture in the process and becomes not only a source of information about the process for the prospective borrower, but also ultimately counsels the borrower on what he or she can afford and identifies the mortgage product that, in the broker’s and lender’s opinion, is appropriate for the borrower.”).

26. See *id.*

27. Cassandra Jones Havard, “Goin’ Round in Circles” . . . and Letting the Bad Loans Win: When Subprime Lending Fails Borrowers: The Need for Uniform Broker Regulation, 86 NEB. L. REV. 737, 746–47 (2008).

28. See Kleiner & Todd, *supra* note 3, at 7.

to their requirements due to their access to more types of loans.²⁹ Mortgage broker specialization and economies of scale also can reduce creditors' origination costs.³⁰ "Use of brokers may also enable a creditor to expand or contract mortgage lending more quickly and at a lower cost than would be possible using its own employees and offices."³¹ Consequently, the advent of mortgage brokers was at first welcomed given their ability to make the mortgage market and entire process more efficient.

Despite the potential benefits of mortgage brokers' role, there is also the potential for exploitation. The one-time nature of the transaction itself incentivizes quantity over quality.³² Brokers' mode of compensation reinforces this incentive structure.³³ Typically brokers are compensated each time a mortgage is consummated, regardless of the long-term viability of the underlying mortgage.³⁴ Generally, "[b]rokers earn money through up-front fees, not ongoing loan payments. To make matters worse for homeowners, brokers typically have a direct incentive to hike interest rates higher than warranted by the risk of loans."³⁵ Brokers' compensation structure is discussed in detail below as it directly relates to brokers' rise in the mortgage market. Yet holding all other factors equal, brokers have every incentive to gain lender approval of as many excessively expensive mortgages as possible.³⁶

B. *Three Vehicles Enabling the Rise of the Mortgage Broker*

Just twenty years ago, the mortgage broker market was by and large "insignificant."³⁷ This is no longer the case. The Federal Reserve estimates that mortgage brokers originated 60% of loans in the last several years.³⁸ In 2004, there were approximately fifty-three thousand mort-

29. See Jack Guttentag, Letter to the Editor, *The Choice: Broker or Lender*, L.A. TIMES, Jan. 2, 2005 ("The key difference between brokers and lenders is that brokers offer loan programs from many different lenders. This means that brokers are more likely than a single lender to find a loan that will meet the specialized needs of borrowers.").

30. Amany El Anshasy et al., *supra* note 19, at 1.

31. *Id.* at 3.

32. See Brescia, *supra* note 5, at 303.

33. See *id.* ("A mortgage broker who is compensated each time a mortgage is consummated, and is rarely held accountable-short of being held responsible for outright acts of fraud, particularly for failing to follow disclosure requirements imposed upon brokers-when those borrowers are delinquent, will obviously pursue quantity over quality.").

34. See *id.*

35. *Ending Mortgage Abuse: Safeguarding Homebuyers, Before the S. Comm. on Banking, Housing, and Urban Affairs, Subcomm. on Housing, Transportation and Community Development*, 112th Cong. note 16 (June 26, 2007) (statement of Michael D. Calhoun, Center for Responsible Lending) (citation omitted).

36. See *id.*

37. Kleiner & Todd, *supra* note 3, at 2.

38. See Ted W. Lieu, *What the Fed Isn't Fixing*, L.A. TIMES, July 16, 2008.

gage broker firms in the United States.³⁹ That same year, such firms originated as much as 68% of all mortgages.⁴⁰ With originations totaling \$1.4 trillion dollars in 2004, the mortgage brokerage industry could no longer be considered inconsequential.⁴¹

This article focuses on three driving forces in the rise of the mortgage broker. First, mortgage brokers answered the increased demand for and availability of subprime mortgages. Second, the mortgage market's structure of passing along risk allowed brokers to originate loans whose long-term viability was questionable. Third, soaring housing prices made brokers' refinancing promises feasible. Common to all three forces is the synergism between it and the mortgage broker industry.

1. THE SUBPRIME MORTGAGE MARKET

Subprime mortgages comprise of loans made to high-risk borrowers.⁴² Between 1994–2003 subprime mortgages grew an average of 25% per year.⁴³ Adjustable rate mortgages, as opposed to traditional fixed-rate, are characteristic of subprime markets. Non-traditional mortgages were promoted at the federal level, most infamously by former Federal Reserve Chairman Alan Greenspan.⁴⁴ Also associated with the subprime market are mortgages approved without verifying the borrower's information.⁴⁵ Such mortgages, dubbed "liar loans," are heavily concentrated in Florida, California, Nevada and Arizona.⁴⁶

There is a notable correlation between the number of mortgage brokers and the number of subprime mortgages originated.⁴⁷ In 2006, mortgage brokers originated approximately two-thirds of all subprime mortgages.⁴⁸ An estimated 70% of now delinquent subprime loans were

39. See Kleiner & Todd, *supra* note 3, at 2 (citation omitted).

40. See *id.*

41. See Havard, *supra* note 27, at 744.

42. See Faten Sabry & Thomas Schopflicher, *The Subprime Meltdown: A Primer*, 1633 Practising Law Institute 89, 92 (Sept. 12, 2007) ("A subprime borrower is one who has a high debt-to-income ratio, an impaired or minimal credit history, or other characteristics that are correlated with a high probability of default relative to borrowers with good credit history.").

43. Sue Kirchoff & Sandra Block, *Suprime Loan Market Grows Despite Troubles*, USA TODAY, Dec. 7, 2004, http://www.usatoday.com/money/perfi/housing/2004-12-07-subprime-day-2-usat_x.htm.

44. See Alan Greenspan, Remarks at the Federal Reserve Board, Understanding Household Debt Obligations (Feb. 23, 2004) ("American consumers might benefit if lenders provided greater mortgage product alternatives to the traditional fixed-rate mortgage.").

45. See *Liar Loans to Prolong Mortgage Crisis*, ARIZ. CENT., Aug. 18, 2008 ("[M]ortgages approved without requiring proof of the borrower's income or assets. The worst of them earn the nickname 'ninja loans,' short for 'no income, no job, and (no) assets.'").

