

‘Predatory Lending, the Financial Crisis and White Collar Crime – the Perfect Storm’

Dr. Nicholas Ryder (Professor in Financial Crime) and Kerry Broomfield (Doctoral Candidate)

Department of Law

Faculty of Business and Law

University of the West of England

Bristol

BS16 1QY

Introduction

The objective of this article is to review the relationship between white collar crime, in particular fraud, and predatory lending. The article critically considers whether fraud and predatory lending can be classified as a ‘related factor’ that contributed towards the most recent or first financial crisis of the new millennium. Furthermore, the article critically assesses the impact that the financial crisis has had on these practices, and considers whether white collar crime has prospered in this economic environment. The aim of this article is not to provide an exhausted list of contributing factors of the financial crisis, which are well documented elsewhere, but to provide insight to long standing problems of white collar crime and predatory lending. The practices of many United States (US) and indeed global lending institutions were setting up the financial system for an inevitable crash,¹ in the search for increased profit these institutions provided subprime mortgages with excessive to low income families.

What is white collar crime?

White collar crime is synonymous with Professor Edwin Sutherland,² who used the term in his presidential lecture to the American Sociological Society in 1939.³ He defined ‘white collar crime’ as “a crime committed by a person of respectability and high social status in the course of his occupation”.⁴ In his seminal paper, Sutherland stated that:

“The present-day white-collar criminals, who are more suave and deceptive than the ‘robber barons’, are represented ... [by] many other merchant princes and captains of

¹ Hill, J. ‘Bailouts and credit cycles: Fannie, Freddie, and the farm credit system’ (2010) Wis. L. Rev. 1

² Green, S. ‘The concept of white collar crime in law and legal theory’ (2004) Buffalo Criminal Law Review, 8, 1–34, at 3.

³ See Sutherland, E. (1940) ‘The white collar criminal’, American Sociological Review, 5(1), 1–12, at 1.

⁴ Sutherland, E. *White collar crime* (Dryden: New York, 1949) 9.

finance and industry, and by a host of lesser followers. Their criminality has been demonstrated again and again in the investigations of land offices, railways, insurance, munitions, banking, public utilities, stock exchanges, the oil industry, real estate, reorganization committees, receiverships, bankruptcies, and politics”.⁵

The most significant part Sutherland’s definition is that white collar crime is committed by people of *a high social standing*, a view supported by Benson and Simpson, who stated that “criminal behaviour by members of the privileged socioeconomic class is labelled white-collar crime”.⁶ White collar crime has also been correctly described as a very “wide concept that speaks generally to illegal behaviour that takes advantage of positions of professional authority and power – or simply the opportunity structures available within business – for personal or corporate gain”.⁷ Friedrichs, supporting Sutherland’s definition added that crimes are “committed on behalf of major financially privileged statuses, including violations of banking Acts, bribery, fraud, tax evasion, money laundering, insider trading, predatory lending, and other deceptive practices”.⁸ However, Green suggested that the interpretation of white collar crime is “deeply contested” and “vague and inconsistent”.⁹ Furthermore, Bookman argued that Sutherland’s definition of white collar crime was too narrow.¹⁰ This was a view supported by Leong, who noted that:

⁵ Sutherland above, n 2 at 2.

⁶ Benson, M. L. and Simpson, S. S. *White-collar crime: an opportunity perspective*, Criminology and Justice Series (Routledge: New York, 2009), as cited in Gottschalk, P. ‘Gender and white-collar crime: only four percent female criminals’ (2012) *Journal of Money Laundering Control*, 15(3), 362–373, at 362.

⁷ Kempa, M. ‘Combating white-collar crime in Canada: serving victim needs and market integrity’ (2010) *Journal of Financial Crime*, 17(2), 251–264, at 252.

⁸ Friedrichs, D. *Trusted criminals: white collar crime in contemporary society* (Wadsworth Cengage Learning: Belmont, 2010) at 190.

⁹ Green above, n 2 at 3. For a more detailed discussion of the problems associated with the definition of white collar crime see Gilligan, G. ‘The problem of, and with, financial crime’ (2012) *Northern Ireland Legal Quarterly*, 63(4), 495–508.

¹⁰ Bookman, Z. ‘Convergences and omissions in reporting corporate and white collar crime’ (2008) *DePaul Business and Commercial Law Journal*, 6, 347–392, at 355.

“the definition of white-collar crime is criticised for being too narrow as it does not include the differential associations between the ‘upperworld’ of corporations and the ‘underworld’ of criminal organisations. At the same time, it is criticised for being too broad as an all-encompassing category. In fact, the distinction between organised crime or ‘business in crime’ and the activities of white-collar offenders blurs, and organised crime often uses and abuses legitimate corporate enterprises”.¹¹

Further criticism was offered by Podgor, who stated that ‘the bottom line is that throughout the last 100 years no one could ever figure it [white collar crime] out’.¹² Brody and Kiehl correctly asserted that the most significant limitation of Sutherland’s definition is that it has not endured the progress and advancement of white collar crime to retain its status as the conventional definition. They concluded that ‘many scholars continue to redefine and develop a more useful and working definition of the term’.¹³ White collar crime has also been referred to as ‘financial crime’, ‘economic crime’ and ‘illicit finance’.¹⁴

In the United Kingdom (UK) financial crime was is defined as ‘any offence involving fraud or dishonesty; misconduct in, or misuse of information relating to, a financial market; or handling the proceeds of crime’.¹⁵ Fleming noted that this definition “relates to a broad and potentially indistinct range of offences”.¹⁶ Similarly, the Federal Bureau of Investigation (FBI) provided a broad definition, which includes corporate fraud, commodities and

¹¹ Leong, A. ‘Definitional analysis: the war on terror and organised crime’ (2004) *Journal of Money Laundering Control*, 8(1), 19–36, at 22.

