Market-Based Innovation in Consumer Protection

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In the aftermath of the financial crisis of 2008, low-income borrowers have been virtually shut out of the housing market. The spectacular failure of overzealous subprime lending at the beginning of the century is the culprit. Creditworthy borrowers exist in that underserved population, though regulation and the continued dominance of traditional banks in the mortgage market have conspired to deny those borrowers access to credit.

A market solution to this problem exists and is gaining momentum. Financial technology firms have begun to focus on the borrower experience and to create tools to help unsophisticated borrowers navigate complex financial products. This Article takes that trend a step further and anticipates market innovations that will broaden the population of eligible borrowers. These market innovations can overcome regulatory missteps to both enhance efficiency and provide meaningful protections to consumers that regulation has failed to deliver.

This Article makes several contributions to the literature. First, it shows how mortgage regulation has simply excluded the market participants it was intended to protect, thereby denying them the social and economic advantages of homeownership. Second, it shows how fintech has begun to work around those regulatory limitations to respond to the problems that led to the financial crisis by offering simpler products directly to consumers and providing more access to information. Third, it offers a market-based solution to the market and regulatory failures that anticipates the direction of fintech innovations. Finally, it argues that the thoughtful application of common law doctrines may be a more effective way to provide necessary consumer protections while allowing market forces to adapt to changing circumstances and emerging technology.

ARTICLE CONTENTS

Market-Based Innovations in Consumer Protection

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INTRODUCTION

Every day, consumers and investors make difficult or complex decisions that they do not really understand. Within our consumer financial markets, there are both experts and people who—facing very high stakes—desperately need help understanding. In a free market, putting those people together so that the knowledgeable can help the uninitiated should not be difficult; it should be inevitable. Nevertheless, fundamental problems with how consumers come to understand products or investments remain and seem intractable.

The consumer finance market is ripe for disruption. The most significant financial decision that most Americans make is the purchase of a home. With the housing market rebounding[1] and mortgage regulation likely to diminish,[2] the current climate presents an excellent opportunity for enterprising technology companies to change the way Americans borrow money to purchase homes. The financial crisis of 2008 and the regulations it inspired have pushed lenders to be more conservative, effectively drying up credit for lower-income borrowers. There are profitable credit risks among those potential borrowers, but the providers of the loans and the potential borrowers are not connecting.

This Article explains the existence and persistence of these two market failures in one of our largest and most-studied industries. It anticipates market solutions given innovative activity in the consumer finance markets by financial technology ("fintech") companies and devises a legal framework that will protect the advances made by those innovators. More specifically, it argues that over-specificity in regulation has entrenched expensive, inefficient, and ineffective intermediaries between homebuyers, sellers, and lenders.

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1 Reuven Glick et al., *What's Different about the Latest Housing Boom?*, FRSBF ECON. LETTER 2015-34 at 2 (Nov. 16, 2015) ("[As of 2015], the median house price has recovered to a level that is only 8% below its prior peak.").

2 *See* Alan Rappeport & Emily Flitter, *Congress Approves First Dodd-Frank Rollback*, N.Y. TIMES, May 23, 2018, at A1 (detailing the first of many promised repeals of the Dodd-Frank Act that, in part, strengthened mortgage regulation).

The housing market is a good motivating example to explore problems with the regulation of intermediaries. Kathryn Judge has highlighted the ways a variety of market intermediaries build and use political power to entrench themselves and the high fees they demand.[3] This Article draws on some of her insights to reveal the mess of disloyal intermediaries that the housing industry has become, lacking anyone clearly motivated to help consumers. The housing market provides particularly fertile ground for exploration of these problems because the stakes for consumers are so high and the practices are so heavily regulated and therefore are firmly entrenched. Change seems difficult, and yet, various firms are well-positioned to side-step regulation to provide better services directly to consumers at a much lower cost than the traditional market.

The market must overcome the entrenchment of real estate and mortgage intermediaries who do not have incentives, and may not even be permitted, to serve the interests of buyers. Even the real estate agents who show homes to buyers and submit offers on behalf of buyers are agents of sellers.[4] Over time, states have enacted regulations to try to balance the duties agents owed sellers and buyers, but the landscape is still murky and most of the players misunderstand who owes what duties to whom.[5] Once a buyer has succeeded in signing a contract on a home, she faces the task of quickly procuring financing. The mortgage lender agent with whom she will work represents the bank originating the loan, and that bank usually plans to sell the loan to yet another bank or a group of investors. Agency costs abound, and they rarely break in favor of the borrower.

Consumer lending, particularly for large loans like home mortgages, is deeply flawed. Strict regulations prevent innovation in mortgage loan terms and effectively exclude large portions of the population from qualifying for home loans at all.[6] Consumers still have little or no help navigating the complex mortgage application process, and many may not know how large

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[3] *See generally* Kathryn Judge, *Intermediary Influence*, 82 U. CHI. L. REV. 573 (2015) (discussing the influence that market intermediaries exert over business transactions).

[4] *See* Royce de R. Barondes & V. Carlos Slawson, Jr., *Examining Compliance with Fiduciary Duties: A Study of Real Estate Agents*, 84 OR. L. REV. 681, 682 (2005) (describing agency in the traditional model).

[5] Ann Morales Olazábal, *Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses,* 40 HARV. J. ON LEGIS. 65, 66 (2003) (describing the confusion over agency between seller and buyer).

[6] By its own admission, the Consumer Financial Protection Bureau curtailed innovations that might help consumers by adopting specific regulations for mortgage underwriting. SULLIVAN & CROMWELL LLP, *Regulatory Guidance Regarding FinTech Products and Services: OCC White Paper and New CFPB Policy Clarify Regulatory Expectations for Financial Institutions and Other Market Participants* 5 (Apr. 5, 2016), available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Regulatory_Guidance_Regarding_Fintech_Products_and_Services.pdf (explaining the lower fees charged by Redfin as compared to traditional brokerages).

of a loan, and what loan terms, are most appropriate for them. We still lack an understanding of what a truly "consumer friendly" mortgage would look like. The Consumer Financial Protection Bureau (CFPB) has called for innovative approaches that will open the mortgage market to lower-income borrowers yet again.[7] Presumably, market participants have had enough time to reflect on the financial crisis and have learned valuable lessons from the mistakes of the early 2000s.

There appears to be a trend in fintech toward developing firms that may more effectively serve homebuyers. Real estate listing sites offer real estate agent services at much lower fees than traditional brokerages.[8] Mortgage lenders are devising ways to communicate more quickly with borrowers, offering them loans with simple terms and lower fees.[9] Other firms have specialized in providing advice to borrowers that is both general and, in some ways, specific. They have developed internet applications, supported by the option to chat online with experts, who help home buyers navigate house hunting, home buying, and the mortgage application process while also providing access to real estate agents, mortgage lenders, and even moving companies.[10] A firm focused on serving borrowers with different degrees of creditworthiness might discover an under-appreciated market.

These fintech firms show how a company designed to identify a broader range of borrowers—including lower-income borrowers—could provide information, guidance, easy-to-understand loan choices, and support while matching borrowers to lenders offering loans with appropriate terms. This Article takes stock of the consumer financial services market and suggests a natural progression that could lead to such a buyer's (or borrower's) side intermediary ("BSI"). The ideas being tested in fintech right now reveal a path to an eventual BSI and show how a BSI may serve the needs of borrowers without compromising the ability to repay lenders. Most importantly, this Article shows how the development of fintech in consumer financial services has so far avoided the pitfalls of prior intermediaries. In particular, fintech firms have not yet successfully lobbied for regulation that would entrench its position in the market and lead to pernicious path-dependence.[11]

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[7] *Id.* at 4.

[8] *See, e.g.*, *How You Save With Redfin,* REDFIN, https://www.redfin.com/why-redfin-how-you-save (last visited Aug. 16, 2018) (claiming a total commission of 4.5% through Redfin, as opposed to a total commission of 6% through a traditional brokerage).

[9] *See, e.g.*, ROCKETMORTGAGE, https://www.rocketmortgage.com/purchase/get-started (last visited Aug. 16, 2018) (claiming to have "[r]einvented the [a]pproval [p]rocess" and promising loan approval "in minutes"); SOFI MORTGAGE LOANS, https://www.sofi.com/mortgage-loan/ (last visited Aug. 16, 2018) (offering a "painless" process that simply and quickly provides consumers with funds).

[10] *See, e.g.*, DOORSTEPS, https://www.doorstepsbuy.com/ (last visited Aug. 16, 2018) (providing resources to home buyers with an open channel of communication to real estate agents).

[11] *See* Judge, *supra* note 3, at 632–33 (noting how intermediaries lobby for regulations that entrench their positions and the high fees they demand).

To be sure, market forces have failed mortgage borrowers in the past, as the financial crisis of 2008 is startling proof. The law should not turn its back on the vulnerable in these significant financial transactions. Fintech firms are likely to follow in the footsteps of other technology startup companies to try to change the law to suit their businesses. Uber is a leader in what Elizabeth Pollman and Jordan Barry call "regulatory entrepreneurship," that is, the practice of some firms of making regulatory change a significant part of their business plan.[12] Regulatory entrepreneurship is evidence that regulation can hamper the market and that businesses may try to influence lawmakers to enact rules that favor them, often to the disadvantage of other businesses or even consumers. Pollman & Barry's observations combined with Judge's reveal the dangers of the strong influence of the regulated in the promulgation of specific regulation. This Article argues that the relatively flexible common law should dominate to the extent possible, with regulation only filling the spaces where the common law cannot reach.

This Article makes several contributions to the literature. In order to make a new observation about the function of regulation and common law as they apply to intermediaries, it uses mortgage lending as an example because the mortgage industry is subject to evolving levels of regulation and is a market that is experiencing real innovation while its relatively unsophisticated consumers try to find the services they need. The Article reveals how regulation has perpetuated practices that can harm mortgage borrowers. It contributes to the literature on fintech and startup firms by finding new businesses and new practices by established businesses springing up through the cracks of the traditional system and the regulations that govern it. Anticipating where these innovations might be headed, the Article offers a market-based solution to the problems keeping many potential and new homebuyers from successfully participating in the mortgage market. Finally, it contributes to recent literature on how businesses influence the regulations that govern them and finds that the common law may be best able to protect the vulnerable while allowing market innovation to flourish.

Part I of this Article explains the problems affecting home buyers in the current consumer finance market. It begins by explaining the difficulty the current mortgage market has in balancing ability to repay with access to funds. In response to the over-lending of the last decade, the "ability to repay" regulations limiting mortgage lending in the Dodd-Frank Act may have led to under-lending.[13] While ability to repay is important to both

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[12] Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 385 (2017).

[13] *See* Jason Scott Johnston, *Do Product Bans Help Consumers? Questioning the Economic Foundations of Dodd-Frank Mortgage Regulation*, 23 GEO. MASON L. REV. 617, 677 (2016) ("While there are certainly other factors contributing to some recent trends in the housing market, Dodd-Frank

lenders and borrowers, too strict a definition can prevent the market from lending at the optimal rate and under optimal terms.[14]

Part II explains that we should adjust the way we think of commercial lending relationships, particularly those that lead to securitized loan obligations. In those situations, we can think of the borrower both as an issuer of a security and a buyer of a financial product. As members of a widely dispersed, poorly represented group in transactions with sophisticated and/or well-diversified parties on the other side, these borrowers/buyers do not have the same kind or degree of protection as similarly situated investors. With large groups of "buyers" on both sides of most modern mortgage transactions, it is important to have adequate representation and opportunities for education about the transaction available for all interests. A real BSI has the potential to do that work, and new and existing firms are beginning to respond to that need. Specifically regulating by industry can result in incorrectly categorizing a transaction and failing to provide appropriate protections.

Part III of this Article explores how intermediaries who are in positions to help unsophisticated consumers have failed to do so and explains how regulation failed to prevent, and possibly even perpetuated, the harm. Learning more about those intermediaries and attempts to deliver different kinds of services to borrowers will help us anticipate the next BSI and to design it in such a way as to avoid the pitfalls of the past. It particularly takes issue with the mortgage broker design and holds mortgage brokers up as an example of the expensive and harmful effects of specific regulation of intermediaries whose allegiances are not truly aligned with the buyers they purport to represent.

Part IV takes stock of the consumer finance market and anticipates likely next steps. It focuses on the kinds of services firms are beginning to offer and what consumers seem to want. Part V then proposes a business model for a BSI. The BSI imagined by this part of the Article may never exist and its specific contours are not the Article's aim. Rather, thinking through how such a firm should operate and how the market could lead to an intermediary that helps buyers more and is still profitable helps us understand the proper role of the law in solving the significant problems posed by our current methods of guiding consumers through difficult financial transactions.