46. *Id.*

47. See Kleiner & Todd, *supra* note 3, at 7.

48. See Sabry & Schopflicher, *supra* note 42.

made by mortgage brokers.⁴⁹ Subprime mortgages' share in total originations went from 8.6% in 2001 to a whopping 20.1% by 2006.⁵⁰ Including all non-prime mortgage originations (both subprime and near-prime) increases the latter number up to 40% of all originations.⁵¹ Thus, it is evident why subprime mortgages have become somewhat of a niche market for mortgage brokers, thus perpetuating one another.⁵²

2. THE STRUCTURE OF THE CONTEMPORARY MORTGAGE INDUSTRY

A second driving force in the growth of mortgage brokers is the incentive structure of the modern mortgage market. While the origin and growth of securitization broadly is beyond the scope of this article,⁵³ suffice it to say securitization plays an important and numerically significant function in the mortgage industry.⁵⁴ Broadly, securitization is the process of bundling mortgages sold by lenders into bonds that are then offered to individual and institutional investors.⁵⁵ Securitization allowed originators to pass off a risky loan since the loan would no longer be kept on its own books. This tolerance at the originators' level affected mortgage brokers as well, who sought out borrowers and loans that the next party in the line would not have transacted with absent securitization.

Simply put, modern mortgage financing involves numerous transfers, each without scrutinizing the underlying mortgage.⁵⁶

With the incentive of a quick payday once the mortgage is transferred to another entity for sale as a security, the broker and originator, who

49. See Havard, *supra* note 27, at 742 (citing Georgette C. Poindexter, *Subordinated Rolling Equity: Analyzing Real Estate Loan Default in the Era of Securitization*, 50 EMORY L.J. 519, 525 (2001)).

50. Gary Gorton, *The Subprime Panic* 6, table 4 (Yale Int'l Ctr. for Fin., Working Paper No. 08-25, Sept. 30, 2008) (citation omitted).

51. DANIELLE DiMARTINO & JOHN V. DUCA, *The Rise and Fall of Subprime Mortgages*, Federal Reserve Bank of Dallas Economic Letter—Insights from the Federal Reserve Bank of Dallas, Vol. 2, No. 11 (November 2007), available at <http://www.dallasfed.org/research/eclett/2007/el011.html>.

52. See Kleiner & Todd, *supra* note 3, at 7; see also Susan Block-Lieb & Edward Janger, *Demand-Side Gatekeepers in the Market for Home Loans* (Brooklyn Law Sch. Legal Studies Research Papers, Paper No. 182, 2010) available at <http://ssrn.com/abstract=1548523> (discussing how innovative securities, including subprime mortgages, were issued in part due to the market's demand and the standards for such securities were relaxed on the supply side due to the passing off of risk).

53. See generally Sabry & Schopflocher, *supra* note 42, at 94 (explaining the process of how a mortgage is securitized); Roger Lowenstein, *Long-Term Capital: It's a Short-Term Memory*, N.Y. TIMES, N.Y. Ed., Sept. 7, 2008, at BU1 (discussing risk and derivatives markets).

54. See Gorton, *supra* note 50, at 6 (“[I]n 2005 and 2006 [subprime mortgage] originations were about \$1.2 trillion of which 80 percent was securitized.”).

55. Kirchoff & Block, *supra* note 43.

56. See Havard, *supra* note 27, at 746.

are both now interested in generating the fees associated with the mortgage closing, are driven by a desire to package as many loans as possible . . . The lender no longer has an incentive that is tied to the borrower's interest in long-term sustainability of the mortgage, and the broker is no longer interested in his or her reputation of bringing viable borrowers to the lenders. The subprime market thus created a classic "moral hazard" similar to that created during the Savings & Loan crisis where banks could lend regardless of the risk; with an advantage in information, no accountability and little risk, brokers and originators in the subprime market were able to engage in aggressive rent seeking, leaving borrowers and the holders of securities with no recourse and devalued assets.⁵⁷

The lack of scrutiny of the borrower's information allowed for the growth of the mortgage broker industry by leaving unchecked the role of brokers as conduits of information between lenders and borrowers. This lack of scrutiny was especially troubling because accurately pricing securities and derivatives requires accurate information regarding the underlying asset's "real" value.⁵⁸

Yet brokers no longer had a reason to incur the extra cost of verifying borrower information and accurately ascertaining value since any credit risk was passed on in the series of transfers. While some of the risk is inherent in the mortgage market structure, its risk transfers enabled brokers to exploit its deficiencies and solidify their role in the mortgage industry. Yet this is only one of many factors attributable to mortgage brokers' ascendancy.

3. HOUSING PRICE BUBBLE

If market price can be determined by past performance, all indications were that housing prices should continue their upward trend.⁵⁹ Home value increased over 54% between 2001–2005.⁶⁰

Brokers undoubtedly took into account expected home value appreciation when matching borrowers with potential mortgages, expecting borrowers would be able to refinance after a few years.⁶¹ "The ability of subprime and [other high-risk] borrowers to sustain their mortgage pay-

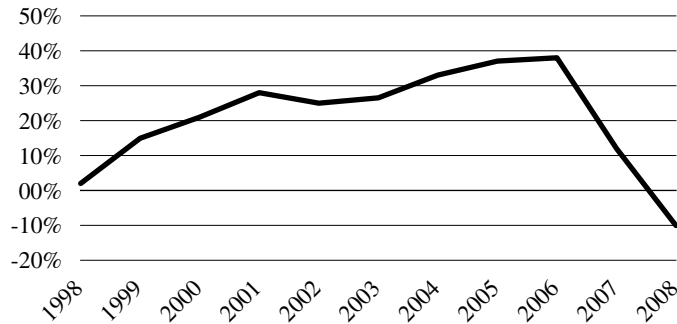
57. Brescia, *supra* note 5, at 297

58. Dorit Samuel, *The Subprime Mortgage Crisis: Will New Regulations Help Avoid Future Financial Debacles?*, 2 ALB. GOV'T L. REV. 217, 249 (2009) ("Given the fact that all derivatives are ultimately dependent upon the "real" value of their underlying assets and are directly subject to the vicissitudes of the market for those real assets, the need for readily available and widespread dissemination of clear information concerning those assets is imperative.")