¹² Podgor, E. ‘White collar crime: a letter from the future’ (2007) *Ohio State Journal of Criminal Law*, 5, 247–255, at 247.

¹³ Brody, R. and Kiehl, K. ‘From white-collar crime to red-collar crime’ (2010) *Journal of Financial Crime*, 17(3), 351–364, at 351.

¹⁴ For a general discussion of these different types of white collar crime see Harrison, K. and Ryder, N. *The law relating to financial crime in the United Kingdom* (Ashgate: Farnham, 2013).

¹⁵ Financial Services and Markets Act 2000, s. 6(3). Friedrichs defined ‘financial crime’ as ‘large-scale illegality that occurs in the world of finance and financial institutions’. See Friedrichs above, n 8, at 9.

¹⁶ Fleming, M. *FSA’s Scale & Impact of Financial Crime project (phase one): Critical Analysis Occasional Paper Series 37* (Financial Services Authority: London, 2009) at 2.

securities fraud, mortgage fraud, healthcare fraud, financial institution fraud, insurance fraud, mass marketing fraud and money laundering.¹⁷ Definitions of the term ‘financial crime’ have also been presented by academics. For example, Gottschalk states that it is ‘a crime against property, involving the unlawful conversion of property belonging to another to one’s own personal use and benefit’, stating that it is often ‘profit driven . . . to gain access to and control over property that belonged to someone else’.¹⁸

The Financial Crisis and White Collar Crime

One of the most important questions that has been answered by many commentators since the outbreak of the 2007 financial crisis is what variables contributed or caused the largest financial crisis since the Great Depression and Wall Street Crash? The Financial Services Authority (FSA) determined that there were six factors that contributed to the financial crisis. This included for example, macroeconomic imbalances increasing complexity of the securitised credit model; rapid extension of credit and falling credit standards; property price booms; increasing leverage in the banking and shadow banking system; underestimation of bank and market liquidity risk, and a self-reinforcing cycle of irrational exuberance.¹⁹ Furthermore, the Department of Treasury stated that key factors included a breakdown in underwriting standards for subprime mortgages; a significant erosion of market discipline; flaws in Credit Rating Agencies (CRAs); risk management weaknesses at some large US and European financial institutions; and ineffective regulatory policies.²⁰ Other well documented

¹⁷ Federal Bureau of Investigation ‘Financial crimes report to the public’, available from <http://www.fbi.gov/stats-services/publications/financial-crimes-report-2010-2011/financial-crimes-report-2010-2011#Financial>, accessed 21 February 2014.

¹⁸ Gottschalk, P. ‘Categories of financial crime’ (2010) *Journal of Financial Crime* 17(4), 441–458, at 441.

¹⁹ *Ibid.*, at 7–12.

²⁰ Department of Treasury ‘President’s Working Group on Financial Markets, policy statement on financial markets developments’, 13 March 2008, available from http://www.treasury.gov/resource-center/fin-mkts/Documents/pwgpolicystatemktturmoil_03122008.pdf, accessed 14 February 2014.

factors include the subprime mortgage crisis,²¹ weak banking regulation,²² high levels of consumer debt,²³ toxic debts,²⁴ securitisation,²⁵ deregulation of banking legislation,²⁶ ineffective macroeconomic policies,²⁷ weak credit regulation, deregulation of consumer credit legislation,²⁸ self-regulated CRAs²⁹ and the culture of banking practices.

It is acknowledged that many factors created the perfect economic environment that was partly fuelled by and then exploited by white collar criminals. This is a view supported by Huisman, who stated that “misconduct in the financial industry is widely seen as having triggered the credit crunch that has pushed the world into an economic crisis”.³⁰ It has also been reported that there have been increases in white collar crime since the start of the financial crisis. For example, this includes insurance fraud,³¹ credit card fraud and ³² business

²¹ See for example European Commission *Report of the High-Level Group on Financial Supervision in the EU* (European Commission: Brussels, 2009).

²² Hutchins, A. ‘Flip that prosecution strategy: an argument for using RICO to prosecute large-scale mortgage fraud’ (2011) *Buffalo Law Review*, 59(1), 293 at 306.

²³ See generally Dickerson, M. ‘Over-indebtedness, the subprime mortgage crisis, and the effect on US cities’ (2009) *Fordham Urban Law Journal*, 36, 395–425.

²⁴ Arsalidou, D. ‘The banking crisis: rethinking and refining the accountability of bank directors’ (2010) *Journal of Business Law*, 4, 284–310, at 292.

²⁵ For a critical discussion of securitisation see Nwogugu, M. ‘Securitisation is illegal: racketeer influenced and corrupt organisations, usury, antitrust and tax issues’ (2008) *Journal of International Banking Law and Regulation*, 23(6), 316–332.