Part VI argues that a common law framework best supports the beneficiaries of intermediaries' services. It explains how common law

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has likely decreased subprime mortgage lending, increased renting, and has led to an increase in other types of lending."); Adam J. Levitin et al., *The Dodd-Frank Act and Housing Finance: Can It Restore Private Risk Capital to the Securitization Market?*, 29 YALE J. ON REG. 155, 171–72 (2012) (detailing how, during the housing bubble, mortgage lenders overpriced mortgages whereas, after Dodd-Frank, there is a persistent problem of underpricing the risk).

[14] *See* Johnston, *supra* note 13, at 678–79 (describing how a rigid definition of the ability to repay has substantially limited the types of mortgages offered to poorer and higher risk consumers).

principles can protect consumers and avoid regulatory capture that has plagued the industry in the past. Finally, it argues that specific regulation may be necessary in some circumstances, but that that regulation must be limited to addressing problems that the common law cannot. Before enacting regulation that will apply to one industry, we must ask why the law is not already addressing the particular problem. And if we discover that it simply cannot, only then is specific regulation recommended.

I. FAILURES IN THE LENDING MARKETS

A surplus of mortgage loans in the early 2000s caused a bubble in housing prices that led to the 2008 financial crisis. When that bubble burst, creditors were no longer able to cover the loans they had made by foreclosing upon homes, consumers could not use equity in the homes to refinance, and borrowers who had received loans they could not realistically repay defaulted in large numbers.[15] Lenders were unable to recoup their losses. An active derivatives market left most major American financial institutions exposed to the significant losses in the mortgage markets, which were on the brink of failure.[16]

A number of behavioral biases and poor predictions by borrowers and lenders[17] caused the over-lending problem.[18] Both borrowers and lenders relied on the faulty assumption that housing prices would rise forever.[19] The assumption that home values would serve as adequate collateral for any loan, no matter how risky, supported the decision to consummate a number of dubious loans. The securitization of loans also contributed to over-lending.

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[15] *See* Brian J.M. Quinn, *The Failure of Private Ordering and the Financial Crisis of 2008*, 5 N.Y.U. J.L. & BUS. 549, 567 (2009) ("As marginal borrowers who were now forced to pay higher rates began to default on their mortgages, the air quickly came out of the real estate bubble as subprime borrowers were forced into foreclosure."); Steven L. Schwarcz, *Understanding the Subprime Financial Crisis*, 60 S.C. L. REV. 549, 551–52 (2009) ("When home prices stopped appreciating, these borrowers could not refinance; in many cases, they defaulted . . . . These defaults in turn caused substantial amounts of low investment-grade mortgage-backed securities to default . . . .").

[16] Indeed, two major investment banks did fail: Lehman Brothers and Bear Stearns. Edward J. Estrada, *The Immediate and Lasting Impacts of the 2008 Economic Collapse—Lehman Brothers, General Motors, and the Secured Credit Markets*, 45 U. RICH. L. REV. 1111, 1116 (2011).

[17] "Lenders" in this Article refers to the source of capital for mortgage loans. Lenders may be banks or fintech firms or other private firms and are often ultimately the purchasers of mortgage-backed securities.

[18] *See* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1121–22 (2009) [hereinafter Bar-Gill, *Mortgage Contracts*] (finding that the complexity of mortgage contracts misleads the "imperfectly rational" borrower); Susan Block-Lieb & Edward Janger, *Demand-Side Gatekeepers in the Market for Home Loans*, 82 TEMP. L. REV. 465, 466 (2009) ("Conflicts of interest and gatekeeper failures on the supply side led to overlending [sic]. But errors in consumer decision making and the absence of demand-side institutions to protect consumers also led to overborrowing.").

[19] Melissa Schulz, Note, *VI. The Subprime Crisis: A Breeding Ground for Litigation*, 27 REV. BANKING & FIN. L. 307, 308 (2008); Schwarcz, *supra* note 15, at 550.

Because the originators of loans were not holding them for repayment, nor servicing the loans themselves, they lacked "skin in the game" and had incentives to originate risky loans that they could then package with safer loans and sell to investors as mortgage-backed securities.[20] If housing prices had increased as everyone assumed they would, borrowers would have been able to use the equity in their homes to refinance their mortgages on more favorable terms. Mortgage originators[21] could sell the loans off long before repayment became a concern—indeed, before payments were due in many cases. Even holders of mortgage-backed securities felt protected by the diversified portfolio of loans they held and their ability to recover the value of unpaid loans from foreclosure sales.[22]

Professor Oren Bar-Gill has explained in detail how lenders framed mortgage loans in terms that would exploit the behavioral biases of borrowers to entice them to take loans that looked inexpensive early in the loan term, but ended up being less affordable in the long term.[23] Lenders were able to make loans seem affordable by designing mortgage products with low upfront costs, such as interest-only loans[24] or adjustable-rate mortgages.[25] These loans often contained pre-payment penalties that significantly increased the cost of refinancing, high overall interest rates, and high penalty fees to which low-income borrowers were more likely to succumb than others.[26] Bar-Gill argued that the ability of lenders to take

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[20] Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 6–7 (2011); *see also* Gary Gorton, *The Panic of 2007* 68 (Nat'l Bureau of Econ. Research, Working Paper No. 14358, 2008), www.nber.org/papers/w14358.pdf (acknowledging "originate-to-distribute" as the idea that "banking has changed in such a way that the incentives have been fundamentally altered").

[21] Mortgage originators may be the banks that are lending the money and either keeping the loan themselves or selling it to another financial institution. They may also be mortgage brokers. The mortgage originator is the party that guides the borrower through the application process and identifies the loan the borrower will receive.

[22] Zachary A. Kisber, *Reevaluating MERS in the Wake of the Foreclosure Crisis*, 42 REAL EST. L.J. 183, 187–88 (2013) ("By the 2000s, mortgage-backed securities, many of which were subprime, were sold and traded in large volumes on the secondary market.").

[23] Bar-Gill, *Mortgage Contracts*, *supra* note 18, at 1109–10.

[24] The borrower only pays the interest on the mortgage through monthly payments for a fixed term. Once this term is over, the borrower will either refinance his/her home, make a lump sum payment, or begin to pay off the principle of the loan. Margaret Graham Tebo, *Unconventional Wisdom*, 91 A.B.A. J. 49, 52 (2005); *see also* Bar-Gill, *Mortgage Contracts*, supra note 18, at 1076 ("Interest-only loans and payment-option ARMs allowed for zero or negative amortization during the introductory period, further increasing the step-up in the monthly payment after the introductory period ended.").

[25] ARMs are mortgages with an interest rate that can change periodically. This change occurs "usually in relation to an index, and payments may go up or down accordingly. . . . It's a trade-off—you get a lower initial rate with an ARM in exchange for assuming more risk over the long run." FED. RESERVE BD., CONSUMER HANDBOOK ON ADJUSTABLE-RATE MORTGAGES 4 http://files.consumerfinance.gov/f/201204_CFPB_ARMs-brochure.pdf (last visited Mar. 23, 2017); *see also* Bar-Gill, *Mortgage Contracts*, *supra* note 18, at 1098–99 (detailing how the alternating interest rate resulted in substantially increased mortgage payments).

[26] Bar-Gill, *Mortgage Contracts*, *supra* note 18, at 1101–02.

advantage of these behavioral biases led to more lending to low-income borrowers and on much more disadvantageous terms than the market could sustain.[27]

More generally, the financial services and lending markets are hard on low income, subprime borrowers. The natural entropy of the market seems to lead to giving subprime borrowers loans they cannot afford and could never hope to repay while profiting from high fees and interest payments.[28] Industry after industry—from payday lending[29] to car sales to higher education[30]—has sought out borrowers with risky credit profiles, promised them access to cash, opportunities, and/or ways out of poverty, only to saddle them with debts equal to several times the amount of principal borrowed.[31] Borrowers with debilitating debt loads often dig even deeper, assuming they could never repay anything they borrow, so they are borrowing as much as they can just to stay afloat.[32] They begin to rely heavily on the income stream provided by debt and fall farther into financial ruin.[33] These tendencies of both lenders and borrowers seem opposed to the goal of finding and lending to responsible, low-income borrowers loans they can reasonably afford to repay.

Without government intervention, predatory lending seems almost inevitable. Any hopes that lenders have incentives to be repaid are dashed when the reality of subprime lending reveals the opposite. Securitization of consumer loans removes the connection between the original lender and the

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[27] *Id.* at 1121–22.

[28] *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7–11 (2008) (arguing the consumer credit markets are failing because imperfectly rational consumers have imperfect information and cannot avoid agreeing to credit contracts that are harmful to them); Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1, 34–37 (2004) (noting the extremely high interest costs and fees associated with subprime loans relative to prime loans and describing the marketing strategies that targeted subprime borrowers and encouraged them to engage in expensive refinancing of their mortgages).

[29] *See* Bar-Gill & Warren, *supra* note 28, at 44, 55 (explaining how consumer irrationality pervades the payday lending business); LISA SERVON, THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES 77, 81 (2017) (noting that payday loans are illegal in fifteen states); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 98 (2002) (referring to payday lending as "economic exploitation").

[30] *See* Susan Dynarski, *A Conveyor Belt of Dropouts and Debt at For-Profit Colleges*, N.Y. TIMES, Oct. 28, 2016, at BU6 (explaining that the loans many students take at for-profit colleges often lead to default).

[31] Bar-Gill & Warren, *supra* note 28, at 34–35, 44; Johnson, *supra* note 29, at 26.

[32] *See* Derek Thompson, *Your Brain on Poverty: Why Poor People Seem to Make Bad Decisions*, ATLANTIC (Nov. 22, 2013), https://www.theatlantic.com/business/archive/2013/11/your-brain-on-poverty-why-poor-people-seem-to-make-bad-decisions/281780/ (discussing research that finds that persistence in pursuing long term goals, such as saving, can be affected by the decision maker's perception of the long term—how long they have to wait and if they think saving will ever be effective).

[33] *Id.* (citing Anandi Mani et al., *Poverty Impedes Cognitive Function*, 341 SCI. 976, 976–80 (2013), which reports findings that living in poverty has a similar cognitive effect to losing an entire night's sleep and adversely affects the decision making of poor people).

eventual repayment of the debt. Fees and high interest rates compensate lenders beyond the repayment of principal.[34] Indeed, the credit card industry has long known that cardholders who pay their balance in full every month are not a source of income for the company.[35] When regulation tries to rein in predatory lending, lenders simply reinvent it.[36]

Government regulation responds as each new instance of predatory lending gains prominence, but market forces seem incapable of stopping predatory lending practices before they reach large numbers of borrowers. Borrowers seem unable or unwilling to select away from predatory loans. It is possible that lenders and borrowers both understand that a subprime borrower is already in financial trouble, desperately needs capital, and is unlikely to be able to repay any loan. Lenders have to make sure that they are able to profit, and borrowers only need to secure financing, no matter the source or the terms. A borrower will not go to jail for a failure to repay debts.[37] Bankruptcy is available often enough; debt collectors can be prohibited from calling.[38] If borrowers are going to freely borrow more money than they can repay, lenders might think they need protection. Designing terms to assure profits of some variety is what lenders receive for making capital available to people who would otherwise be barred from many sources of economic advancement. In these subprime markets, borrowers and lenders alike are behaving opportunistically. Under such

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[34] *See* James H. Carr & Lopa Kolluri, *Predatory Lending: An Overview, in* FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 31, 31–32 (Fannie Mae Found. Ed., 2001) (discussing the high interest rates associated with predatory lending).

[35] *E.g.*, *How do Credit Card Companies Make Money — The Business Model,* WALLETBUDDY (May 10, 2017), https://medium.com/walletbuddy-insights/how-do-credit-card-companies-make-money-the-business-model-d4892d301ac3.

[36] For-profit higher education seems to be at the forefront of convincing people to borrow money they cannot afford to repay by promising a future that will help them repay it, knowing full well that the likelihood of a profitable future is extremely low. Stephanie Riegg Cellini & Nicholas Turner, *Gainfully Employed? Assessing the Employment and Earnings of For-Profit College Students Using Administrative Data* (Nat'l Bureau of Econ. Research, Working Paper No. 22287, 2018). For-profit colleges are usually not able to offer their students the same kinds of future employment opportunities as their better-established non-profit counterparts. *Id*. Still, federally subsidized student loans fund tuition for educational programs regardless of the quality of the school, its reputation, or its ability to place graduates in jobs after graduation. Unscrupulous schools attract students and their ability to bring in federal dollars, then watch as those students, rather predictably, drop out of the program before completing it or are unable to find a job that allows them to repay the loans. *See* Dynarski, *supra* note 30 (noting that it is not the lender—the federal government—that is necessarily taking advantage of students, but the school that is taking advantage of both the borrower and the lender by promising a profitable future it cannot deliver).