59. See, e.g., Jim Clayton, *Rational Expectations, Market Fundamentals and Housing Price Volatility*, 24 Real Estate Economics 441 (Winter 1996).

60. See Gorton, *supra* note 50, at 20 (citation omitted).

61. See Gorton, *supra* note 50.



Source: Gary Gorton, *The Panic of 2007*, Yale Sch. of Mgmt. and Nat'l Bureau of Econ. Research, p.51 (Aug. 25, 2008), available at <http://ssrn.com/abstract=1255362> (citation omitted).

ments depends heavily on housing price appreciation because of the need for refinancing.”⁶² During the periods of rapid home price appreciation, mortgagors could also borrow against their equity to make house payments or sell their homes to settle their debts.⁶³

As home prices continued to rise and even after initial “teaser” rates expired and adjustable rate mortgage terms kicked in, existing borrowers were able to refinance mortgages with unfavorable terms due to the increased equity they enjoyed with rising home prices . . . These refinances made more money available to borrowers, and borrowers dipped into their growing equity to pay their mortgage brokers and originators for the ability to refinance, even when these actors may have been the same individuals and companies the borrowers had paid when they assumed the initial underlying mortgage. In this way, the strong market delayed any questions about affordability of the underlying mortgage, or the inequitable nature of its terms, to a day when rising home values could no longer make up for the borrower’s inability to meet the terms of his or her mortgage.⁶⁴

In addition to the housing price boom, the impetus for refinancing also stemmed from deregulation at the federal level. “Congress in 1986 ended the deductibility of consumer debt, such as credit card payments, though still letting filers deduct mortgage interest. The change provided incentives for refinancing.”⁶⁵ Further federal legislation in the 1980s laid the groundwork for the current market. This legislation included the

62. *Id.*

63. DiMartino & Duca, *The Rise and Fall of Subprime Mortgages*, Federal Reserve Bank of Dallas Economic Letter—Insights from the Federal Reserve Bank of Dallas, Vol. 2, No. 11 (Nov. 2007), <http://www.dallasfed.org/research/ecllett/2007/el011.html>.

64. Brescia, *supra* note 5, at 295.

65. Kirchoff & Block, *supra* note 43.

Depository Institutions Deregulation and Monetary Control Act⁶⁶ and the Garn-St. Germain Depository Institutions Act,⁶⁷ both of which broadened the types of investments that banks and institutions, respectively, could make.⁶⁸ Loosening the standards created a larger demand for securitized mortgages and trickled-down to mortgage brokers who in turn reached into new markets of borrowers to satisfy this demand.

Deregulation certainly played a role in getting the mortgage market to this point. While deregulation is a popular culprit in the wake of the crisis, it was certainly not the only force. Instead, other factors such as the assumed stability of the housing market as a whole also played a significant role.

When housing prices took a severe downturn refinancing was no longer an option.⁶⁹ “In 2006, when home prices flattened, interest rates rose, and more onerous loan terms started to kick in for many subprime mortgagors, the subprime crisis began to take its toll”⁷⁰ The first and major domino fell in the housing market and thus triggered a downward spiral. Mortgage brokers and housing prices enjoyed a symbiotic relationship from mutual gains, and when housing took a downturn it was only a matter of time until it reached the mortgage brokers.

C. *Self-Perpetuating Adverse Incentives*

Generally, mortgage brokers are driven primarily by the fees received from consummated mortgages. Brokers are compensated either directly or indirectly.⁷¹ Direct compensation represents a percentage of the loan and is received from the borrower at or before closing.⁷² Indirect compensation, referred to as “back funded payments” or “yield spread premiums,” is received from lenders or wholesalers.⁷³ Indirect compensation is typically either based on the interest rate of each loan entered into or “volume-based.”⁷⁴ “The higher the fees and interest rates a mortgage broker packs into a loan, the greater their compensation.”⁷⁵

66. See 12 U.S.C. § 248(a) (2006).

67. See 12 U.S.C. § 1823(c) (2006).

68. Samuel, *supra* note 58, at 226.

69. See Gorton, *supra* note 50.

70. Brescia, *supra* note 5, at 296.

71. U.S. Department of Housing & Urban Development, Regarding Lender Payments to Mortgage Brokers, available at <http://www.hud.gov/offices/hsg/sfh/res/resp0222.cfm> (last visited Jan. 17, 2009).

72. *Id.*

73. *Id.*

74. *Id.*

75. Jeanette Bradley & Peter Skillern, *Predatory Lending: Subprime Lenders Trick Homeowners Into Expensive Loans*, Ntn’l Hous. Inst., Issue 109, Jan./Feb. 2000, <http://www.nhi.org/online/issues/109/bradley.html>.

Given the transaction-based nature of brokers' fees, their incentive is to create and refinance as many loans as possible.

Brokers' compensation structure therefore emphasizes quantity over quality of mortgages. "[T]he cycles of finance and re-finance . . . meant even more income for the brokers . . . they would collect their fees with each consummated mortgage or refinance agreement. In this way, the interest of the mortgage brokers and originators is to enter into as many mortgages as possible . . ." ⁷⁶ Yet entering into as many loans as possible conflicts with the broker's role as the information gate-keeper, and failing to fulfill that role the market was flooded with mortgage loans of dubious quality.

More specifically, brokers had an incentive to originate the most high-interest loans possible. On a typical five-hundred thousand dollar loan, a broker could make between twenty- to forty-thousand dollars in fees. ⁷⁷ Brokers had a particular motive to place consumers in high-interest riskier loans. ⁷⁸ "The higher the price the broker can induce the borrower to pay, the larger the markup." ⁷⁹ A three-hundred thousand dollar "liar loan" could mean as much as fifteen-thousand dollars in fees to the broker. ⁸⁰ A comparable traditional loan would yield much less, between two- to four-thousand dollars. ⁸¹

It is thus evident how their compensation structure incentivized steering borrowers "to mortgages that provide higher compensation to the broker but are not necessarily the lowest cost or most advantageous to the consumer." ⁸² Further, brokers began to actively market mortgage products to maximize fees realized from unrealistic mortgages and frequent refinancing. ⁸³ In short, this compensation structure both created and fostered brokers' impetus to match borrowers with pricey mortgage products. ⁸⁴

This "quick payday" mentality did not consider the long-term suitability of the mortgage to the borrower. ⁸⁵ "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest

76. Brescia, *supra* note 5, at 296-97.

77. See Gretchen Morgenson, *Was There a Loan It Didn't Like*, N.Y. TIMES, N.Y. Ed., Nov. 2, 2008, at BU1.

78. See Lieu, *supra* note 38.

79. Guttentag *supra* note 29.

80. *Liar Loans to Prolong Mortgage Crisis*, A.Z. CENT., Aug. 18, 2008.