²⁶ The arguments on the relationship between the financial crisis and banking deregulation relate to the impact of several pieces of legislation, including the Graham–Leach–Bailey Act 1999, the Depository Institutions Deregulation and Monetary Control Act 1980 and the Garn St Germain Depository Institutions Act 1982. See Levitin, A. ‘The crisis without a face: emerging narratives of the financial crisis’ (2009) *University of Miami Law Review*, 63, 999–1010, at 1004.

²⁷ Gevurtz, G. ‘The role of corporate law in preventing a financial crisis: reflections on in re Citigroup Inc shareholder derivative litigation’ (2010) *Pacific McGeorge Global Business and Development Law Journal*, 23, 113, at 3.

²⁸ See for example the impact of the decision in *Marquette National Bank of Minneapolis v First Omaha Service Corp* 439 U.S., at 299.

²⁹ See European Commission above, n 21.

³⁰ Huisman, W. ‘White-collar crime and the economic crisis’ (2012/2013) *Newsletter of the European Society of Criminology*, 11, at 8. This is a view supported by Gee, who stated that ‘there is considerable evidence that fraud was a major cause of the recession, with widespread sale of financial securities based on sub-prime mortgages, which were known to be worthless’. See Gee, J. ‘Fraud 2009 bad, 2010 better?’ (2010) *Computer Fraud and Security*, 2010, February, 2, 13–15, at 13. However, it is important to acknowledge that not all commentators agree with the contention that white collar crime was an important variable that contributed towards the financial crisis. See for example Gill, M. ‘Fraud and recessions: views from fraudsters and fraud managers’ (2011) *International Journal of Law, Crime and Justice*, 39, 204–214.

³¹ Rayner, G. ‘Families turning to insurance fraud to beat credit crunch’, 25 December 2008, available from <http://www.telegraph.co.uk/finance/financialcrisis/3949048/Families-turning-to-insurance-fraud-to-beat-credit-crunch.html>, accessed 28 March 2013.

fraud.³³ Huisman argued that an increase in white collar crime emanating from the financial crisis is largely attributed towards accounting fraud.³⁴ Other commentators, such as Nguyen and Pontell, asserted that prevalent mortgage fraud is associated with the financial crisis.³⁵ The link between the financial crisis and white collar crime is clearly illustrated by an increase in the related enforcement actions of the Securities and Exchange Commission (SEC), the Commodities Futures and Trading Commission (CFTC), the FBI, the Department of Justice, the FSA, the FCA and the Serious Fraud Office (SFO). For example, since the start of the financial crisis the SEC has charged 161 companies and individuals, including 66 senior corporate officials, with related offences and 37 individuals have either been barred from acting as company directors or suspended from doing so. In addition it has imposed penalty orders of \$1.53bn, enforced disgorgement orders totalling \$800m and obtained \$400m compensation for affected investors. The total amount of penalties amounts to \$2.73bn.³⁶ The CFTC has been heavily involved in the manipulation of the London inter-bank offered rate (LIBOR) by banks in the UK and US and has fined Barclays \$200m,³⁷ UBS \$700m,³⁸ RBS \$325m³⁹ and ICAP \$65m.⁴⁰ Additionally, the Department of Justice

³² BBC News 'Credit crunch fuels fraud cases', 30 April 2008, available from <http://news.bbc.co.uk/1/hi/business/7375091.stm>, accessed 28 March 2013. In this report the BBC cited figures from the UK fraud prevention service CIFAS. See for example CIFAS '2007 fraud trends', January 2008, available from <http://www.cifas.org.uk/secure/contentPORT/uploads/documents/Press%20Release/2008/A%20-%202007%20Fraud%20Trends.pdf>, accessed 28 March 2013.

³³ Masters, B. 'Corporate fraud rises to £1.2bn', 19 January 2009, available from <http://www.ft.com/cms/s/0/344179e6-e5c9-11dd-afe4-0000779fd2ac.html#axzz2OpRGIItRM>, accessed 28 March 2013.

³⁴ Huisman, Q.W. 'Corporate crime and crisis: causation scenarios' in Deflem, M. (ed.), *Economic crisis and crime* (Emerald: Bingley, 2011) at 111.

³⁵ Nguyen, T. and Pontell, H. 'Mortgage origination fraud and the global economic crisis' (2010) *Criminology and Public Policy*, 9(3), 591–612, at 592.

³⁶ Securities and Exchange Commission 'SEC enforcement actions addressing misconduct that led to or arose from the financial crisis', 1 September 2013, available from <http://www.sec.gov/spotlight/enf-actions-fc.shtml>, accessed 7 October 2013.

³⁷ Commodities Futures Trading Commission 'FTC orders Barclays to pay \$200 million penalty for attempted manipulation of and false reporting concerning LIBOR and Euribor benchmark interest rates', 27 June 2012, available from <http://www.cftc.gov/PressRoom/PressReleases/pr6289-12>, accessed 12 August 2013. Also see Gensler, G. 'Libor, naked and exposed', 6 August 2012, available from http://www.nytimes.com/2012/08/07/opinion/libor-naked-and-exposed.html?_r=3&ref=opinionpiecesaboutlibor&, accessed 12 August 2013.