[37] Matt Tatham, *Can You Go to Jail for Not Paying Your Bills?,* EXPERIAN (Dec. 12, 2017), https://www.experian.com/blogs/ask-experian/can-you-go-to-jail-for-not-paying-your-bills/.

[38] *Can a Debt Collector Try to Collect on a Debt That Was Discharged in Bankruptcy?*, CONSUMER FIN. PROTECTION BUREAU (updated Oct. 25, 2017), https://www.consumerfinance.gov/ask-cfpb/can-a-debt-collector-try-to-collect-on-a-debt-that-was-discharged-in-bankruptcy-en-1425/; *See also* 15 U.S.C. § 1692d (2012) (noting that a debt collector may not make phone calls "repeatedly or continuously with intent to annoy, abuse, or harass").

circumstances, it seems as though predatory lending is a sort of equilibrium.[39]

If it is an equilibrium, it is not a healthy one for lenders, borrowers, or the credit markets as a whole. Businesses that do not add value are propped up on the government's dime in the case of federally guaranteed loans. Unaffordable extravagances are funded with more enthusiasm than basic necessities, rendering basic necessities more difficult to afford as debt accumulates. Inability to repay debts is not always life-altering, but evictions and home foreclosures are significant hardships. Once the cycle of over-borrowing begins, it is difficult, if not impossible, to end without a bailout from a third party—often the government, through federal guarantees or the availability of bankruptcy protection—with all of the moral hazards that entails for both sides of the transaction.[40]

Thus, it would appear that not all equilibriums are net social benefits.[41] Subprime borrowing and industries built around giving low income, low credit score borrowers the illusion of participating in the middle and upper classes create negative externalities.[42] Borrowers might behave differently if they could properly appraise the future payoffs. A strong optimism bias prevents borrowers from accurately pricing their future payoff from borrowing money on the offered terms. For-profit education is a strong example of this problem. Even if low post-graduation employment numbers are reported accurately, optimistic students believe they will complete the program and be one of the lucky few to secure a high-paying job.[43] More generally, it is often easy to believe that we will make more money in the future, that income will increase over time, and that job prospects will

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[39] If the economy experiences a downturn, mass defaults could keep these arrangements from being profitable for predatory lenders at all. Someone has to be able to pay them something.

[40] David M. Herszenhorn, *Congress Approves $700 Billion Wall Street Bailout,* N.Y. TIMES, Oct. 3, 2008, https://www.nytimes.com/2008/10/03/business/worldbusiness/03iht-bailout.4.16679355.html.

[41] Often, in collective action situations, "the socially optimal outcome is not automatically achievable as the Nash equilibrium of the game." AVINASH DIXIT & SUSAN SKEATH, GAMES OF STRATEGY 356 (Ed Parsons ed., 1st ed. 1999).

[42] Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics,* 80 N.Y.U. L. REV. 513, 516 (2005).

[43] This miscalculation applies to more traditional, non-profit education as well where students pay large sums for programs that offer low probabilities of well-paying employment in the future. The New York Times has covered this phenomenon extensively. *See, e.g.*, The Editorial Board, *Keep For-Profit Schools on a Short Leash,* N.Y. TIMES, May 1, 2017, at A22 (noting that for-profit schools must get ten percent of their revenue from somewhere other than federal loans, and part of this ten percent can be private loans). Some for-profit schools offer the loans themselves, but charge high fees and interest rates. *Id.* One of the most well-known examples is ITT Technical Institute, which was sued in 2015 for fraud. *Id. See also* Erica L. Green, *For Students Swindled by Predatory Colleges, Relief May Only Be Partial*, N.Y. TIMES, Dec. 21, 2017, at A17 (discussing Corinthians College, which has a similar story to ITT Tech). The day before the Trump administration took office, the Obama administration approved $450 million of full loan relief. *Id.* Now, under the Trump Department of Education spearheaded by Betsy DeVos, the students who expected the full relief may only receive partial loan relief. *Id.*

improve with more education and stability. Information asymmetries and optimism biases prevent many borrowers from accurately pricing a loan's costs and benefits.[44] Both default on the loan and the tremendous burden of trying to make payments on it can cause severe negative externalities, such as reliance on social welfare programs, decreased productivity, increased costs of credit for all borrowers, and in extreme cases, harm to the credit markets or the economy.[45]

The regulatory reaction to these problems in the mortgage markets was to try address the information asymmetry without attempting to correct the optimism bias.[46] Congress included regulation of the mortgage industry in the Dodd-Frank Act[47] and created the Consumer Financial Protection Bureau.[48] The goal of the regulatory response was to make credit safer for consumers.[49] The Dodd-Frank Act, among other things, requires lenders to try to determine a borrower's ability to repay mortgage loans.[50] More broadly, the CFPB is responsible for ensuring that consumer financial products are safe for consumers by regulating against "unfair, deceptive, or abusive ads and practices."[51] The CFPB has broad authority to regulate consumer credit transactions and the sale or service of a variety of financial products.[52]

Both regulatory regimes take steps to limit the kinds of loans available to consumers in the interest of providing only "safe" products to consumers.[53] For instance, the Dodd-Frank Act requires mortgage lenders to determine before approving a loan that the borrower has the "ability to repay" loan at the time it is consummated.[54] Lenders find a safe harbor from this requirement when they make what are known as "qualified" loans whose

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[44] Barr, *supra* note 42, at 534.

[45] *See* Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 781-89 (2008) [hereinafter Bar-Gill, *Consumer Contracts*].

[46] *Id.* at 765–68.

[47] The Dodd-Frank Act's contributions to mortgage regulation were enacted in various sections of the Truth in Lending Act, the Department of Housing and Urban Development Act, the Real Estate Settlement Procedures Act of 1974, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Equal Credit Opportunity Act, and the Protecting Tenants at Foreclosure Act. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 11-203, 124 Stat. § 1376 (2010).

[48] The CFPB was formed to protect consumers in financial transactions. Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 334–35 (2013) [hereinafter, Levitin, *The CFPB*].

[49] Bar-Gill & Warren, *supra* note 28, at 98 (proposing the agency that would become the CFPB, and that one of its authors would head, as a way to ensure the safety of financial products for consumers).

[50] 124 Stat. § 1376.

[51] Levitin, *The CFPB*, supra note 48, at 337.

[52] *Id.* at 344–46.

[53] 12 C.F.R. § 1008.1 (2018).

[54] The lender must make a good faith determination to this end by collecting and analyzing documents relating to the borrower's financial condition and must consider the borrower's ability to repay all aspects of the loan: taxes, fees, insurance on the home, as well as the principal and interest payments due for the life of the loan. 124 Stat. § 1376.

terms fall within specified parameters of affordability and predictability.[55] The safe harbor for qualified mortgages ensures that consumers can understand and afford the highest payments they will have to make during the life of the loan, that the term of the loan does not extend beyond thirty years, and that the accompanying interest rate "points" and other fees do not exceed a threshold level.[56] With these restrictions in place, lenders are more likely to give prime loans (usually those accompanied by a twenty percent down payment, no or few points, and long term monthly payments that are safely within the borrower's ability to repay) than sub-prime or "Alt-A" loans.[57]

Rather than helping low-income, less-savvy consumers borrow more safely, the regulations seem to have prevented them from borrowing at all.[58] While discerning a consumer's ability to repay debt is important, so is ensuring that the consumer understands the terms of a loan and the consequences of various payment scenarios. Imposing liability on lenders for taking risks on lower-income consumers means denying access to credit to those consumers, many of whom would be able to repay the loans if they were given the chance.[59] Sensitivity to the fact that new regulations may chill lending too much and leave part of the population without meaningful access to credit has led the Office of the Comptroller of the Currency and the CFPB to ask lenders to devise innovative products that will allow lower income populations to have access to credit without imposing the widespread and

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[55] *Id.* § 1412.

[56] *Id.*

[57] "Alt-A" loans are "'medium risk' loans between subprime and prime" loans. Bar-Gill, *supra* note 18, at 1089.

[58] *See* Patrick T. O'Keefe, Note, *Qualified Mortgages & Government Reverse Redlining: How the CFPB's Qualified Mortgage Regulations Will Handicap the Availability of Credit to Minority Borrowers*, 21 FORDHAM J. CORP. & FIN. L. 413, 432 (2016) (discussing how minority borrowers with particular loan-to-debt ratios may become delinquent on their loans); Patrick Barnard, *Hispanic Market Represents Huge Opportunity for Mortgage Lenders*, MORTGAGEORB (Oct. 5, 2016), https://mortgageorb.com/hispanic-market-represents-huge-opportunity-for-mortgage-lenders ("It has been estimated that more than 50 million creditworthy borrowers were shut out of the mortgage market in the aftermath of the financial crisis, mainly due to stricter underwriting standards resulting from increased regulation."); Henry Grabar, *The Rich are Getting More Mortgages. The Poor are Getting More Car Loans*, SLATE: MONEYBOX (May 19, 2017, 4:51 PM) http://www.slate.com/blogs/moneybox/2017/05/19/the_rich_are_getting_more_mortgages_the_poor_are_getting_more_car_loans.html ("[B]ecause expensive debt goes where it can, and has flowed into the auto loan business . . . from the more tightly regulated mortgage industry . . . . [m]ore than [sixty] percent of new home loans go to borrowers with super-high credit scores, a record since record-keeping began in 2003 and double what the share was then.")..

[59] A borrower's inability to satisfy the current debt-to-income ratio does not mean that the borrower will not be able to repay her mortgage. O'Keefe, *supra* note 58, at 432 ("When loan-to-value ratio, total loan amount, and a borrower's credit score are all considered during the underwriting process, borrowers with a debt-to-income ratio between [forty-three and forty five percent] were only slightly more likely to become delinquent on loan payments than borrowers with a debt-to-income ratio between [thirty-six and forty percent].").

systemic risks subprime loans did in the early 2000s.[60] The balance is difficult to strike and the regulatory agencies seem to be interested in using market innovation to help reach it, recognizing that a balance, not just one-sided prime lending, is an important goal.

The goal seems to be to induce lenders to provide consumer-friendly loans. A consumer-friendly loan is one that a consumer is reasonably likely to be able to repay on time and without incurring penalty fees. Because individuals not only differ in their financial resources, but also their spending habits, the degree of financial assistance they receive from family and friends, and their future earning potential, discerning a consumer's ability to pay is more of an art than a science. Some information, like contributions from family members toward a down payment, could and would be disclosed, but creditors have learned that even very risky loans are often repaid eventually and such loans are often very lucrative for lenders.[61] Borrowers also benefit from the access to credit provided by risky loans because it allows them to achieve a standard of living that may have otherwise been unavailable to them. Thus, it is not beneficial to either borrowers or lenders to limit mortgages to only "qualified" or "safe" mortgages. A "risky" loan may still be "consumer friendly." Providing credit to low-income borrowers or those with low credit scores has always been a difficult proposition.[62] The recent financial crisis is evidence that too many such loans can cause serious systemic problems. Still, a "consumer-friendly approach" balances access to credit and a responsible attitude toward repayment.

The focus of the regulatory response on disclosure has been ineffective because the disclosures are too long and detailed for consumers to be able to read and understand and because the disclosure of mere terms of a loan, even if it is intelligible, does not overcome an optimism bias that may tempt borrowers to agree to loans they cannot repay. The understanding and accurate evaluation of the information is just as important as its receipt. In turn, understanding loan terms, interest rates, monthly payments, and fees is helpful, but it still does not overcome biases about how much a borrower will be able to afford over the life of the loan. Forcing lenders to explain to borrowers what lenders know about a particular borrower's

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[60] CONSUMER FIN. PROTECTION BUREAU, FAIR LENDING REPORT 24–26 (Apr. 2016), *available at* https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201704_cfpb_Fair_Lending_Report.pdf.

[61] Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1258 (2002).

[62] Christopher P. Guzelian, Michael Ashley Stein, & Hagop S. Akiskal, *Credit Scores, Lending, and Psychosocial Disability*, 95 B.U. L. REV. 1807, 1811-24 (2015) (discussing the multitude of barriers to receiving credit that low-income individuals face).

creditworthiness, as suggested by Bar-Gill, would address this problem.[63] Lenders are able to predict with some accuracy which borrowers will have to pay late fees and how often. They know which loans are most likely to default and when. This information is included in the interest rate, but often disguised or manipulated in adjustable rate loans or interest only loans or hidden in fees the borrower may be convinced she will not ever incur. Communicating to a borrower directly that a loan has an x percent chance of defaulting or that a loan is in the x percentile of the riskiest loans may make the point more plainly.