81. See *id.*

82. Kleiner & Todd, *supra* note 3, at 8-9 (citation omitted).

83. See *id.* at 9.

84. See *id.* at 28.

85. Brescia, *supra* note 5, at 297.

rates the market will bear.”⁸⁶ The broker’s profit-maximizing behavior certainly diverges from and may directly conflict with consumers’ interests.⁸⁷ This behavior continued unabated without any meaningful enforcement of regulations prohibiting such conflicts of interest.

The “quick payday” mentality was perpetuated by the asymmetric information between borrower-broker and broker-market. “The chain made valuation opaque; information was lost as risk moved through the chain.”⁸⁸ In this way, brokers could conceal the ill-suitability of many mortgages to the borrower or even that the borrower had no verified income.⁸⁹ Borrowers were not worried as long as housing prices continued to rise.⁹⁰ They had no motivation to verify the accuracy of borrower information when risk was so easily passed along the chain and their compensation was independent of mortgage credibility.

III. WHERE WE ARE: CURRENT REGULATION

For the sake of clarity and simplicity, this article will focus exclusively on current regulatory schemes in Arizona, California and Florida—states that have been infamously hard-hit by the housing crisis.⁹¹ The expectation would be that these states had deficient mortgage broker regulations enabling the housing crisis. However, this article’s examination of these three states’ regulatory frameworks below shows the necessary laws were on the books well before the crisis struck. What was lacking instead was meaningful enforcement of these laws.

A. Regulation in Arizona

A mortgage broker doing business in Arizona, called a “loan officer,” is exempt from Arizona law if the broker does business under another state’s laws.⁹² This exemption may be a disservice to Arizonan borrowers if the other state in which the broker practices does not enforce its own laws. There are three prerequisites to obtaining a license

86. *Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations*, HARV. U., JOINT CENTER FOR HOUSING STUDIES, William Apgar, et al., Policy Paper No. CCC04-1, Mar. 9, 2004, at 4–5, available at http://www.jchs.harvard.edu/whatsnew/new_pubs.html.

87. See Lieu, *supra* note 38.

88. Gorton, *supra* note 50.

89. See Kleiner & Todd, *supra* note 3, at 9.

90. See Brescia, *supra* note 5, at 295.

91. Between 2000–2004, Arizona home prices increased 41% and subprime mortgages grew from 13% of all originated loans to 20%. During the same period in California, home prices ballooned 225% and subprime mortgages went from composing 13% to 22% of mortgages originated. Housing prices in Florida increased 134% during this period; subprime mortgages went from 14% to 23%.

92. ARIZ. REV. STAT. ANN. § 6-902 (1987).

in Arizona.⁹³ First, the State administers a written test.⁹⁴ The test's content is determined by a testing committee appointed by the superintendent.⁹⁵ However, the statute requires testing of a broker's knowledge of basic agency concepts.⁹⁶ Given the superficial nature of the test, it is unlikely to serve as an effective barrier to entry. Second, a course of study must have been completed within the prior three years.⁹⁷ Third, the applicant must have a minimum of three years of experience as a mortgage broker or have five years of equivalent lending experience.⁹⁸ The superintendent may require additional information on the "background, honesty, truthfulness, integrity . . ." of the applicant yet this is not required.⁹⁹ These three basic requirements are easy to satisfy, and even easier to falsify given many states' limited resources.

Once a license has been granted, the broker must post a ten-thousand dollar surety bond before conducting business.¹⁰⁰ In order to receive compensation from a given transaction, a broker must be licensed, "reasonably supervise" the loan originator, and make the proper disclosures.¹⁰¹ Required disclosures include information regarding the borrower's ability to make the loan payments.¹⁰² Again, verifying that these requirements have actually been satisfied would impose an enormous cost on the state. Further, the requirements are easy to meet on a superficial level and so are not meaningful prohibitions on brokers' activities.

Regulations of broker conduct are governed by a superintendent.¹⁰³ Grounds for revoking a broker's license broadly include if the licensee is shown to be not a person of honesty, truth, or good character.¹⁰⁴ However, when revocations occur they are often on a larger firm level rather than on the individual broker level and consequently do not serve as an effective deterrent for the mass of brokers.¹⁰⁵

While this set of regulations was enacted in 1987 and is thus some-

93. See § 6-903(B).

94. See § 6-903(B).

95. See § 6-908.

96. See § 6-908.

97. See § 6-903(B).

98. See § 6-903(B).

99. § 6-903(C).

100. See § 6-903(G)-(H).

101. § 6-909(I)(2), (Q).

102. See § 6-907(A)(3)(b).

103. See § 6-903(C).

104. See § 6-905(A)(2).

105. See *In re* Revocation of the Mortgage Broker License of Lending House Financial Corp. and Doron Jampolsky, No. 09-BD042 (Ariz. Dep't of Financial Institutions, May 14, 2009). This administrative decision is illustrative of enforcement actions against large firms, as opposed to individual brokers.

what outdated, the legislature has taken more recent action. Working with the Federal Bureau of Investigation, in 2008 Arizona instituted “Operation Cash Back” to investigate and prosecute mortgage fraud.¹⁰⁶ One month into the program thirty arrests had already been made in mortgage fraud-related cases in the Phoenix and Tucson areas.¹⁰⁷ However, this investigation appears to be too little, too late. Arizona has also passed a new law regulating individual loan officers. It establishes a criminal background check as a prerequisite to licensing.¹⁰⁸ However, the law was not effective until recently, in January 2010.¹⁰⁹

B. *California Regulation*

The predominant source of mortgage broker regulation in California is the California Residential Mortgage Lending Act.¹¹⁰ Unlike Arizona, California does not exempt from its regulation “loan brokers” doing business in other states.¹¹¹

A real estate broker’s license must be held by anyone who “[s]olicits borrowers or lenders for or negotiates loans or collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property.”¹¹² Since California does not issue “mortgage broker licenses” but instead “real estate broker licenses,” the licensing requirements are not specific to mortgage brokering as is the case in other states.¹¹³ The lack of tailoring regulations to mortgage brokers specifically is a weakness of the California laws, since mortgage brokers encompass a category of their own within the broader real estate market.