³⁸ Commodities Futures Trading Commission 'CFTC orders UBS to pay \$700 million penalty to settle charges of manipulation, attempted manipulation and false reporting of LIBOR and other benchmark interest rates', 19

announced that RBS Securities Japan Limited, a wholly owned subsidiary of RBS, pleaded guilty to wire fraud and its role in influencing the Japanese yen LIBOR.⁴¹ Similarly, the FBI has seen a significant increase in its enforcement and investigative activities towards white collar crime, especially mortgage fraud, since the start of the financial crisis.⁴² For example, at the time of writing the FBI is investigating 1,954 allegations of mortgage fraud, approximately 70 per cent of which exceed \$1m; it made 1,079 indictments and secured 1,026 convictions in 2012, approximately \$13bn was lost and there are 141 open investigations.⁴³ The increase in mortgage fraud is illustrated by also examining the number of mortgage fraud related suspicious activity reports (SARs) filed by the Financial Crimes Enforcement Network (FinCEN), the US Financial Intelligence Unit.⁴⁴ In 2010, FinCEN received 70,472 mortgage loan fraud SARs, a 4 per cent increase from 2009.⁴⁵ In 2011, FinCEN reported that 92,028 mortgage loan fraud SARs had been reported, an increase of 31 per cent from 2010.⁴⁶ We have also seen increased enforcement activities of regulatory agencies in the UK since the start of the financial crisis. The FCA and its predecessor, the FSA adopted what it refers to as a ‘credible deterrence’ approach towards its then financial

December 2012, available from <http://www.cftc.gov/PressRoom/PressReleases/pr6472-12>, accessed 12 August 2013.

³⁹ Commodities Futures Trading Commission ‘CFTC orders The Royal Bank of Scotland plc and RBS Securities Japan Limited to pay \$325 million penalty to settle charges of manipulation, attempted manipulation, and false reporting of yen and Swiss franc LIBOR’, 6 February 2013, available from <http://www.cftc.gov/PressRoom/PressReleases/pr6510-13>, accessed 12 August 2013.

⁴⁰ Commodities Futures Trading Commission ‘CFTC charges ICAP Europe Limited, a subsidiary of ICAP plc, with manipulation and attempted manipulation of yen Libor’, 25 September 2013, available from <http://www.cftc.gov/PressRoom/PressReleases/pr6708-13>, accessed 8 October 2013.

⁴¹ Department of Justice ‘RBS Securities Japan Limited agrees to plead guilty in connection with long-running manipulation of Libor benchmark interest rates’, 6 February 2013, available from <http://www.justice.gov/opa/pr/2013/February/13-crm-161.html>, accessed 8 February 2013.

⁴² Fisher, L. ‘Target marketing of subprime loans: racialised consumer fraud and reverse redlining’ (2009) *Journal of Law and Policy*, 18, 121–155, at 144.

⁴³ Federal Bureau of Investigation ‘Mortgage fraud’, n/d, available from http://www.fbi.gov/about-us/investigate/white_collar/mortgage-fraud/mortgage_fraud, accessed 6 March 2013.

⁴⁴ For a more detailed discussion on the role of the Financial Crimes Enforcement Network see Ryder, N. *Money laundering – an endless cycle? A comparative analysis of the anti-money laundering policies in the United States of America, the United Kingdom, Australia and Canada* (Routledge Cavendish: Abingdon, 2012) at 49–52.

⁴⁵ Financial Crimes Enforcement Network *Mortgage loan fraud update suspicious activity report filings from January 1 –December 31 2010* (Financial Crimes Enforcement Network: Washington DC, 2011) at 2.

⁴⁶ *Ibid.*

crime statutory objective.⁴⁷ Both institutions imposed a record number of financial penalties and several prohibition orders. For example, in 2007 the FSA imposed a total of £5.3m in financial sanctions.⁴⁸ A year later, it reported that the figure had increased to £22.7m.⁴⁹ In 2009 the amount of financial sanctions increased to £35m.⁵⁰ The figures for 2010 and 2011 illustrated an increase to £89.1m⁵¹ and a decrease to £66.1m.⁵² However, in 2012 the FSA imposed financial sanctions that amounted to £311.5m,⁵³ a majority of which were associated with the LIBOR scandal. In 2013 a total of £474.1m penalties were imposed by the FSA and FCA.⁵⁴ As of February 2014, the FCA has imposed fines amounting £69.1m.⁵⁵ These figures have been influenced by the imposition of a series of record fines due to the LIBOR scandal. This includes, for example, the £59.5m fine on Barclays,⁵⁶ the £160m fine on UBS⁵⁷ and the £87.5m fine on RBS.⁵⁸

⁴⁷ Financial Services Authority ‘Delivering credible deterrence’, speech by Margaret Cole, Director of Enforcement, FSA, Annual Financial Crime Conference, 27 April 2009, available from http://www.fsa.gov.uk/library/communication/speeches/2009/0427_mc.shtml, accessed 8 March 2013.

⁴⁸ Financial Services Authority ‘FSA fines table 2007’, n/d, available from <http://www.fsa.gov.uk/about/press/facts/fines/2007>, accessed 8 March 2013.