This Article addresses the problem created by the regulatory response to the role subprime lending played in the financial crisis. Poor borrowers do not understand many of the mortgage terms they must choose among and do not understand how a given mortgage might affect them financially in the short or long term. Meanwhile, there is no one responsible for explaining mortgage terms and their consequences to these less sophisticated borrowers, and they are without representation in the most complex financial transactions of their lives. Because the problems created by lending to subprime borrowers are so systemically harmful, the response has largely been to simply stop lending to them.[64]

Improving upon the system of intermediaries available to facilitate mortgage transactions will be an important step in making mortgage loans more widely available and more successful. Under-lending to subprime borrowers excludes a large portion of the population not only from the financial and emotional benefits of home ownership,[65] but also from making valuable contributions to the economy. Banks and large lenders are concerned with systemic risk. They need to ensure only that their portfolio of loans does not fail; they are insensitive to the risks of any individual loan. Individual borrowers bear the greatest risk of loss if they default on their loans and are forced from their homes by foreclosure. Because the sophisticated parties making most of the decisions in the mortgage process do not bear much, or any, individual risk with the success or failure of individual loans, the borrowers who shoulder the bulk of the risk of loss are at a severe disadvantage. Paradoxically, they have the most to lose yet exercise the least control over the process. Further, consumers do not buy

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[63] Bar-Gill, *Consumer Contracts*, *supra* note 46, at 797–800 (pointing out that credit card issuers have information and models that will predict how a consumer will use the card and incur fees and suggesting that that information be shared with, or at least priced for, the consumer).

[64] The FHA still provides some refuge for those with poor credit and those who want to loan them money. It insures loans to people with low credit scores and/or those making small down payments, provided they show signs of financial responsibility such as having made timely payments on all of their obligations for a particular period of time. *FHA Loan Requirements: Important FHA Guidelines for Borrowers*, FHA.COM, http://www.fha.com/fha_loan_requirements (last visited Oct. 14, 2018).

[65] *See* William M. Rohe & Mark Lindblad, *Reexamining the Social Benefits of Homeownership After the Housing Crisis*, JOINT CTR. FOR HOUSING STUDIES HARV. UNIV. 1, 21 (2013), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-04.pdf (citing studies finding that owning a home gives a people a sense of stability which reduces stress and helps them manage hardship).

homes often, so they are not able to realize the benefits of being repeat players in the mortgage market. While lenders are able to perfect their strategies over time and are able to develop relationships with real estate agents and others who may send borrowers their way, borrowers are not able to realize those advantages. Working toward developing an intermediary who can be a repeat player in service of borrowers may be valuable as long as that intermediary is prevented from being captured by lenders. A legal framework to support the use of BSIs can help to provide that protection.

II. CHANGING THE WAY WE THINK ABOUT CONSUMER DEBT

First, it will help to understand that mortgage borrowers are both buyers and sellers in a loan transaction and to appreciate the incentives the various parties to a mortgage transaction have. There are two ways to think of the relationship between mortgage borrowers and lenders. One view labels mortgage borrowers as issuers who are "selling" or "issuing" debt. This is the securities law paradigm.[66] Borrowers are issuers or sellers, and lenders are investors, or buyers, of promissory notes. The other view, used by consumer law, labels mortgage borrowers as buyers who are purchasing mortgages, which are complex financial products.[67] Lenders are selling mortgage products and borrowers are buying money at a price and under terms set by lenders.

The difference is important because we usually think of sellers as having an informational advantage over buyers. We design disclosure rules and define representatives in response to a belief that buyers must be able to overcome some informational asymmetries with sellers. With regard to mortgage lending, both views are accurate. Both sides of the transaction require information from the other that the law would rather the parties not be able to conceal. Both are relatively vulnerable to sharp dealing by the other at various points in the transaction. A solution that appreciates and balances the two views is likely to lead to more efficient lending and borrowing than one that sees borrowers as only vulnerable or lenders as the only party requiring information to make an investment choice.

Securities law views borrowers as sellers. When a party wants to raise money from the capital markets on credit, that party is considered the "issuer" of the debt security, and the lenders purchase the securities the issuer offers. Issuers are subject to significant and often expensive registration requirements, so it stands to reason that consumer notes are not

[66] *See* Reves v. Ernst & Young, 494 U.S. 56, 66–67 (1990) (explaining that a note will be considered a security if: (1) it has an investment purpose; (2) it is from a common trading investment; (3) the public expects the note to be a security; and (4) the Securities Acts are necessary to reduce the risk associated with the note).

[67] *See* Bar-Gill & Warren, *supra* note 28, at 9 (discussing the uninformed yet rational consumer's understanding of sellers).

considered securities. It would be impractical to consider consumer borrowers "issuers" for the purposes of the notes they "sell" to lenders.[68] The liability that attaches to the issuer of a security would be prohibitive for most consumers. For this reason, commercial law and consumer protection law govern consumer loans while securities law only regulates loans made to businesses for investment purposes.[69]

For the most part, commercial law does an adequate job of regulating the rights and responsibilities of consumer borrowers and lenders once they have entered a lending relationship. It also governs lending transactions between banks and businesses, focusing most of its regulatory effort on payment methods and the use of security for loans.[70] Bankruptcy law supplements the commercial law governing debtors and creditors by determining a borrower's rights vis-à-vis its creditors and creditors' rights vis-à-vis other creditors when a borrower cannot pay all creditors as agreed.[71]

But there is a gap in helping the vulnerable buyer navigate the negotiation of the terms of the complex financial product. The commercial law, focused on lending transactions, does not respond particularly well to problems with negotiating loans, either with regard to the terms that apply to the loan or ways to ensure an unsophisticated consumer's understanding of those terms. These issues are mostly addressed through special regulation relating to consumer loans, such as the Truth in Lending Act.[72] The common law of contract can respond to some of the problems posed by negotiation between parties of vastly different sophistication by refusing to enforce loan agreements that involve fraud, misrepresentation, or unconscionability.[73] But as more loans and other kinds of contracts become more standardized and consumers become more accustomed to ignoring boilerplate terms, traditional contract law is less effective at protecting consumer borrowers from sophisticated lenders. Attempts to specifically regulate disclosure of contract terms and loan terms to consumers have succeeded mostly in making disclosures longer, thereby making consumers feel more

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[68] *See Reves*, 494 U.S. at 66 ("If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose . . . the note is less sensibly described as a 'security.'"); United Housing Found., Inc. v. Forman, 421 U.S. 837, 850–51 (1975) (finding a share of stock carrying a right to subsidized housing was not a security because "the inducement to purchase was solely to acquire subsidized low-cost living space" and not to invest for profit).

[69] *Reves*, 494 U.S. at 67.

[70] *Id.*

[71] *See* Bar-Gill & Warren, *supra* note 28, at 74 (discussing how consumers can be protected by contract law and bankruptcy law).

[72] Truth in Lending Act, 15 U.S.C. §§ 1601–1667.

[73] Nolo, *What Makes a Contract Valid?*, FORBES (Nov. 20, 2006, 2:46 PM), https://www.forbes.com/2006/11/20/smallbusiness-statelaw-gifts-ent-law-cx_nl_1120contracts.html#2f03146e6aff.

comfortable and protected, whether or not they actually are.[74] Some regulations have specifically addressed permissible terms of certain kinds of loans—notably mortgage loans—but fall short of encouraging market conditions that can lead to the creation of innovative loan products that allow low-income borrowers safe and responsible access to credit. Despite regulations designed to protect them, unsophisticated, inexperienced borrowers are either shut out of large consumer loans or have significant difficulty understanding the risks associated with the decisions they have to make in choosing the right loan terms.

Because of the different paradigms we've used for thinking about securities law and large-scale consumer lending, the two bodies of law have been hesitant to draw from one another. Borrowing consumer law's view of borrowers as buyers will allow us to apply lessons from securities law to the similar situation presented by the current mortgage lending environment. In mortgage markets, just as in securities markets, unsophisticated consumers are buying a complex financial product. The securities law has focused on creating conditions that protect unsophisticated investors from being taken advantage of at the hands of more sophisticated "sellers."[75] For example, the securities laws and the market conditions upon which they rely interpose learned intermediaries for securities offerings to individual investors and between issuers and individual investors on the secondary market. In the primary market, where securities are initially offered to investors, the issuer must either file a registration statement with the SEC before offering the securities to the public,[76] or demonstrate that the securities are being offered privately to a few sophisticated investors—or, in some cases—investors with a sophisticated representative.[77] Further, the extensive disclosure system mandated by securities regulation assumes that sophisticated intermediaries, usually analysts and institutional investors, read and digest the complex disclosures issuers make. Individual investors are not expected to read and understand these disclosures themselves, but are deemed protected by them because they are trading in a market informed by professional analysis of that detailed information. The consumer finance market mandates disclosure and tries to regulate what kinds of consumers

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[74] *See* BEN-SHAHAR AND SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 666–67 (2014) (finding that mandated disclosure rarely works, as most people assume that they can safely ignore most disclosures and lack the literacy to analyze them anyway); *see also* Angela A. Hung et al., Final Report, *Effective Disclosures in Financial Decisionmaking*, RAND CORP. 13–14 (2015), http://www.rand.org/pubs/research_reports/RR1270.html (noting that disclosure used in isolation may not provide investors with enough support to make informed decisions).

[75] C. Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 6 DUKE L.J. 1081, 1083 (1988).

[76] 15 U.S.C. § 77e(c) (2012).

[77] *See* 15 U.S.C. § 77d(a)(2) (2015) (noting that § 77e does not apply to transactions which do not "involv[e] any public offering.").

can be given access to which products, but fails to rely on or even suggest sophisticated intermediaries who can make investment judgments for inexperienced consumer borrowers. None of this is to say that securities intermediaries are perfect, only that some of them have helpfully focused on compensating for investors' lack of understanding of complicated disclosures. Consumer finance intermediaries have not yet evolved to serve the same purpose.

Mortgage borrowers have a collective interest and a collective action problem just as securities holders do.[78] The mortgage products banks made available to them are designed to appeal to a large number of borrowers. Each product, or set of mortgage terms, is designed for borrowers with particular characteristics, but may also be sold to borrowers in varying financial circumstances depending on the judgment of individual mortgage lenders. Securities investors are a similarly diverse group facing decisions about buying expensive, complex financial products. The securities regulations have sought to protect investors based on their common vulnerabilities while leaving room for markets to discover the best precise terms upon which investors can purchase securities.

The complete picture of modern mortgage investment is more complex than identifying the one seller and one buyer of a financial product. Borrowers are also issuers and public investors are still buyers of debt. Because mortgages are securitized, there is a traditional securities transaction after the mortgage product is sold to the borrower. A mortgage lender, typically a national bank,[79] securitizes a group of mortgages and sells interests in the income stream from a group of mortgages to securities investors.[80] Investment banks may also purchase and securitize mortgages, underwriting their own issuance of mortgage securities.[81]

There is some concern that agency costs affect the interactions between the mortgage originators and the ultimate purchasers of mortgage-backed securities.[82] Because they are planning to immediately sell the mortgages they negotiate with borrowers, mortgage originators may be less concerned about a given borrower's ability to repay. Indeed, many blame this state of affairs for the housing market bubble in the 2000s.[83] Some Dodd-Frank

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[78] *See* Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269, 278–79 (2003) ("Dispersed shareholders unable to act collectively allow opportunistic managers to expropriate large private benefits of control. Any single shareholder who expends additional resources in monitoring management or coordinating with other shareholders to change management will typically bear the costs alone . . . .").

[79] Either the original lender or a bank that buys mortgages from originators can serve this purpose.

[80] Victoria V. Corder, *Homeowners and Bondholders as Unlikely Allies: Allocating the Costs of Securitization in Foreclosure*, 30 NO. 5 BANKING & FIN. SERVS. POL'Y REP. 19, 20 (2011).

[81] *Id.*

[82] *See* Levitin & Twomey, *supra* note 20, at 8 (noting the inherent agency problem within the growth of consumer debt securitization).

[83] Adam J. Levitin et al., *supra* note 13, at 157.

regulations, such as those requiring that originators keep some "skin in the game" seek to alleviate that difficulty,[84] but commentators worry that those regulations are not enough.[85] Agency costs between the loan originator and the ultimate MBS investors mean the investors may be buying riskier products than they would otherwise, and because they cannot see the details about all of the borrowers who are obligated on the mortgages making up the security's income stream, they are riskier products than they realize. This second information problem, in addition to the agency problem, persists even after Dodd-Frank and may discourage private investment in the credit risk associated with mortgage loans.[86]

The models that have emphasized the agency problem in the mortgage-lending context have described the mortgage originators as the agents and the investors in mortgage-backed securities as the principals.[87] This is so even though these "agents" are sellers vis-à-vis MBS investors just as they are "sellers" of mortgage products to borrowers. Given the structure of the transaction, there is very little reason to think the mortgage originators are any more the agents of MBS investors than they are agents of borrowers. In both situations, the originator is selling a complex financial product to a buyer who does not have as much information about the product or the likely outcome of the transaction as the originator does. In both situations, the originator has an important informational advantage both with regard to the particular transaction, but also with regard to the market in similar transactions overall. Again, our traditional understanding of debt relationships stands in the way of seeing the relationships as similarly situated and applying similar principals to resolving their similar problems.