Also, a “residential mortgage lender” may act as a broker under its license if the lender enters into a written agreement with the borrower.¹¹⁴ To be a licensed residential mortgage lender, an applicant must complete educational courses required of real estate licensees.¹¹⁵ The fact that a lender may act as a broker with merely the written consent of the borrower evokes the question of whether the borrower is informed in enter-

106. See Chris Casacchia, *New Arizona Law Imposes Regulations on Loan Officers*, PHOENIX BUS. J., July 14, 2008, at A11.

107. See *id.* (citation omitted).

108. See *id.*

109. See *id.*

110. See CAL. FIN. CODE § 50000, et seq. (1994).

111. CAL. FIN. CODE § 50003 (1994).

112. CAL. BUS. & PROF. CODE § 10131(d) (1999).

113. Cal. Dep’t of Real Estate Mortgage Lending Section, *Frequently Asked Questions: Mortgage Loan Brokering in California*, March 2007, pg 1.

114. CAL. FIN. CODE § 50701(a) (1994).

115. See CAL. FIN. CODE §§ 50700(c), 50705 (1994).

ing into this agreement, thus negating the purpose of the writing requirement to begin with.

The California Department of Real Estate indicates mortgage brokers must disclose in writing to both borrowers and lenders all fees received in connection with brokering a loan, including rebates or premiums.¹¹⁶ The requisite disclosure statement must include the estimated costs to be paid by the borrower, the loan brokerage commission, terms of the loan and maturity date of the loan.¹¹⁷ These requirements can easily be satisfied as long as the numbers are buried somewhere within the pile of pages, but ensuring the borrower has actually been disclosed this information is the regulation's aim. Most significantly, California imposes a fiduciary duty on mortgage brokers.¹¹⁸ Yet meaningful enforcement of that duty requires more than words on paper.

Even though California legislation is more contemporary than its Arizona counterpart, the former has also recently acted in response to the crisis. As of September 2008 there were approximately thirty-five thousand mortgage brokers in California. State legislators recently proposed a bill that would have prohibited "mortgage steering, in which borrowers who qualify for lower-interest mortgages are persuaded to take higher-cost and higher-risk loans."¹¹⁹ Yet California Governor Arnold Schwarzenegger vetoed the bill, reasoning it would have put state brokers at a competitive disadvantage and would thus only induce brokers to find ways to bypass the regulation instead.¹²⁰ The bill would have really only prohibited one type of fiduciary duty breach and would have thus been repetitive in that California courts have expressly found mortgage brokers owe a fiduciary duty to borrowers.¹²¹

California has also recently enacted ten mortgage-related bills.¹²² Among other things, these bills "require brokers to disclose their license number upon first contact with customers, allow regulators to suspend a real estate license for violations of state law and establish a state mort-

116. See Letter to Mr. Chris Salazar, President of California Association of Mortgage Brokers (Aug. 1, 1991) (on file with Cal. Dep't of Real Estate).

117. See CAL. BUS. & PROF. CODE § 10241 (1989); see also Dennis L. Greenwald & Michael Asimow, *Cal. Prac. Guide: Real Prop. Trans., Ch. 6-D Mortgage Loan Brokers and Mortgage Loan Broker Agreements* (2008).

118. See *Wyatt v. Union Mortgage Co.*, 24 F.3d 773, 782 (3d Cir. 1979); see also Letter to Mr. Chris Salazar, President of California Association of Mortgage Brokers (Aug. 1, 1991) (on file with Cal. Dep't of Real Estate).

119. Marc Lifsher, *Schwarzenegger Vetoes Bill Increasing Oversight of Mortgage Brokers*, L.A. TIMES, Sept. 26, 2008, at C3.

120. See *id.*

121. See *supra* note 118.

122. See Michael Shaw, *Schwarzenegger Signs California Mortgage Bill*, S.F. BUS. TIMES, July 8, 2008, <http://www.bizjournals.com/eastbay/stories/2008/07/07/daily34.html>.

gage refinancing program.”¹²³ While these recent laws are all well-intentioned, their efficacy is only evident when enforced.

C. Florida Regulatory Scheme

“Florida has the most statutory provisions regulating mortgage brokers.”¹²⁴ The Florida Financial Services Commission, Office of Financial Regulation, Division of Finance rules supplement the statutory provisions.

The three statutory prerequisites to obtaining a mortgage broker license are payment of an application fee, fingerprinting, and no prior invalidating criminal history.¹²⁵ The commission has the authority to require additional information from any applicant.¹²⁶ A license application will be denied if the applicant has committed an enumerated violation¹²⁷ or has a pending criminal prosecution or administrative enforcement action involving fraud, dishonest dealing, or other acts of moral turpitude.¹²⁸

On their faces, these regulations impose sufficient obstacles to obtaining a license for those of questionable backgrounds. Yet, as stated above,¹²⁹ hundreds of licensed brokers in Florida should have been denied licenses due to their criminal histories. So the solution to the current crisis is *not* enacting duplicative regulations. Instead, the regulations already on the books need to be *actually* enforced.

Also, the commission has authority to promulgate rules regarding license renewal.¹³⁰ During the two-year period immediately preceding the renewal deadline, mortgage brokers must successfully complete at least fourteen hours of professional continuing education.¹³¹ The content of such education must cover primary and subordinate mortgage financing transactions and applicable statutory provisions.¹³²

Licensed mortgage brokers are prohibited from simultaneously associating with more than one licensed mortgage brokerage business, licensed mortgage lender, or licenses correspondent mortgage lender.¹³³

123. Lifsher, *supra* note 119.

124. Kleiner & Todd, *supra* note 3, at 20.

125. See FLA. STAT. § 494.0031 (2006).

126. See § 494.0033(2)(d) (such additional information may include the applicant’s “full name and any other names by which he or she may have been known, age, social security number, qualifications and educational and business history, and disciplinary and criminal history”).