⁴⁹ Financial Services Authority ‘FSA fines table 2008’, n/d, available from <http://www.fsa.gov.uk/about/press/facts/fines/2008>, accessed 8 March 2013.

⁵⁰ Financial Services Authority ‘FSA fines table 2009’, n/d, available from <http://www.fsa.gov.uk/about/press/facts/fines/2009>, accessed 8 March 2013.

⁵¹ Financial Services Authority ‘FSA fines table 2010’, n/d, available from <http://www.fsa.gov.uk/about/press/facts/fines/2010>, accessed 8 March 2013.

⁵² Financial Services Authority ‘FSA fines table 2011’, n/d, available from <http://www.fsa.gov.uk/about/press/facts/fines/2011>, accessed 8 March 2013.

⁵³ Financial Services Authority ‘FSA fines table 2012’, n/d, available from <http://www.fsa.gov.uk/about/press/facts/fines/2012>, accessed 8 March 2013.

⁵⁴ Financial Conduct Authority ‘Fines table 2013’, 24 January 2014, available from <http://www.fca.org.uk/firms/being-regulated/enforcement/fines/2013>, accessed 25 February 2014.

⁵⁵ Financial Conduct Authority ‘Fines table 2014’, 13 February 2014, available from <http://www.fca.org.uk/firms/being-regulated/enforcement/fines>, accessed 25 February 2014.

⁵⁶ Financial Services Authority ‘Barclays fined £59.5m for significant failings in relation to LIBOR and EURIBOR’, 27 June 2012, available from <http://www.fsa.gov.uk/library/communication/pr/2012/070.shtml>, accessed 8 February 2013.

⁵⁷ Financial Services Authority ‘UBS fined £160m for significant failings in relation to LIBOR and EURIBOR’ 19 December 2012, available from <http://www.fsa.gov.uk/library/communication/pr/2012/116.shtml>, accessed 8 February 2013.

⁵⁸ Financial Services Authority ‘RBS fined £87.5m for significant failings in relation to LIBOR’, 6 February 2013, available from <http://www.fsa.gov.uk/library/communication/pr/2013/011.shtml>, accessed 8 February 2013.

Predatory Lending and the Financial Crisis

“Home ownership is a fundamental aspect of American life – a dream to which many aspire. On the other hand, purchasing a home is one of the most complex and expensive transactions that a typical person will be involved in. Practically all homes are purchased with the aid of outside financing, and such financing typically comes in the form of a mortgage”.⁵⁹

It is our contention that predatory lending practices are one of the important factors that contributed towards the financial crisis.⁶⁰ The most comprehensive definition of predatory lending was afforded by the Department of Treasury’s Task Force on Predatory Lending:

“Predatory lending – whether undertaken by creditors, brokers, or even home improvement contractors – involves engaging in *deception* or *fraud* [author’s emphasis], *manipulating* the borrower through aggressive sales tactics, or taking *unfair* advantage of a borrower’s lack of understanding about loan terms . . . that, alone or in combination, are *abusive* or make the borrower more vulnerable to abusive practices”.⁶¹

It has been argued that *any* loan could be categorised as predatory lending where the debtor does not have adequate funds to meet the monthly repayments.⁶² Furthermore, it has been

⁵⁹ Putney, A. ‘Rules, standards, and suitability: finding the correct approach to predatory lending’ (2003) Fordham Law Review, April, 71, 2101–2139, at 2103–2104.

⁶⁰ Shelley, M. and Jackson, M. ‘Sub-prime lending, its deficiencies and the government responses’ (2008) Journal of International Banking Law and Regulation, 23(10), 523–537, at 527.

⁶¹ Department of Treasury Task Force on Predatory Lending *Curbing predatory home mortgage lending* 1 (Treasury Task Force on Predatory Lending: Washington DC, 2000) at 1.

⁶² Nwogugu, M. ‘Corporate governance and high-risk finance: alternative methods for financing domestic/foreign emerging growth companies with inadequate collateral’ (2005) Journal of International Banking Law and Regulation, 20(10), 541–558, at 544.

suggested that even “aggressive lending practices can amount to predatory lending”.⁶³ Predatory lending has been described as “real, pervasive, and destructive”,⁶⁴ “harsh lending practices”,⁶⁵ “a catalogue of onerous lending practices”⁶⁶ and a “syndrome of loan abuses that benefit mortgage brokers, lenders, and securitizers to the serious detriment of borrowers”.⁶⁷ In some instances, lenders have been accused of “intentionally target[ing] individuals and demographic groups whom they identify as most vulnerable”.⁶⁸ Engel and McCoy noted that:

“predatory lending is a syndrome of abusive loan terms or practices that involve one or more of the following five problems: loans structured to result in seriously disproportionate net harm to borrowers, harmful rent seeking, loans involving fraud or deceptive practices, other forms of lack of transparency in loans that are not actionable as fraud, and loans that require borrowers to waive meaningful legal redress”.⁶⁹

Predatory lending can be divided into two categories. First, the lending activity includes *illegal* lending practices such as *fraud*.⁷⁰ Secondly, predatory lending behaviour that is not necessarily illegal but actions that are “misused by unprincipled lenders”.⁷¹ Examples of conduct that amounts to predatory lending include “credit insurance, balloon payments, padded fees, rapid refinancing, broker kickbacks disguised as yield spread premiums, high

⁶³ Putney above, n 59, at 2105.