Creditors are not agents of borrowers, nor should they be. Creditors make decisions about whether to lend money and how much to lend based on their own financial interests. The fact that there is or could be a conflict of interest between the borrower's interests (in obtaining a loan) and the creditor's interests (in being repaid) is obvious to all involved. In the

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[84] *Id.* at 158.

[85] *See generally id.* (arguing that Dodd-Frank reforms that serve as "skin-in-the-game" credit-risk retention fail to solve the informational problems in the housing market). Specifically, the proposed bonding function where banks retain credit risk on securitized assets is likely insufficient because "investors cannot determine where a bank is competent at evaluating the risk on mortgages." *Id.* at 162. Therefore, Dodd-Frank is merely "replac[ing] one informational problem—that of securitization—with another—that of financial conglomerates." *Id.* Further, providing investors with large amounts of loan-level data will have limited benefit "absent proven credit risk models that can make sense of the relationships between the different variables disclosed." *Id*. at 173.

[86] *Id.* at 159–60. Credit risk, they say, is made up of both the risk of default and the risk associated with the severity of loss upon default. *Id.* at 157. Interest rate risk, on the other hand, is simply the risk assumed by all lenders that market interest rates will go down. *Id*. at 169. At the moment, the government takes on almost all credit risk associated with mortgages, while private investors stick to interest rate risk. *See id*. at 156–57.

[87] *Id.* at 226.

mortgage market, the original lender's lack of skin in the game creates a conflict of interest with both the borrower and the ultimate purchaser of the loan or the investor in an MBS containing the loan. That conflict is less obvious to the borrower. Lenders who are going to sell the loan to a third party have incentives to make riskier loans and so are not necessarily protecting their interest in being repaid. The Dodd-Frank Act tries to mitigate that problem by emphasizing the ability to repay in loan origination and by imposing "skin in the game" requirements for mortgage originators, but the fact remains that a securitization lending model complicates the mortgage originator's incentives beyond a borrower's assumptions or even understanding.[88] While not justifying anything like a fiduciary duty, the fact that borrowers cannot see or anticipate a given originator's incentives in making a loan means that the borrower lacks an important understanding of what the approval of a loan means and how the borrower should decide which loan product makes the most sense for her.

Before thinking through the design of a BSI that could better guide buyers through the mortgage process while also expanding access to credit and preventing large-scale foreclosures, we should first consider other uses of intermediaries in similar circumstances. Understanding the legal and regulatory pitfalls those intermediary systems encountered will help us to avoid those mistakes in the future.

III. THE TROUBLE WITH INTERMEDIARIES

Intermediaries abound. Salespeople and retailers of all stripes help consumers purchase products from manufacturers. Various brokers and agents facilitate more complex transactions. Lawyers and courts serve as intermediaries between citizens and the civil and criminal justice systems.

As noted above, Kathryn Judge has written about the lobbying power of intermediaries and how they can use their political and market influence to entrench high fees, even as those fees are inefficient and corrupt their incentives.[89] Of particular note for our purposes is the confusion around real estate agents. While Judge focused on fees, we will turn our attention to the buyer's understanding of the homebuying experience and to how courts have responded to a tangle of state regulations to try to honor the expectations and protect the vulnerabilities of buyers. This Part will also look at the mortgage broker, a position that was designed to represent buyers in the mortgage borrowing process, helping them select a loan and complete the application. Finally, it will consider the work of securities underwriters, largely for the purpose of borrowing from the dual roles underwriters play to inform the design of a potential BSI later in the Article. Securities regulations are very

[88] Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 161 (2009).

[89] Judge, *supra* note 3, at 641.

different from the market solutions to the mortgage borrower's difficulties this Article is most concerned with. But studying the design of the underwriting process and how the expectations of underwriters are managed can be helpful to thinking about how to design intermediaries in similar situations.

A. *Real Estate Agents*

Most people are mistaken about how real estate agency works.[90] There is a widespread assumption, even among real estate agents, that the selling agent—that is, the agent that shows the buyer the house and submits the buyer's bid—represents the buyer.[91] Traditionally, the listing agent is an agent of the seller and the selling agent is a subagent of the seller.[92] Many states realized that this arrangement left the buyer unrepresented and both the buyer and selling agent confused.[93] Buyers would often tell selling agents the most they were willing to pay for the house and the selling agents, contrary to their duty to the seller, would not pass that information on to the seller.[94] The truth of the arrangement left buyers completely unrepresented, often without their knowledge, because all agents were supposed to be cooperating to sell the house for the seller. This cooperation among agents seemed necessary to allow agents to openly share information about listings.[95] Another justification for the arrangement is the notion that the seller pays the agents' commissions out of the sales proceeds. Of course, sellers demand more money from buyers in the first place because they factor in the costs of real estate commissions. To say that only the seller pays the commissions does not quite tell the whole story. Granted, the buyer is only willing to pay so much, and once the seller finds the most the market seems to be willing to pay for her house, real estate commissions must be paid out of that total. But it seems obvious that if real estate agents did not exist, housing prices would be noticeably lower.[96] Buyers therefore incur some of the cost of real estate commissions. And yet, they are not necessarily

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[90] *See* Barondes & Slawson, *supra* note 4, at 682 (noting that common assumptions about real estate agents may be erroneous).

[91] *Id.*; Paula C. Murray, *The Real Estate Broker and the Buyer: Negligence and the Duty to Investigate*, 32 VILL. L. REV. 939, 949–50 (1987); Olazábal, *supra* note 5, at 72–73.

[92] Murray, *supra* note 91, at 939–40; Olazábal, *supra* note 5, at 72–73.

[93] Barondes & Slawson, *supra* note 4, at 683–84.

[94] *Id*. at 694.

[95] The advent of the Multiple Listing Service, a subscription-based service where all homes listed by realtors were collected and shared with all other licensed realtors, gave rise to the subagency arrangement. *See* Olazábal, *supra* note 5, at 73–76 (describing the role of MLS in mandating the subagency structure). The National Association of Realtors "agreed to eliminate seller-subagency as a condition of participation in a regional or local multiple listing service" in 1992. *Id*. at 74–75; Matthew Collette, *Sub-Agency in Residential Real Estate Brokerage: A Proposal to End the Struggle with Reality*, 61 S. CAL. L. REV. 399, 406–08 (1988).

[96] Judge, *supra* note 3, at 585–86.

represented by anyone in the transaction.

Recognizing that buyers are at a disadvantage both in their lack of representation and in their informational disadvantage vis-à-vis the seller, states have regulated home buying. Many regulations focus on mandating disclosure about the homes to be sold. Sellers simply must disclose and warrant the condition of certain elements of the home they are selling.[97] Regulation has also addressed the lack of buyer representation. States have taken different approaches, all aimed at allowing some kind of direct representation of, or help for, buyers in varying degrees.[98] Some can fully act as buyers' agents, while others may only perform ministerial acts such as submitting bids or making appointments.[99] Some states have given up on direct fiduciary representation of buyers and sellers entirely, designating real estate agents as "transaction brokers" who are beholden to the transaction itself, rather than to representing either party.[100]

These regulatory responses try to solve the problem of how to provide representation for both sides of a transaction where both parties are unsophisticated, and where the same agents or agency may be doing the work on both sides. The newer, specific regulations have failed to resolve the confusion about who represents whom because the regulations vary by jurisdiction and seem to complicate technicalities rather than resolve more fundamental questions of who truly represents the interests of [and helps] each party.[101] Only regimes that provide for separate agents for buyers and sellers with clearly disclosed roles can overcome confusion about what the role of a real estate agent is. Anything short of designating a separate agent to represent each party in a transaction is bound to result in confusion and some disloyalty to—or mistreatment of—one side of the transaction or the other.

Courts have been able to provide remedies for buyers, state regulation and industry practices notwithstanding. Some have found a fiduciary relationship even when the broker and buyer did not specifically enter into an agency relationship.[102] Others have done so by imposing obligations on agents to be "honest," "fair[]," and "ethical" in dealings with buyers even where no agency relationship was established. These requirements were

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[97] Murray, *supra* note 91, at 946; George Lefcoe, *Property Condition Disclosure Forms: How the Real Estate Industry Eased the Transition from Caveat Emptor to Seller Tell All*, 39 REAL PROP. PROB. & TR. J. 193, 198–99 (2004).

[98] Olazábal, *supra* note 5, at 75–76.

[99] *Id.* at 76–79, 86.

[100] *Id.* at 87–88.

[101] *Id.* at 130–31. The entire article is a critique of specific state regulatory attempts to solve the problems caused by the seller subagency system. Olazábal stresses that the regulatory response may have solved individual, particular problems, but may not have considered the big picture and may therefore have left unfortunate consequences of the operation of the real estate agent law and practice unremedied.

[102] Murray, *supra* note 91, at 957 (citing Harper v. Adametz, 113 A.2d 136, 189 (Conn. 1955)).

based on a "public interest" theory—that real estate agents and brokers owe duties to the community to behave in an ethical manner that does not harm the buyer by, for example, not communicating a buyer's bid to the seller or by misleading the buyer in fraudulent ways.[103] Still others have provided remedies to buyers for a failure of a broker to disclose key information about a property, relying on theories of misrepresentation.[104] Despite formal practices and the definitions of agent loyalties provided by statute, courts have still been willing to find remedies for buyers who have been treated poorly in their interaction with real estate agents who purport to work for sellers. The courts have been able to, on an equitable basis, provide a remedy where regulation failed to even provide clarity.

The fact of the matter is that real estate agents are most loyal to the transaction. That is, they want the deal to close.[105] They want houses to sell. More sales mean more commissions. High prices are nice, but higher volume is nicer.[106] This tendency by real estate agents harms sellers in that it prevents them from getting as high of a price for their home as they might be able to obtain if they waited longer.[107] It harms buyers to the extent agents may encourage buyers to buy any home quickly rather than waiting for the right home at the right price to come on the market. Representing her own interests, a real estate agent imposes agency costs on the transaction and does not have incentives to learn and pursue the best interests of either party. Pushing everyone to say "yes" can be detrimental when "yes" is the wrong answer for one or both sides of the transaction. When thinking about the optimal characteristics of a true buyers' side intermediary, it will be important to design incentives that are not tied to closing just any deal. But first, we turn to another intermediary in the home buying process: the mortgage broker.

B. *Mortgage Brokers*

Mortgage brokers are only used in about twelve percent of mortgage transactions.[108] This is in contrast to mortgage brokers' participation in the

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[103] *Id.* at 960–63.

[104] *Id.* at 964–84; *see also* Lefcoe, *supra* note 97, at 199 (describing common law remedies available to homeowners when sellers fail to disclose "known material latent defects (as defined by courts over time) not readily observable to buyers").

[105] Steven D. Levitt & Chat Syverson, *Market Distortions When Agents Are Better Informed: The Value of Information in Real Estate Transactions*, 90 REV. ECON. & STAT. 599, 599 (2008) (noting that real estate agents have strong incentives to sell houses quickly).

[106] *Id.*

[107] *Id.* at 599–600.

[108] *Lenders 101*, DOORSTEPS, https://www.doorstepsbuy.com/learn-more/2/lenders-101 (last visited Oct. 14, 2018).

majority of mortgage loans in 2002.[109] They have fallen out of favor with both lenders and borrowers. They once held the promise of being BSIs, learning about a borrower's credit qualifications and budget, then choosing from a large portfolio of loan options to find the right one for each specific borrower.[110] Because they had access to a variety of loans, brokers could often find more or better options for lower-income borrowers.[111] As is often the case, the problem with mortgage brokers and their incentives arose from how they were paid.