127. See §§ 494.001–494.0077.

128. See § 494.0033.

129. See *supra* note 2.

130. See § 494.0032.

131. See § 494.00295(1).

132. See § 494.00295(1).

133. See § 494.00331.

The Office of Financial Regulation “may conduct an investigation . . . whenever [it] has reason to believe, either upon complaint or otherwise, that any violation . . . has been committed or is about to be committed.”¹³⁴ Complaints may be filed and their status monitored electronically via the Office’s website.¹³⁵ While the investigations can be effective deterrents to broker misconduct, it is dubious whether the state has the resources to carry out thorough and sweeping investigations if the state lacks the resources to first verify the satisfaction of license requirements.

Florida law also prohibits mortgage brokers from employing any device or scheme to defraud,¹³⁶ to engage in a transaction or course of business in connection with a mortgage loan purchase or sale that operates as fraud,¹³⁷ or to obtain property by fraud or willful misrepresentation.¹³⁸ Brokers are further proscribed from knowingly and willfully concealing or falsifying a material fact, making any false statement, and knowingly using any false document.¹³⁹ Broadly, brokers may not extend credit “without regard to the payment ability of the borrower.”¹⁴⁰ Disciplinary action may be taken when a broker employs “[f]raud, misrepresentation, deceit, negligence, or incompetence, in any mortgage financing transaction.”¹⁴¹ Again, while these regulations establish a sufficient floor on broker conduct, what is necessary is their effective enforcement.

Florida laws also mandate certain disclosures mortgage brokers must make. The disclosures relate mostly to fees the broker receives from the transaction.¹⁴² When making loans to non-institutional investors, brokers are subject to heightened disclosure requirements, including disclosure of any broker-appraiser relationship.¹⁴³ The disclosures must be in writing and presented when the loan is offered and anytime the terms of the adjustable rate mortgage loan materially change before closing.¹⁴⁴ The Florida Fair Lending Act also imposes additional disclosure obligations.¹⁴⁵ The only relevant in this context is disclosure con-

134. § 494.0012.

135. See REAL Online Services Guide: File a Finance Complaint, <http://www.flofr.com/REAL/Forms/FileComplaint.pdf> (last visited Mar. 8, 2010).

136. See § 494.0025(4)(a).

137. See § 494.0025(4)(b).

138. See § 494.0025(4)(c).

139. See § 494.0025(5).

140. § 494.00791(6).

141. § 494.0041(2)(b).

142. See § 494.0038.

143. See § 494.0043.

144. See § 494.0038.

145. See § 494.0078.

tent and timing changes for high-cost home loans.¹⁴⁶

While Florida has the most comprehensive regulatory scheme of all states, it also recently adopted new legislation in response to the current crisis. The most salient of such efforts has been the Florida Emergency Rule mirroring the federal Secure and Fair Enforcement in Mortgage Licensing Act of 2008.¹⁴⁷ The legislation adopts stricter licensing standards when the applicant has a criminal background. Such legislation was necessary in Florida, the state with the nation's highest mortgage fraud rate.¹⁴⁸ Florida's administrative bodies are also undergoing internal change, as the former Financial Regulation Commissioner resigned in September 2008.¹⁴⁹

Similarly to the regulations in Arizona and California, it is apparent that all the states' regulations impose sufficient standards regarding broker licensing, conduct, and discipline. However, as will be discussed, the regulations are rendered meaningless if they are not enforced.¹⁵⁰

IV. WHY ENFORCEMENT OF EXISTING REGULATIONS IS NECESSARY

A. *What Went Wrong*

First and foremost, the housing bubble burst.¹⁵¹ "The current crisis has its roots in housing, a mainstay of the economy, and with the bubble's bursting the damage has been enduring and severe."¹⁵² When housing prices fell, refinancing was no longer an option and credit became tight. As a result, foreclosures and delinquencies spread like wildfire.¹⁵³ State housing markets and mortgage defaults proved more closely correlated than originally thought.¹⁵⁴ While most of the wrong had been done by then, the burst exposed mortgage broker activities that had gone unnoticed during the boom.

When the first signs of the impending crisis manifested, mortgage market insiders' response worsened the inevitable.¹⁵⁵ Some of the underlying bad actions by brokers may have resulted simply from incomplete

146. See § 494.00792.

147. See Florida Financial Services Commission, Emergency Rules 69VER08-1, 69VER08-2, and 69VER08-3 (Aug. 12, 2008).

148. See Bill Kaczor, *State Let Ex-Cons Do Mortgages, New Report Says*, HERALD TRIBUNE, Sept. 17, 2008, at 7B.

149. See *id.*

150. See *infra* Part IV.A–B.

151. See *supra* text accompanying notes 59–64.

152. Lowenstein, *supra* note 53.

153. See James R. Hagerty, *Foreclosures, Overdue Mortgages Increase Again*, WALL ST. J., Sept. 6, 2008, at A3.

154. See Lowenstein, *supra* note 53.

155. See Samuel, *supra* note 58, at 258 ("The problem was then amplified by unqualified and unlicensed mortgage brokers, who either did not fully understand or had no misgivings about

information given to borrowers—less than full disclosure of loan terms, for instance.¹⁵⁶ However, as the examples below demonstrate, other broker actions were more akin to intentional fraud.¹⁵⁷

One example occurred in Los Angeles where a mortgage broker stole identities to buy homes and also cut up documents and pasted them onto other documents.¹⁵⁸ Brokers in neighboring states were not much better. Described as the “Bonnie and Clyde” of mortgage fraud, one Nevada couple allegedly stole \$8.7 million in straw buyers mortgages—mortgages in which there were no buyers in reality.¹⁵⁹ In another example brokers attempted to bribe loan processors to approve loans.¹⁶⁰ Such bribery includes one broker who allegedly flat-out offered to pay for a Washington Mutual processor’s son to go to football summer camp.¹⁶¹ The processor rejected the offer, but was disciplined by her bosses for investigating the veracity of borrower and home information for that broker’s loan.¹⁶² While a complaint has since been filed bringing brokers’ and lenders’ bad actions to light in that Washington Mutual example, there were probably thousands more similar schemes going on throughout the nation.¹⁶³ Such mortgage fraud has and will continue to impose enormous costs on the market.¹⁶⁴ Yet as the bubble burst, brokers rushed into a panic trying to reap the last few riches on the fall down.