⁶⁴ Peterson, C. ‘Predatory structured finance’ (2007) *Cardozo Law Review*, April, 28, 2185–2282, at 2189.

⁶⁵ *Ibid.*

⁶⁶ Engel, K. and McCoy, P. ‘A tale of three markets: the law and economics of predatory lending’ (2002) *Texas Law Review*, 80(6), 1255–1281, at 1260.

⁶⁷ Guentes, N. ‘Defrauding the American dream: predatory lending in Latin communities and reform of California’s lending law’ (2009) *California Law Review*, August, 97, 1279–1335, at 1285.

⁶⁸ Davenport, T. ‘An American nightmare: predatory lending in the subprime home mortgage industry’ (2003) *Suffolk University Law Review*, 36, 531–557, at 541.

⁶⁹ Engel and McCoy above, n 66, at 1260.

⁷⁰ McNonagle, D. ‘In pursuit of safety and soundness: an analysis of the OCC’s anti-predatory lending standard’ (2004) *Fordham Urban Law Journal*, November, 31, 1533–1554, at 1538.

⁷¹ *Ibid.*

pressure marketing, and of course, high rates”.⁷² Davenport argued that predatory lending “provide[s] an overview of the types of predatory tactics prevalent in the subprime industry. These categories include loan ‘flipping’, charging of excessive fees and ‘packing’, lending without regard to the borrower’s ability to repay or ‘equity stripping’, and outright fraud”.⁷³ The Federal Trade Commission stated that:

“Predatory lending in the subprime mortgage market covers a wide range of practices. While the practices are quite varied, there are common traits. They generally aim either to extract excessive fees and costs from the borrower or to obtain outright the equity in the borrower's home. This is often accomplished through a combination of aggressive marketing practices, high-pressure sales tactics, and loan terms, such as prepayment penalties, that inhibit a borrower's ability to go elsewhere for credit”.⁷⁴

Forrester offered a damning indictment of predatory lending, and stated:

“The effects of predatory lending are devastating for the individuals who are victims and for their neighbourhoods. At best, the victims of predatory lenders end up paying too much in fees and interest for their loans. The worst case scenario is that they lose their homes to foreclosure. A dramatic increase in foreclosures in inner-city neighbourhoods has followed the increase in subprime lending in recent years. For individuals and families, the loss of a home to foreclosure is devastating, both financially and psychologically. Foreclosures caused by predatory lending have a negative impact on neighbourhoods as well since the impact of foreclosures may be

⁷² Peterson, C. ‘Federalism and predatory lending: unmasking the deregulatory agenda’ (2005) *Temple Law Review*, Spring, 1–98, at 13.

⁷³ Davenport above, n 68, at 541.

⁷⁴ Federal Trade Commission ‘Predatory lending practices in the subprime industry’, 24 May 2000, available from <http://www.ftc.gov/os/2000/05/predatorytestimony.htm>, accessed 21 October 2013.

concentrated in low-income areas. Vacant homes caused by foreclosures can cause a decrease in property values and an increase in crime, thereby destabilizing at-risk neighbourhoods. Therefore, predatory lending has an impact beyond the homeowners who obtain predatory loans”.⁷⁵

Shelley and Jackson noted that predatory lending encourages “situations where borrowers are unable to meet loan repayments because of the loan conditions, not because of unforeseen changes to their financial position. It goes beyond a borrower not understanding terms and conditions to a deliberate intent on the part of the lender to take advantage of the borrower”.⁷⁶

Davenport added that the “goals of all predatory lenders are easy to identify: to increase profit by charging the borrower excessive rates and fees and/or to take the equity in the borrower’s home”.⁷⁷ It has been argued that the foundations of predatory lending were put in place by legislation that was originally designed to prevent such practices, end redlining (refusing people access to credit based on where they live) and increase consumers’ access to credit. For example, the Fair Housing Act 1968, the Community Reinvestment Act 1977 and the Financial Services Modernization Act 1999 contributed to “the seeds of predatory lending and pursuit of unacceptable risk ... blossom[ing] into the carnivorous plants of financial meltdown”.⁷⁸ Other legislation that has attempted to limit the impact of predatory lending includes the Truth in Lending Act 1968, the Home Ownership Equity Protection Act 1994, the Equal Credit Opportunity Act 1949 and the Federal Trade Commission Act 1914.⁷⁹

⁷⁵ Forrester, J. ‘Still mortgaging the American dream: predatory lending, pre-emption, and federally supported lenders’ (2006) *University of Cincinnati Law Review*, Summer, 74, 1303–1371, at 1350.

⁷⁶ Shelley and Jackson above, n 60, at 534.

⁷⁷ Davenport above, n 68, at 541.

⁷⁸ Seitz, N., Gilsinan, J., Fisher, J., Harshman, E., Islam, M., Yeager, F. and Millar, J. ‘Bank integrity: the case of subprime lending’ (2009) *Company Lawyer*, 30(9), 271–276, at 271

⁷⁹ Davenport above, n 68, at 541.