Mortgage brokers are often paid with origination fees, which are paid in cash by the borrower at closing.[112] In order to allow borrowers to pay the mortgage broker's fee over the life of the loan with their regular monthly mortgage payments, mortgage brokers used to be paid by yield spread premiums. A yield spread premium is in addition to the interest rate a borrower pays on a loan.[113] The mortgage broker is paid from the premium.[114] This form of payment allowed mortgage brokers to disguise their fee from borrowers and to receive more than they would have by simply charging an origination fee.[115] It also gave mortgage brokers incentives to stick borrowers, particularly riskier borrowers, with much higher interest rates than they would otherwise have to pay. They could tell borrowers that the excess interest was in their best interest because it lowered the amount of cash due at closing, which was an appealing option to lower-income borrowers. Some brokers collected cash from borrowers and yield spread premiums from lenders. It was not necessarily made clear to borrowers how much they were paying and why.[116]

The Dodd-Frank Act banned yield spread premiums.[117] Now, mortgage brokers can be paid with lender credits, which function slightly differently. Mortgage brokers may still add to the loans' interest rate, and they receive a

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[109] Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 290–91 (2007) (citing U.S. DEP'T OF HOUSING & URBAN DEV. OFF. POL'Y DEV. & RES., ECONOMIC ANALYSIS AND INITIAL REGULATORY FLEXIBILITY ANALYSIS FOR RESPA PROPOSED RULE TO SIMPLIFY AND IMPROVE THE PROCESS OF OBTAINING MORTGAGES TO REDUCE SETTLEMENT COSTS TO CONSUMERS 12 (2002)).

[110] *See id.* at 291 (describing the wide range of services provided by most mortgage brokers to assist borrowers with selecting the appropriate loan products).

[111] *See id.* (describing the lender and customer relationships of the average mortgage broker, which typically reviews the offerings of at least a dozen lenders and makes recommendations that are usually accepted by the customer).

[112] *Id.* at 289–90.

[113] *Id.*

[114] *Id.* at 291–92.

[115] *Id.* at 295–96 (reporting that mortgage brokers were paid significantly more—sometimes two or three times as much—when paid via yield spread premium rather than in cash with an origination fee).

[116] *Id.*

[117] 15 U.S.C. § 1639b(c)(1) (2018) ("[N]o mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal).").

commission from lenders, but they cannot collect both a lender credit and an origination fee from the borrower, and they must disclose the lender credit clearly to the borrower.[118]

Unfortunately, the new lender credit regime still does not solve the problem that mortgage brokers are paid by lenders nor does it address the conflict of interest inherent in the fact that mortgage brokers are bound to have closer relationships with lenders than with borrowers because they have repeated interactions with lenders. Further, the fact that mortgage brokers are paid as a percentage of the loan value encourages them to approve loans for higher principal amounts, regardless of the borrower's budget.[119] The ability to just add to the interest rate and amortize the loan over decades means that large differences in costs are made more palatable to borrowers. None of this is necessarily illegal, nor should it be, provided there is sufficiently clear disclosure. But it is not necessarily considerate of the borrower's best interests, and mortgage brokers retain some perverse incentives even after the Dodd-Frank Act's intervention.

C. *Securities Underwriters*

Understanding that securities investors and mortgage loan applicants are *buyers* of important, expensive financial investments[120] allows us to draw useful comparisons to securities offerings. There, the intermediary of interest is the underwriter. Underwriters negotiate with issuers on behalf of securities investors to investigate the issuer and the proposed offering, to price the offering and negotiate its terms, and to bring the security to the public market.[121] The price of the security depends not only on the value of the company's equity or the strength of its borrowing position, but also on any other advantages securities holders may have. For instance, bondholders may benefit from any collateral that secures the loan or the seniority of the position of their tranche of debt, or particular covenants that give the bondholders rights against the firm or its management in times of financial distress. Preferred shareholders may benefit from special rights to dividend payments, the ability to convert their shares to common stock, or voting rights. The underwriter's goal is to negotiate a security at a price and with

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[118] *Id.*

[119] Indeed, some lenders have vowed to stop accepting loans originated by mortgage brokers because they find that lender-originated loans are less likely to default. Marcie Geffner, *Banks Cut Off Mortgage Brokers*, BANKRATE (Apr. 2, 2009), https://www.bankrate.com/finance/mortgages/banks-cut-off-mortgage-brokers-1.aspx.

[120] *See supra* Part III.

[121] There are a variety of different underwriting relationships available. Most common is the "firm commitment" arrangement under which the underwriter agrees to buy the entire issuance of securities from the issuer and then sell those securities to the market. John S. D'Alimonte, *The Letter of Intent and Basic Structure of an Offering*, *in* SECURITIES UNDERWRITING: A PRACTITIONER'S GUIDE 94 (Kenneth J. Bialkin & William J. Grant, Jr. eds., 1985).

terms that will be marketable to the public.[122] If the terms the underwriters negotiate for the security are not appealing to investors, the underwriters will not be able to unload their shares and will lose money and significant investments of time.

Like listing agents, underwriters are retained and paid by issuers,[123] so they have incentives to work on an issuer's behalf to price and deliver securities to the market at a price that will support liquidity in the firm's securities. Unlike real estate agents, underwriters generally guarantee the IPO price of a stock by purchasing the stock themselves to maintain the initial offering price.[124] The issuer's and underwriter's interests are aligned in wanting to offer securities, a species of financial product, to the public on terms that will be desirable to investors. However, allegiance to the issuer also presents opportunities for capture of an underwriter by the issuer.[125] Not only does the issuer select and pay the underwriter, but the issuer may also use other segments of the underwriter's business. For instance, an investment bank that serves as an underwriter may have a retail investing division that operates mutual funds which the issuer could use for retirement plans.[126] The underwriter may also be so hungry for underwriting business that it is willing to give the issuer a break in order to keep the engagement.[127] Before the enactment of the Volcker Rule,[128] which bars proprietary trading

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[122] Wendy Gerwick Couture, *Price Fraud*, 63 BAYLOR L. REV. 1, 21–24 (2011); *see also* Arthur B. Laby, *Differentiating Gatekeepers*, 1 BROOK. J. CORP. FIN. & COM. L. 119, 132–33 (2006) (describing the role of the underwriter in advising the issuer on steps it can take to make its securities offer "more attractive" to buyers).

[123] The issuer initiates the process by engaging the underwriter to promote the distribution of securities. This conversation typically predates the securities offering, with the managing underwriter acting as an advisor on many issues pertinent to the offering. The underwriter acts in something of a fiduciary capacity with the issuer but also may have a direct or indirect financial interest in the offering because its fee is tied to the success of the offering at hand and the performance of each offering affects opportunities with future issuers. Laby, *supra* note 122, at 132–33.

[124] *See* Joe Nocera, *Facebook's Brilliant Disaster*, N.Y. TIMES, May 25, 2012, http://www.nytimes.com/2012/05/26/opinion/nocera-facebooks-brilliant-disaster.html?_r=0 (using the Facebook public offering to explain IPOs).

[125] Royce de R. Barondes, *NASD Regulation of IPO Conflicts of Interest – Does Gatekeeping Work?*, 79 TUL. L. REV. 859, 869–71 (2005); *see also* Laby, *supra* note 122, at 133–34 ("[U]nderwriters continue to have an interest in cultivating the client relationship to obtain additional consulting and other work."); Jeremy McClane, *The Agency Costs of Teamwork*, 101 CORNELL L. REV. 1229, 1238 (2016) (comparing prices of an IPO when issuer's counsel has worked with the underwriter in the past to when they have not worked together).

[126] *See* Barondes, *supra* note 125, at 870.

[127] *See* Laby, *supra* note 122, at 133–34.

[128] 12 U.S.C. § 1851 (2012). The rule was enacted as part of Dodd-Frank to prevent banks from making certain speculative investments to the detriment of their customers. Five agencies jointly issued final regulations implementing the Volcker Rule. *See* Keith R. Fisher, *Volcker Rule Agencies Issue Interim Final Rule Exempting TruPS-Backed CDOs*, 67 CONSUMER FIN. L.Q. REP. 337 (2013) (listing those agencies that were involved with the promulgation of the Volcker Rule and their goals). In part, the rule prohibits the activities of banking entities that "would involve or result in a material conflict of interest" between the entities and their clients or customers. 12 U.S.C. § 1851(d)(2)(A)(i) (2012).

by underwriters that would directly conflict with underwriting business, an underwriter may have had an independent equity stake in the issuer for whom it was underwriting an offering of more equity securities.[129]

Underwriters are notorious for over or underpricing securities.[130] Underpricing a security allows the underwriter's insiders to make a quick profit by trading IPO shares on the open market early in trading.[131] Overpricing shares may be an attempt to capture a larger fee than an offering warrants and disserves early investors in the issuance. The cost of overpricing is borne directly by investors with no benefit to the issuer. An underwriter's various interests may compromise its ability to serve as an effective gatekeeper. Attempts to discipline underwriters through regulations provide more examples of specific regulation having limited utility and the failure of regulations focused on disclosure to control behavior or incentives.

Intermediaries can add value by offering the benefit of their reputations to the parties they connect. Issuers can realize important benefits from the value of an underwriter's reputation among investors.[132] If investors can generally trust that a given underwriter has negotiated a fair deal for investors at an appropriate price, they will be more willing to purchase the security, and secondary market trading of the security will take off with the IPO price as a starting point. The success of prior offerings helps issuers when they return to the capital markets for funding in the future.[133] When issuers are able to offer reliably liquid markets in their securities, investors are more likely to want to purchase them. Retaining a well-regarded underwriter to sign on to an offering is an important part of securing public financing.[134]

While reputation is important to the value of a securities underwriter, reputations take time to build and have proven again and again to be an insufficient guard against opportunism by intermediaries. Many of the players responsible for the spate of financial fraud in the early aughts—such

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[129] Laby, *supra* note 122, at 133.

[130] Christine Hurt, *Initial Public Offerings and the Failed Promise of Disintermediation*, 2 ENTREPRENEURIAL BUS. L.J. 703, 725 (2008) ("[A]n agency cost hypothesis explains in the simplest terms why an underwriter would underprice IPO shares. In doing so, the underwriter rewards loyal customers, including institutional investors and investment banking clients . . . .").

[131] *Id.* at 723–24.

[132] Paul Schultz & Mir Zaman, *Do the Individuals Closest to Internet Firms Believe They Are Overvalued?*, 59 J. FIN. ECON. 347, 369 (2001) ("Underwriters, like venture capitalists, return to the initial public offering market repeatedly. Their desire to protect their reputation provides an incentive to avoid selling overpriced IPOs.").

[133] Laby, *supra* note 122, at 133.

[134] Andrew F. Tuch, *Conflicted Gatekeepers: The Volcker Rule and Goldman Sachs*, 7 VA. L. & BUS. REV. 365, 386 (2012) ("In metaphorical terms, underwriters are regarded as renting their reputations to corporations, a function that economizes on information costs and creates value for the issuing corporations.").

as rating agencies, securities analysts, and auditors—were supposed to rely on their reputations to maintain credibility and stay employed.[135] The risk of losing their good reputations did not keep them from engaging in massive fraud or misrepresentation.[136] So, while a valuable check, reputation alone is not enough to prevent capture by an intermediary and is certainly not enough to ensure that intermediary's competence. Part VI will suggest other legal mechanisms for preventing capture of BSIs by lenders and ensuring that BSIs do not defraud lenders in their eagerness to extend credit to new borrowers.

As all intermediaries do, underwriters impose agency costs on the securities offering process. Market forces, such as the effect of an underwriter's reputation on the success of an offering, can help lower agency costs, but do not eliminate them. The dual role the underwriter serves and its vulnerability to capture by issuers makes it difficult to monitor the underwriter's behavior and to figure out whether the underwriter is over-pricing or underpricing securities for self-interested reasons.

IV. MARKET ADVANCES

Markets often create new intermediaries as they grow. New start-up firms devise better ways to bring transacting parties together and to represent the interests of each. There are firms in the consumer finance market, including the firms described below, that are well-positioned to help home buyers in various stages of the process, particularly in deciding how much money to borrow and on what terms. No firm has become a pure BSI, however.

A BSI could solve the primary problems this Article has identified with the mortgage lending process. A BSI could help borrowers understand the terms of their loans and the short and long-term consequences of the mortgage terms to which they agree. It could also expand access to credit among lower-income markets by finding good credit risks among the borrowers currently shut out of mortgage borrowing. The presence of BSIs could improve borrower representation as they convince lenders to simplify loan terms and lower the costs of identifying worthy borrowers by applying improved techniques for evaluating creditworthiness. All of these worthy goals are in reach, as demonstrated by the work of the firms considered in this Part of the Article.

This Part of the Article explores developments fintech firms have made in helping consumers borrow money and buy homes. It considers what their work tells us about the existence of a market for these kinds of services and the gaps the market seems ready to fill with innovative business practices.

[135] JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 353 (2006).

[136] *Id.*

These new firms, or old firms growing into new areas, show potential for disrupting a field long dominated by tradition and strict regulation.