B. *Why More Regulation is Not the Answer*

The current crisis is an opportunity to revamp the regulatory approach to an industry that represents a significant role in both the housing market and the U.S. economy. However, the numerous calls to

leading people into mortgage products without fully disclosing the potential risk associated with these products.”).

156. See *Liar Loans to Prolong Mortgage Crisis*, A.Z. CENT., Aug. 18, 2008 (“[Borrower] was attracted by the low monthly payments, but says the mortgage broker who signed him up for the loan didn’t tell him the principal balance could increase. It has risen about \$24,000 to \$276,000.”).

157. See, e.g., Bradley & Skillern, *supra* note 75 (“The broker had added \$6,500 in fees to [borrower’s] loan, and changed the loan from a fixed-rate to a more expensive adjustable-rate mortgage.”).

158. See Rocco Parascandola, *Mortgage Broker Pleads Guilty to Scheme*, *Newsday*, July 1, 2008, available at <http://www.newsday.com/news/new-york/mortgage-broker-pleads-guilty-to-scheme-1.882859?qr=1> (last visited Mar. 10, 2010).

159. Martha Neil, “Bonnie and Clyde” of Mortgage Fraud Stole \$8.7M, *Feds Say*, A.B.A. J. REAL EST. & PROP. L., at 1 (Oct. 30, 2008).

160. See Morgenson, *supra* note 77.

161. See *id.*

162. See *id.*

163. See *In re Washington Mutual, Inc.*, No. 07-1809 (W.D. Wash., Aug. 5, 2008).

164. J. Alex Heroy, *supra* note 15, at 325 (“Mortgage fraud perpetrated in 2006 has been estimated to cost anywhere between almost one billion dollars and \$4.2 billion, and the numbers are rising each year.”).

arms from a wide array of media, political, and citizen groups must be cautiously considered.

One of the most popular measures being espoused is creating an express fiduciary duty.¹⁶⁵ The rationale behind the existence of a fiduciary duty—two parties in which one relies on and trusts the other—clearly applies here. Specifically, there is a relationship of trust between borrower-broker and even lender-broker. The borrower trusts the broker to be its intermediary with the lender and to represent its best interests, and the broker is authorized as the borrower's agent to carry out that representation. However, the process of drafting, voting into law, and implementing such legislation would be futile and a waste of legislative resources at this stage of the crisis. Additionally, if the basic standards of broker conduct espoused in current legislation were not enforced then, there is no assurance that establishing a fiduciary duty by legislation would be any more effective. Certainly the legislation could give private plaintiffs an express cause of action, but borrower-plaintiffs suing under contractual breaches already have convincing grounds to argue for a court to impose an implied fiduciary duty.

Further, such regulation would be duplicative in at least several jurisdictions. Some states, including California, have already expressly imposed such a duty.¹⁶⁶ As alluded to above, even states that have not made an express finding would be hard-pressed to not implicitly find this duty given the current panic and likely impending litigation.

A better alternative is to actually investigate and penalize bad behavior.¹⁶⁷ This would not only partially remedy past wrongdoing, but would create an incentive for brokers to voluntarily assume this fiduciary duty as being in their best interest.¹⁶⁸ Instead of expending judicial and legislative resources to pass a law imposing a fiduciary duty, enforcement agencies should thoroughly pursue wrongdoing. "Rather, we must create an environment that will promote full disclosure to all market participants that in turn will lead to serious monitoring of financial institutions, rating agencies, and related entities, resulting in severe discipline for non-compliant behavior."¹⁶⁹ The threat of enforcement should be a significant risk to brokers such that the benefits of compliance with the law would exceed the potential costs of non-compliance.

165. See, e.g., Havard, *supra* note 27, at 742.

166. See *Wyatt v. Union Mortgage Co.*, 24 F.3d 773, 782 (3d Cir. 1979); see also Letter to Mr. Chris Salazar, President of California Association of Mortgage Brokers (Aug. 1, 1991) (on file with Cal. Dep't of Real Estate).

167. See Samuel, *supra* note 58, at 257 ("Optimally, any such scheme must provide for vigorous and meaningful penalties for non-compliance.").

168. See Brescia, *supra* note 5, at 304-06.

169. Samuel, *supra* note 58, at 256.

Another widely advocated measure involves increasing mortgage broker license requirements. One way of doing this would be to regulate who is eligible to obtain licenses. Federal legislation prohibiting tiers of criminal offenders from obtaining broker licenses is aimed toward this goal yet is also duplicative of state legislation.¹⁷⁰ Since the federal law has already been passed, criticizing the necessity for such regulations is a moot point.

An additional licensing alternative would be to increase bond posting requirements. However, one study has found bond posting requirements actually do more harm than good.¹⁷¹ The study noted how “state licensing of mortgage brokers increased at both the extensive (more states) and intensive (more restrictions per state) margins between 1996 and 2006.”¹⁷² This was oddly the prime period in which the crisis developed. Therefore, increasing bond requirements by state legislation obviously was not effective during the ten-year period that was the foundation for the current crisis, so its efficacy after-the-fact is improbable.

Notwithstanding this, “a surge in mortgage foreclosures has provided political momentum for the enactment of further regulation.”¹⁷³ While the public impetus is there, the aforementioned study found increasing licensing requirements is unlikely to improve consumer outcomes and may even decrease competition, increase foreclosure rates, and result in a higher percentage of high-interest rate mortgages.¹⁷⁴ Therefore, enacting that type of legislation is not likely to yield the best outcome for the outraged public.

Instead of imposing duplicative regulations that could actually be inimical to consumer interests, states should more vigorously enforce regulations that are already on the books. Additional regulations may impede the recovery process by limiting the financial market’s reemergence potential.¹⁷⁵ Further, more regulations may do more harm to the U.S. mortgage market than good.¹⁷⁶ “[T]he US system of financial regulation has been built up over the years into a staggering skyscraper

170. See Casacchia, *supra* note 106; see also Florida Financial Services Commission, Emergency Rules 69VER08-1, 69VER08-2, and 69VER08-3 (Aug. 12, 2008).