The link between predatory lending, fraud and the financial crisis has been acknowledged by several commentators. For example, Ament took the view that “one of the more egregious forms of predatory lending involves fraud [and] two basic forms of fraud exist in the predatory lending market”.⁸⁰ The first type of fraud relates to not disclosing certain types of legally required information and the second is connected to illegal activity that seeks to defraud providers of credit.⁸¹ It has also been argued that predatory lending involves “deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding about loan terms”.⁸² The link between predatory lending and fraud has also been recognised by the judiciary. For example, in *American Financial Services Association v Toledo* the court stated that predatory lending involves “the use of fraud or deception, manipulation of the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding of loan terms”.⁸³ It has been argued by Engel and McCoy that:

the most blatant forms of predatory lending involve the age-old problem of fraud ... all of the deceptive practices in this category are violations of existing laws, such as state fraud statutes, state consumer-protection laws, state fiduciary duties, and federal disclosure statutes such as the Truth in Lending Act or the Real Estate Settlement Procedures Act.⁸⁴

By its very nature, predatory lending amounts to unfair, misleading, deceitful and even fraudulent conduct on the part of the lender. It is impossible to determine how many of the

⁸⁰ Ament, H. ‘Predatory lending: what will stop it?’ (2009) *Journal of Business and Technology Law*, 4, 371–394, at 387–388.

⁸¹ *Ibid.*, at 379.

⁸² Department of Treasury Task Force on Predatory Lending above, n 61.

⁸³ 830 N.E.2d 1233 (Ohio Ct. App. 2005), rev'd, 859 N.E.2d 923 (Ohio 2006) at 1238.

⁸⁴ Engel and McCoy above, n 66, at 1267.

subprime loans issued before the start of the financial crisis fell within the definition of predatory lending.⁸⁵ It is important to note that by 2006 “\$600bn of subprime loans were originated, most of which were securitized. That year, subprime lending accounted for 23.5% of all mortgage originations”.⁸⁶ Therefore, it can be argued that some of the subprime loans that contributed towards the financial crisis were conducted in a fraudulent manner.

There have been several attempts to regulate predatory lending. The Truth in Lending Act 1968 “attempts to create a uniform terminology for all consumer credit contracts that facilitates comparison shopping and informed decision making. TILA requires lenders to give consumers a disclosure statement that expresses some of the most important provisions of a credit contract in federally defined terminology”.⁸⁷ Davenport added that the purpose of the Truth in Lending Act was to “assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit”.⁸⁸ Furthermore, the Real Estate Settlement Procedures Act 1974 tried to regulate unreasonable systems and high costs in closing mortgages.⁸⁹ More recently, the Home Ownership and Equity Protection Act 1994 amended the “Truth in Lending Act to more directly respond to the problem of predatory home mortgage lending”.⁹⁰ This Act bans “several terms common in predatory loans, including balloon payments for loans which mature in less than five years, payment arrangements that cause negative arrangements, increases in the interest rate after default, and most prepayment penalties”.⁹¹ Putney noted that the Act’s main ‘method of operation is to set a system of triggers that

⁸⁵ See Bruce, H., Gruenstein, D., Herbert, C. and Scheessele, R. ‘Subprime foreclosures: the smoking gun of predatory lending?’, n/d, available from <http://www.huduser.org/publications/polleg/hpcproceedings.html>, accessed 21 October 2013.

⁸⁶ Financial Crisis Inquiry Commission *Financial Crisis Inquiry Commission report* (Financial Crisis Inquiry Commission: Washington DC, 2011) at 99.

⁸⁷ Peterson above, n 64, at 2227.

⁸⁸ Davenport above, n 68, at 546.

⁸⁹ Peterson above, n 64 at 2226.

⁹⁰ *Ibid.*, at 2227.

⁹¹ Davenport above, n 68, at 548–549.

activate additional scrutiny and restrictions on loans that go beyond certain criteria. The two triggers for high cost are APR of the loans or its associated fee.⁹² However, the Home Ownership and Equity Protection Act has been criticised for not going far enough.⁹³ This is a view supported by Forrester, who noted that “very few subprime loans exceeded the interest rate threshold ... the free trigger excludes reasonable fees paid to third parties ... it does not apply to high-cost mortgages, reverse mortgages, or home equity lines of credit”.⁹⁴ The Fair Debt Collection Practices Act 1977 seeks to promote and maintain standards of civility in the collection of debts. For example, Peterson stated that the Act “forbids harassment, false or misleading representations, and a variety of other unfair collection tactics, including threatening foreclosure when not legally entitled to do so”.⁹⁵ Other measures include the Mortgage Reform and Anti-Predatory Lending Act 2007. This Act created a “Nationwide Mortgage Licensing System and Registry” which “require[d] individual mortgage brokers and bank employees to obtain a national licence, through registration on a national database after meeting minimum education in certification standards”.⁹⁶ A legislative measure that was introduced to tackle the problems associated with such lending practices was the Credit Card Accountability, Responsibility and Disclosure Act 2009. Nonetheless, the effectiveness of these measures has been questioned. For example, Ament concluded that “predatory lending has devastated the mortgage market and as foreclosures rise, politicians and scholars are in the unenviable position of finding a solution. The ineffectiveness of regulations ... only compounds matters”⁹⁷

⁹² Putney above, n 59, at 2115.