A. *Peer-to-Peer Lending—A False Start*

One consequence of the 2008 financial crisis was a steep decline in the availability of credit to individuals and businesses of all kinds and at all levels of wealth. Banks were not making loans, and when they did, they were not taking chances. As the sharing economy was gaining steam connecting those willing to help with consumers needing assistance, a similar practice took hold in financial services. Fintech firms tried to connect individual borrowers, seeking small loans for consumer purposes, with individuals willing to loan money to borrowers about whom they could learn via the lending platform.[137] This arrangement is known as "peer-to-peer" ("P2P") lending. Its goal is to serve "moneyball borrowers,"[138] that is, borrowers who may not have the hallmarks of prime borrowers, but who would be good credit risks anyway. P2P lending platforms could allow lenders to make a different kind of investment—to realize a return on loans usually only available to banks—while at the same time providing a way for borrowers with weaker credit profiles to access capital. There was money to be made and help to be found in the business the banks were refusing.

When consumers had trouble putting together enough of a credit line from a credit card or had trouble borrowing enough money from a bank on an unsecured basis, they turned to P2P loans. Most P2P loans were relatively small. A borrower may have wanted a loan to buy a car or to refinance credit card debt on more favorable terms. Early P2P loans were as small as hundreds of dollars and involved a high degree of contact between borrower and lender.[139] Individual borrowers would post their request for a loan online along with personal details about themselves and what they wanted to use the money for.[140] Lenders could "shop" among borrowers and select a borrower who wanted a loan of the appropriate size and whose story resonated with the lender.[141] Compared to banks, lenders in a P2P were more

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[137] Kathryn Judge, *The Future of Direct Finance: The Diverging Paths of Peer-to-Peer Lending and Kickstarter*, 50 WAKE FOREST L. REV. 603, 604 (2015).

[138] The term "moneyball" was famously coined by Michael Lewis in his book, *Moneyball: The Art of Winning an Unfair Game*, about Billy Beane's innovations as the Oakland Athletics' general manager. Beane focused on statistics to find underappreciated baseball players who were overlooked by scouts but would play well as a team. MICHAEL LEWIS, MONEYBALL: THE ART OF WINNING AN UNFAIR GAME (2004).

[139] Judge, *supra* note 137, at 604 ("[P2P lending] was simultaneously heralded as potentially expanding the pool of persons who could obtain credit, enabling persons who might not readily qualify for a bank loan to nonetheless obtain needed financing.").

[140] *Id*. at 609 (explaining that would-be borrowers had "the opportunity to tell their stories in their own terms," and would-be lenders also had the chance to read these stories and compare competing requests).

[141] *Id*.

willing to take bigger risks and to make loans on more favorable terms to borrowers because they were able to get a more personal sense for a borrower's creditworthiness.[142] Borrowers could turn to the lending marketplace for loans when it did not seem worthwhile to go to banks or when credit card interest rates were too high.

Over time, peer lenders wanted the same degree of creditworthiness upon which banks insisted.[143] P2P lenders started to use the same metrics as banks, and P2P lending platforms began to serve more as underwriters of debt securities than as online spaces for individual borrowers and lenders to find each other.[144]

Now, borrowers apply for loans on one part of the site, and accredited investors sign up on another part to invest in debt securities put together by the online lender.[145] Lender-investors are assured that they are investing in quality loans. No longer does a member of the middle class decide it would be fun to invest $200 in someone else's dream and surf over to the Lending Club to find the right recipient of their funds.[146]

Fintech innovation has come to mortgages as well. Because of the size of mortgage loans and the regulations that attend mortgage loan origination, marketplace lending for mortgages is not direct P2P lending. Instead, the fintech company finances the loan, securitizes its mortgage portfolio, and allows accredited investors to invest in its mortgage backed securities. These firms, such as SoFi, may try to attract borrowers with high credit scores by promising social interaction with other borrowers (and with SoFi executives) or by offering only three or four loan products with simple terms.[147] Borrowers may feel like they are borrowing with and from friends, and so they may feel more comfortable with the process, trusting SoFi more than they would a bank. This may be an important way for fintech mortgage lenders to compete with banks. Competing first for the borrower's trust and

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[142] Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & ECON. 673, 681 (2017) (describing the proprietary models used by marketplace lenders to rate the risk of particular loans while assessing the risk of various credit investments differently than banks would, and using more information than a simple credit score).

[143] Judge, *supra* note 137, at 605.

[144] *Id.*

[145] *E.g.*, *SoFi Mortgage Loans*, SOFI, https://www.sofi.com/mortgage-loan/ (last visited Aug. 25, 2018); *SoFi Private Placement*, SOFI, https://www.sofi.com/investing-resources/ (last visited Aug. 25, 2018).

[146] Judge, *supra* note 137, at 619 ("[T]oday's lenders have no direct relationship with the borrower receiving the funds provided. Rather, they have a claim only against the lending platform. . . . Thus, when looking at the structure of the relationship—as opposed to the expected return on the investment—it begins to look a lot more like a traditional bank."). There are platforms for such largess, but those more closely resemble crowdfunding (such as www.Gofundme.com) than traditional loans given in untraditional ways.

[147] Oliver Stanley, *A U.S. Online Lender Keeps its Millennial Customers by Helping Them Find Jobs (and Friends and Life Partners)*, QUARTZ (Feb. 13, 2017), https://qz.com/905980/us-online-only-lender-sofi-retains-millennial-customers-by-finding-them-jobs-and-life-partners/.

then providing simple, transparent loan terms the borrowers can easily understand would provide a more consumer-friendly experience than traditional banks offer.

Other innovations in the mortgage lending space have used the technology provided by the Internet to streamline and simplify the application process. For example, Rocket Mortgage, owned by Quicken Loans, promises to give applicants simple loan choices appropriate for their circumstances.[148] While these new approaches can be useful and save time, they fall short of offering borrowers different kinds of loans than other banks offer or more advice. They have focused on streamlining rather than disrupting the mortgage process.

P2P lending and marketplace mortgage lending have identified holes in the traditional credit markets that lenders and investors in debt securities are willing to fill. P2P lenders have shown that some lenders may be willing to lend on a smaller scale to Alt-A or subprime borrowers for lower interest rates than traditional banks.[149] Fintech firms may also be willing to help individuals reorganize their credit after banks have given up. They may also have identified an appetite borrowers have for a more personal experience and for more confidence that the loans they are agreeing to are affordable and understandable. Combining these insights might point to where new BSIs could start.

Finding ways to lend to low-income borrowers without government involvement is difficult. Private sources of capital simply do not have to take the risk and so choose not to. Fintech's attempts to reach underserved borrowers have failed to disrupt, or even significantly change, the consumer lending industry.[150] While there may be a few exceptions, credit scores seem to be a good enough metric that tell enough of a story about a borrower's credit worthiness to allow potential lenders and investors to decide whether to risk their capital.[151] There may be money to make in these riskier markets, but the current crop of lenders does not yet have the incentives to take the time and energy to develop that business.

B. *The Consumer Assistance Industry*

Firms elsewhere in the financial services market are positioning

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[148] ROCKET MORTGAGE, http://www.rocketmortgage.com/ (last visited Feb. 27, 2018).

[149] Judge, *supra* note 137, at 625 ("Paying off an outstanding credit card balance with a three-year or five-year loan from a P2P platform avoids any such complications and typically enables the borrower to pay a rate of interest that is significantly lower than the interest rate she had been paying on that balance.").

[150] Karan Kaul, *Will Fintech Innovation Benefit Borrowers of All Incomes?*, URB. INST. (April 16, 2018) https://www.urban.org/urban-wire/will-fintech-innovation-benefit-borrowers-all-incomes (discussing fintech limitations in reaching underserved borrowers).

[151] *See* Judge, *supra* note 137, at 617–18 (discussing the role credit plays in the borrower screening process).

themselves to help unsophisticated and relatively less creditworthy home buyers and mortgage borrowers. Examples include Zillow and Realtor.com and their subsidiaries. Various firms also offer to help consumers track and better understand their credit.[152] This Section will identify aspects of those businesses that BSIs could build upon, bringing together the strengths from other sources of help for consumers while adding a layer of sophistication that closes the gap between the borrowers and a successful, confident home-buying experience. I will then show how true BSIs would develop from current business innovations.

1. *Real Estate Help*

Zillow is a large corporation that specializes in making real estate information such as home prices and values easily accessible to buyers. Its subsidiaries include Trulia, which is a real estate shopping website that allows anyone on the Internet to browse real estate listings anywhere in the country for free. In another spin-off, Zillow recently launched RealEstate.com, a tool that takes an interesting approach to giving borrowers more guidance about the costs of mortgage loans and what a prospective borrower can afford on a given budget.[153]

RealEstate.com is targeted at first-time home buyers. It breaks down the monthly cost of purchasing a home with specific dollar amounts for individual fees and costs, including a utilities estimate, and provides users a total monthly price to compare to rent payments.[154] One immediate shortcoming of the site in providing advice to borrowers is that it relies on the borrower to set her own budget. The borrower must arrive at a responsible view of what she can afford to pay each month on her own, without guidance from the site. RealEstate.com compensates for errors the borrower may make in budgeting by showing users homes well within and below their budget and only showing a few properties near the top of their budget.[155] For example, using the traditional "two and a half times your income" metric, let's suppose a person making $200,000 per year could afford a $500,000 home with a $3,000 monthly mortgage payment. Entering $3,000 per month and $100,000 down into the RealEstate.com budget tool, the most expensive property in the search was $500,000. The search results began with properties priced as low as $45,000. A user can overcome this by searching for a price range for the total list price rather than focusing on

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[152] *See, e.g.*, CREDIT KARMA, https://www.creditkarma.com (last visited Sept. 7, 2018) (offering users the ability to monitor their credit and learn how to improve credit scores).

[153] Madeline Stone, *Zillow is Launching a New Site Just for Millennials Looking for Their First Home*, BUS. INSIDER (May 2, 2017, 9:00 AM), http://www.businessinsider.com/zillow-launches-realestatecom-for-millennials-2017-5.

[154] REALESTATE.COM, http://www.realestate.com/ (last visited June 8, 2017) ("Our All-In Monthly Pricing search includes estimated property taxes, HOA fees, PMI, utilities, insurance and closing costs to help take the surprises out of buying a home.").

[155] *Id.*

monthly cost, but that would not take advantage of the chief advertised benefit of RealEstate.com, which is the help it provides in understanding how a particular mortgage payment would fit within a given budget, and would duplicate searches available on all other real estate listing sites.

Strongly biasing search results to come in well below budget shifts the paradigm used by most home buyers, their real estate agents, and their mortgage lenders when searching for suitable homes. Many buyers may be biased in favor of finding the largest, most expensive home they can possibly afford. Real estate agents who want to close deals are unlikely to talk such buyers down. Buyers want larger homes with more amenities, real estate agents want larger commissions, and lenders like to write big loans with high interest rates. That kind of behavior contributed to the housing bubble and resulting crisis.[156] Such over-optimism can lead to foreclosure. Designed to provide advice for first-time home buyers, RealEstate.com seems to be nudging buyers toward shopping conservatively by drawing their attention to all they can find for far less than the most they could possibly manage—or not manage—to pay.[157]

A disinterested third party focused on giving advice can try to nudge homebuyers in a more responsible direction. Zillow's main home appraisal estimation business has become a key player in helping homeowners decide when to sell their homes and can act as a supplement to home-buying research in a given area. One could imagine Zillow and RealEstate.com putting together a suite of online applications that serve as a valuable source of advice and information as homebuyers approach the market. Armed with the tools such applications could provide, borrowers may be more sophisticated in their dealings with lenders and may have a better idea of how much they should borrow and on what terms. For instance, they could know in advance what their monthly payments and fees would look like and would be less likely to be surprised by higher-than-expected monthly mortgage bills. These kinds of tools may educate borrowers and simultaneously stifle some over-optimism. Further, because they will have looked thoroughly at a number of homes that are below budget for them, home buyers might be less likely to run to the upper-reaches of their financial limits.

Another innovative source of home buying advice is Doorstepsbuy.com, which is owned by Realtor.com. There, buyers create profiles any time

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[156] *See supra* Part II.