171. See Kleiner & Todd, *supra* note 3.

172. *Id.*, *supra* note 3, at 3 (citation omitted).

173. *Id.*

174. *Id.*, *supra* note 3, at 3-4 (citation omitted).

175. See Samuel, *supra* note 58, at 256 (“A heavily regulated market might have lower volatility, but it is also more cumbersome and slow in developing new and creative financial products that stimulate growth.”).

176. Gerard Baker, *More Regulation Will Harm, Not Help, Recovery*, THE TIMES, Sept. 19, 2008, http://www.timesonline.co.uk/tol/comment/columnists/gerard_baker/article4782481.ece (discussing United States mortgage market in addition to global perspective).

of rules and institutions that induce a sort of governing paralysis. The regulatory framework is not too small.”¹⁷⁷ As discussed above,¹⁷⁸ legislation at the state level is on its face adequate yet actual enforcement is not.

In addition to being potentially duplicative, such regulations may impose costs on mortgage transactions exceeding any potential benefits. “[W]e cannot ignore the fact that regulation can impair the efficient functioning of our financial systems by making transactions more cumbersome and costly and indeed may even produce direct financial harm.”¹⁷⁹ Therefore, more regulation may impose both immediate and long-term costs on financial markets and states whose budgets are already pinched.

Instead, wronged consumers need more involvement in the process than merely submitting a complaint online and tracking the complaint’s progress through administrative red-tape.¹⁸⁰ They should be able to access more information about the broker *ex ante* and have meaningful redress *ex post*. By enforcing regulations, including regulatory investigations thereunder, consumers can verify remedial actions are being taken and should be given a voice in the investigatory process.

Administrative bodies must also act more rapidly to detect and redress fraud. In one example, the investigation of a Coral Gables lender was initiated five months after the lender’s default rate exceeded twice the national average.¹⁸¹ By the time action was taken, its default rate had reached thirteen times the national average.¹⁸² The inaction on the part of the state permits fraud to be continued. Instead, once a consumer files a complaint, either the mortgage broker’s license should be put on hold or there should be a notation made in a public record indicating the pending complaint.

Given the summary of existing laws in three of the nation’s hardest-hit states, it is clear the statutory standards give enough power to even administrative bodies to investigate suspicious conduct. Consumer complaints should be promptly and seriously investigated, and officials should not wait for the crisis to reach its zenith before taking action.

What is clear from similar past crises is quick-fixes are not the

177. *Id.*

178. *See supra* text accompanying notes 91–148.

179. Samuel, *supra* note 58, at 221–22.

180. *See, e.g.*, REAL Online Services Guide: File a Finance Complaint, <http://www.flofr.com/REAL/Forms/FileComplaint.pdf> (last visited Mar. 8, 2010).

181. *See* Barry Meier, *As F.H.A.’s Role Grows, So Does the Risk of Fraud*, N.Y. TIMES, N.Y. Ed., Dec. 10, 2008, at B1.

182. *See id.*

answer.¹⁸³ As stated, increasing occupational regulation has been shown to and may actually reduce the quality of an occupation's output.¹⁸⁴ The current regulations on the books in California, Arizona, and Florida set a viable long-term standard for the industry. Actually implementing and enforcing these laws is necessary to reach a lasting resolution.

V. ENFORCEMENT AS A SOLUTION: IMPLICATIONS AND POTENTIAL CRITICISMS

While perhaps unpopular in the wake of a crisis often attributed to deregulation, this position strikes a necessary balance between regulating an industry, doing so efficiently and effectively, and allowing occupations to engage in monitored self-policing.¹⁸⁵ This position keeps the task of regulating mortgage brokers still in regulators' hands while recognizing that this is probably best carried out at the state level. Retaining local control over mortgage brokers increases the likelihood of actual enforcement since state regulators are best-equipped to investigate and monitor local brokers' activities.

Additionally, this position advocates efficiently managing the legislative process. Having a cornucopia of regulations does not necessarily ensure better results; Florida is an example of this.¹⁸⁶ This article carefully evaluates the knee-jerk response to crises calling for government intervention and increased regulation.

In short, history demonstrates that the cycle of financial crisis followed by regulation, followed by new financial crisis, followed by new regulation, has continued unabated. . . . What becomes clear is the limited utility in the future of a pattern of new regulations aimed at protecting us after the fact from the most recent crash, without the ability to predict and protect us from possible future financial crashes.¹⁸⁷

In place of the widely-advocated immediate response for increased regulation, this article urges states to actually enforce existing regulations to create the proper incentive structure whereby brokers will police themselves.¹⁸⁸

183. See Lowenstein, *supra* note 53.

184. See Kleiner & Todd, *supra* note 3, at 27.

185. See generally Samuel, *supra* note 58, at 229 ("The difficult task is to find ways to let the financial markets blossom with these kinds of initiatives and innovations without the dampening effect of cumbersome, costly, complicated, and time-consuming regulations, while also protecting the public and investors from the abuses and predatory conduct that appear in the wake of market success.").

186. See Kleiner & Todd, *supra* note 3, at 20 (citation omitted).

187. Samuel, *supra* note 58, at 228.

188. See Brescia, *supra* note 5, at 304, 306.

VI. CONCLUSION

The current economic crisis evidences the need for change in many respects, significantly to this article in the context of mortgage broker regulation. The increased origination of subprime mortgages, the structure of the contemporary mortgage industry and its risk transfers, and the housing bubble all enabled to the mortgage broker's rise. Self-perpetuating adverse incentives due to the mortgage broker compensation structure further solidified their position in the market. State regulations in Arizona, California and Florida are illustrative states that had already imposed adequate regulations by the time the crisis struck. Thus, this article asserts that what was probably lacking instead was enforcement of these laws.

While states could simply enact more legislation, the only potentially positive effect of this would be a temporary boost in approval ratings by appeasing public opinion. Instead, ensuring that mechanisms are in place so that regulators are equipped to deal with the next crisis requires enforcement of existing regulations. This is a long-term solution to a fundamental problem that has developed over the past thirty years.

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