⁹³ *Ibid.*, at 2116.

⁹⁴ Forrester above, n 75, at 1317.

⁹⁵ Peterson above, n 64, at 2228.

⁹⁶ Shelley and Jackson above, n 60, at 533.

⁹⁷ Ament above, n 80, at 393.

Writing in 2003 Putney argued that “a spate of prosecutions and settlements suggests that law enforcement agencies are beginning to take the issue seriously”.⁹⁸ However, Putney warned that ‘the difficulty in moving against predatory lenders is twofold. First, identifying predatory loans can be tricky ... the second problem is that legitimate subprime lenders are apt to be harmed by any attempt to regulate predatory lenders’.⁹⁹ Several large financial sanctions have been imposed on US financial institutions over their predatory lending practices. The Federal Trade Commission Act 1914 prohibits unjust and misleading practices.¹⁰⁰ The Act provides the Federal Trade Commission with the ability and flexibility to determine what amounts to unjust and misleading practices. Furthermore, the Federal Trade Commission is charged with enforcing the Federal Trade Commission Act and is provided with an array of enforcement powers. Forrester took the view that:

“the Federal Trade Commission has filed enforcement actions against lenders engaged in predatory lending activities ... between 1998 and 2003, the Federal Trade Commission filed nineteen complaints and reached settlements in most of these cases. Most of the settlements required compensation to consumers and an agreement by the lender to stop certain practices”.¹⁰¹

For example, Household International paid a \$484m settlement to the Federal Trade Commission,¹⁰² Ameritrust paid \$325m for conducting predatory lending practices,¹⁰³ Bank of America agreed a \$335m settlement with the Department of Justice over discriminatory

⁹⁸ Putney above, n 59, at 2103–2106.

⁹⁹ *Ibid.*, at 2108.

¹⁰⁰ 15 U.S.C 45(a)(1) 2006.

¹⁰¹ Forrester above, n 75, at 1318.

¹⁰² Santanu, R. and Chakrabarti, B. ‘Operational risk and the banking sector’ (2005) *Journal of International Banking Law and Regulation*, 20(10), 535–540, at 536.

¹⁰³ Connecticut Department of Banking ‘Ameritrust to pay \$325 million for predatory lending practices that bilked consumers’, 23 January 2006, available from <http://www.ct.gov/dob/cwp/view.asp?a=2245&q=309018>, accessed 21 October 2013.

lending practices¹⁰⁴ and Wells Fargo also reached a settlement with the Department of Justice for \$175m to resolve fair lending claims.¹⁰⁵ Furthermore, in September 2008 the Federal Trade Commission reached an agreement with Bear Stearns and EMC Mortgage for \$28m; they admitted engaging in “unlawful practices in servicing consumers’ home mortgage loans”.¹⁰⁶ There has been some debate about whether or not predatory lending is a criminal offence. For example, Hunt argued that “criminal fraud statutes could be enthusiastically brought to bear on the most egregious cases of racialized predatory lending through any number of mail or wire fraud provisions”.¹⁰⁷ However, Engel and McCoy stated that ‘criminal fraud actions afford little or no relief to victims of predatory lending’.¹⁰⁸ At the time of writing no criminal convictions have been achieved in this area.

Conclusion

The practice of white collar crime and predatory lending has undoubtedly contributed towards the financial crisis. The implementation of the very legislation designed to prevent such practices such as fraud, red-lining and government policies intended to promote access to credit have built the foundations for predatory lending. Although it is impossible to determine the level of white collar crime and how many loans can actually be included within the term predatory lending it is clear that such practices have risen since the emergence of the financial crisis. The development of complex credit products, such as subprime mortgages,

¹⁰⁴ Isidore, C. ‘BoFA settles unfair lending claims for \$335 million’, 21 December 2011, available from http://money.cnn.com/2011/12/21/news/companies/bank_america_settlement/, accessed 21 October 2013.

¹⁰⁵ Department of Justice ‘Justice Department reaches settlement with Wells Fargo resulting in more than \$175 million in relief for homeowners to resolve fair lending claims’, 12 July 2012, available from <http://www.justice.gov/opa/pr/2012/July/12-dag-869.html>, accessed 21 October 2013.

¹⁰⁶ Federal Trade Commission ‘Bear Stearns and EMC Mortgage to pay \$28 million to settle FTC charges of unlawful mortgage servicing and debt collection practices’, 9 September 2008, available from <http://www.ftc.gov/opa/2008/09/emc.shtm>, accessed 21 October 2013.

¹⁰⁷ Hunt, C. ‘In the racial crosshairs: reconsidering racially targeted predatory lending under a new theory of economic hate crime’ (2003) *University of Toledo Law Review*, Winter, 3, 211–315, at 217.

¹⁰⁸ Engel and McCoy above, n 66, at 1302.

has pushed the boundaries of consumer understanding and calls into question whether these practices have created the perfect economic environment that has then been exploited and misused by unprincipled lenders. Attempts to legislate and regulate predatory lending have proved to be largely ineffective. This is somewhat surprising given the aggressive stance of the Department of Justice and FBI to high profile fraud during the Savings and Loans Crisis, the collapse of Enron and WorldCom and the convictions of Bernard Madoff and Alan Stanford.