[157] *See* Casey Fleming, *Rent vs. Buy: Are You Ready to Own Your First Home?*, REALESTATE.COM, http://www.realestate.com/first-time-home-buyers/big-decision/rent-vs-buy/ (last visited Aug. 25, 2018) ("If you work on commission, carry credit card balances every month and have just enough to qualify for the loan and close on a home, a large monthly mortgage payment might crush you if you have something like a car breakdown, medical emergency or job loss were to happen. You can probably get approved for a loan with a 43-percent debt-to-income ratio, but, man, are you sure? You are better off waiting or shopping for homes that would result in a monthly payment that's 25 to 33 percent of your gross income.").

during the home-buying process, up to years before the buyer is ready to make a purchase. The profiles capture information such as what sort of home the buyers are looking for, geographical areas of interest, and the features that are most important to them. Consumers also input information about their finances and are able to put together all of the information they will need for the mortgage application in their Doorsteps profile. Real estate agents and lenders can then pay a monthly fee to have a presence on Doorsteps that allows them to access their customers' profiles to collect the information they need to serve their clients. Doorsteps does not charge home buyers, and its claimed services include:

> 100% unbiased information, written by industry experts and insiders, so you can avoid all the homebuying mistakes that helped worsen the housing crisis of the last ten years. That includes overpaying for a home, a mortgage, or any one of the dozens of service providers you'll need along the way. It also means finding the right people to support you – like inspectors or attorneys – and knowing they have the right information, presented in the right way, to be as efficient and effective on your behalf as possible.[158]

Doorsteps also provides help through a chat function that connects directly to an in-house customer service agent.[159] It is not clear how Doorsteps would prevent someone from "overpaying for a home" or a mortgage beyond giving conservative budget estimates once financial information is entered, but giving advice with those concerns in mind and orienting the buyer to the complicated process in a step-by-step way may help to overcome a fair amount of a first time buyer's lack of sophistication.

The Doorsteps mission shares some similarities with the goals of a BSI, but Doorsteps simply provides a platform for consumer communication with agents and lenders as well as generic advice which may be tailored to address particular financial profiles. It does not negotiate on consumers' behalf or otherwise involve itself in the process. It is a helpful platform but does not go as far as a BSI could.

One could easily see how a BSI could grow from these companies that provide advice and detailed information to consumers. Interest in their services indicates market interest for a BSI. These models for consumer information and advice represent helpful starting points for how a BSI could interact with buyers and help them understand the process while gaining enough information about a buyer to help the buyer find the right loan. As the next section will show, any company with access to a great deal of consumer data will have a natural advantage in taking steps to establish a

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[158] *Our Mission*, DOORSTEPS, https://doorstepsbuy.com/about_us (last visited June 8, 2017).

[159] *For Professionals*, DOORSTEPS, https://www.doorstepsbuy.com/professionals (last visited Sept. 7, 2018).

BSI.

2. *Credit Help*

Borrowers would benefit from advice serving their best interests, giving them the value of others' experience and savvy. Loan originators and banks that make mortgage loans have seen enough loans and loan applications to know what circumstances are most likely to lead to default and foreclosure; they know safe loans from risky loans and under what circumstances riskier loans may work out.[160] The benefit of that experience is rarely used to help borrowers make decisions that are best for borrowers. The incentives for loan originators are not aligned to encourage them to help borrowers. Competing with banks may be what it takes to encourage lenders to serve borrower needs beyond traditional financing.

Using BSIs for consumer borrowing is not just a matter of adopting a different mindset when originating loans, it requires involving different actors in lending decisions. BSIs should be able to identify borrowers presenting different degrees of credit risk and to evaluate them to determine what kinds of loans make the most sense for them. A number of market participants have the raw materials necessary to develop the models that would be helpful in predicting the success of various loans.[161] They may be able to sell that information to potential BSIs, but conflicts of interest may prevent them from doing so in a way that would benefit borrowers.

Credit reporting bureaus are examples of firms with detailed financial information about prospective borrowers and sophisticated algorithms that predict borrower behavior and likelihood of repayment.[162] Indeed, tracking and predicting creditworthiness is their main function.[163] Credit reporting agencies lack the connections to borrowers and banks that would lead to them becoming captured by one or the other.[164] A credit reporting agency would have a natural advantage in predicting what kind of home loan a particular borrower could repay and would be well-positioned to sell that information to interested parties. Because they place a premium on their ability to accurately predict borrowers' creditworthiness, credit reporting agencies would not be tempted to recommend borrowers for more aggressive loans than a given borrower could afford.

But it would be difficult for a credit reporting agency to build relationships with lenders and investors and to market themselves as helpers—rather than gatekeepers—to borrowers. It would require adding a

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[160] *See supra* notes 61–63 and accompanying text.

[161] *See supra* notes 153–59 and accompanying text for discussion of Zillow and Doorsteps.

[162] Mikella Hurley & Julius Adebayo, *Credit Scoring in the Era of Big Data*, 18 YALE J.L. & TECH. 148, 163 (2016).

[163] Brooke Niemeyer, *Who Are the Major Credit Reporting Agencies?*, CREDIT.COM (Apr. 11, 2018), https://www.credit.com/credit-reports/credit-reporting-agencies/.

[164] *See id.* (discussing the role credit reporting agencies play in helping consumers and business owners in the lending process).

completely different division to their business and may include changing the goals of their credit modeling. Rather than warning lenders about which borrowers to stay away from, a matchmaking credit reporting agency would be trying to help even the less creditworthy borrowers find appropriate mortgage loans. That may undermine their central purpose of providing reliable predictions about how borrowers will behave and would present a conflict of interest that may be insurmountable.

A better use of credit reporting agency data and modeling would be to create a division within the agency that sells specialized models to prospective lenders and BSIs. One important, though recently controversial, innovation of credit reporting agencies has been to sell credit monitoring subscriptions that give borrowers constant access to their credit reports and FICO scores.[165] The promise of honest communication with borrowers about how lenders see them and where they stand when applying for loans is an important step that could close some of the sophistication gap between borrowers and lenders. In addition to credit tracking, a subscription for credit monitoring could tell borrowers what loan terms lenders are most likely to offer them as well as what loan terms they are most likely to be able to repay, at what cost, and over what period of time. The trove of information credit agencies have on hand is exceptionally valuable to both borrowers and lenders, and the agencies are just beginning to learn how best to sell that information to interested parties.

Credit agencies cannot go quite far enough to truly close the information gap. The car sales market demonstrates some of the difficulty of having third parties provide pricing information to consumers. For example, consumers can look to Edmunds to appraise their cars for private sale or trade-in and can look at True Car to see the best prices others are receiving in their geographic area, but neither Edmunds nor True Car is available to actually provide that price to the conscientious consumer.[166] Consumers can share those numbers with car dealers, and while that information may inform the negotiation or may even pressure the car dealer to some extent, at the end of the day, the car dealer can name a price and the consumer cannot turn to the third party firm to get the better deal it claims should be available.[167] So even if a credit reporting agency says a borrower is qualified for a particular loan or should be able to receive a particular interest rate, that does not provide

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[165] *See, e.g.*, *Credit Monitoring*, TRANSUNION, https://www.transunion.com/credit-monitoring (last visited Sept. 7, 2018) (advertising a subscription credit monitoring service for "the low monthly cost of $19.95 per month").

[166] *See Car Selling*, EDMUNDS, https://www.edmunds.com/sell-car/ (last visited Sept. 7, 2018) (offering tips on how to sell a used car, but no price guarantees); TRUE CAR, https://www.truecar.com (last visited Sept. 7, 2018) (advertising the ability to get a "trade-in True Cash Offer in minutes," but no price guarantee from dealers).

[167] Indeed, this author has been invited to "go sell [her] car to Edmunds, then" by more than one car dealer.

any assurance that the borrower will be able to succeed in finding a loan on those terms.

The recent dustup between the credit reporting agencies and the CFPB shows that the agencies are very comfortable telling borrowers what they want to hear on one hand while promising to be good gatekeepers for lenders on the other.[168] Mortgage lenders also obtain far more information about a borrower's financial situation than a credit reporting agency does or could. So while the agency's metrics may work in broad strokes to convey information about where a borrower fits on a spectrum of borrowers based on past repayment behavior and outstanding credit, there is important information the credit bureaus may not have—current income, a new job not yet begun, a recent job loss, a recent marriage, a large loan or gift from a family member, or an inheritance—that would be essential to making a mortgage lending decision.

Of course, the credit agencies could easily offer the information to borrowers, which could serve the purpose of making the borrower a better-informed negotiator and shopper when looking to buy a home. The borrower could enter detailed information into a credit agency's form as part of her credit monitoring service and gain a better understanding of what kind of borrower she is and what her budget is before she begins shopping for a home. The credit agencies could use their data and models to put that information in a form the borrower could easily use without attaching the advice to a particular lender, loan, or property. That would have the advantage of giving the borrower some of the information she needs without attendant social pressure from a real estate agent, a mortgage lender recommended by a real estate agent, or the desire for a particular home.

BSIs could provide that service or buy the necessary data and algorithms from credit agencies. They could combine those resources with a long-term relationship with their borrowers to create an increasingly detailed and accurate picture of their borrowers over time so that the BSI could become an advisor upon whom the borrower relies again and again. The BSI's interest in the long-term relationship with borrowers and the superior effectiveness of their product when part of a long-term relationship would help to protect borrowers against capture of the BSI by lenders. A BSI's desire and incentives not to set its borrowers up for failure would also give lenders a place to go for responsible, well-vetted borrowers, lowering their costs of research and lending.

BSIs may be tech firms, they may be financial advisors, or they may be

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[168] The CFPB found that Equifax and TransUnion had deceived customers by telling them that the credit scores they purchased from the credit reporting agencies were the same scores lenders used to make credit decisions. They were not. Press Release, Consumer Financial Protection Bureau, CFPB Orders TransUnion and Equifax to Pay for Deceiving Consumers in Marketing Credit Scores and Credit Products (Jan. 3, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-transunion-and-equifax-pay-deceiving-consumers-marketing-credit-scores-and-credit-products/.

off-shoots of lenders. They may have any number of ways of signaling their incentives to borrowers and lenders. They may specialize in creating credit models and then using those models to match borrowers to the best loans for those with certain characteristics. Or instead, they might focus on customer service, offering a supportive borrowing experience with handcrafted loan products funded by outside lenders. In the likely regulation-free days ahead, there will be money to be made in finding ways to help borrowers responsibly navigate large personal financial transactions without winding up in a housing crisis, a credit crisis, or mass foreclosures. In the next Part, this Article suggests one specific way to provide that good.

V. A BUYERS' SIDE INTERMEDIARY

The BSIs proposed by this Article would be a market response to a problem caused by a market flaw exacerbated by flaws in regulation. In an attempt to protect borrowers, regulation has mandated detailed disclosures of the terms that apply to mortgage loans.[169] The disclosure is more than borrowers can easily read and understand, and the complexity of loan terms makes it difficult for borrowers to make informed choices about their mortgage loans. Moreover, the regulation is expensive for lenders, so it raises the costs of new lenders entering the market.[170] As in other industries, mortgage intermediaries were allowed to grow in prominence as their roles and methods of payment became specifically enshrined in regulation. Every party consumers encounter in the mortgage borrowing process either works for lenders, or, at best, offers generalized advice about how the borrowing process usually works, with little individual consideration of borrowers' interests.[171] But there is room for disruptive innovation—for the market to begin to operate differently. BSIs could avoid the high costs of regulation by not becoming lenders or mortgage brokers themselves and could serve as learned intermediaries who help borrowers understand the terms that govern their mortgages.

BSIs could operate as independent third parties to loan transactions. They could fill a market void by providing superior service and advice to a more diverse population of borrowers than banks currently serve. They could take care to have on hand a number of loan products from different banks to connect with their borrowers depending on the borrower's needs. As third-party actors, BSIs would avoid some of the incentives lenders have

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[169] *See supra* notes 58–63 and accompanying text.

[170] Jack Milligan, *How Technology Alters the Reality of Regulatory Compliance*, BANK DIRECTOR (Apr. 18, 2018), https://bankdirector.com/issues/technology/how-technology-alters-reality-regulatory-compliance/ ("The banking industry spends an estimated $60–$70 billion a year on compliance, and many banks complain they have been forced to expand their compliance staffs in recent years just to keep up with the increase in regulations. Indeed, compliance-related activities can account for nearly 20 percent of a bank's overhead.").

[171] *See supra* Part III.B.

that lead them to make loans to borrowers on troublesome terms. Freed from pressure to make a large number of expensive loans, BSIs would be able to give advice based on a particular borrower's best interests, even offering conservative advice about how a borrower should proceed. A BSI would provide lenders with borrowers well suited to loan products individual lenders offer. Such borrowers, ideally, would have a lower rate of default than those screened less carefully or those screened using less accurate assumptions about creditworthiness. Banks would continue to lend on their own, but might "subscribe" to a stream of borrowers identified and counseled by a BSI. Such an arrangement, providing banks with borrowers in varying financial circumstances, would allow experimentation with new ways banks could outsource the identification and vetting of borrowers.

A. *What Would BSIs Do?*

BSIs are most likely to begin as small start-up operations. Large banks are unlikely to design new mechanisms for originating mortgage loans because they already have substantial mortgage businesses and they are subject to regulation that makes it difficult and expensive for them to innovate. Large banks are able to do "enough" mortgage business using traditional methods and would lack the inclination and perhaps the time to develop mechanisms for finding overlooked borrowers. Giving into path dependence would allow banks to originate loans more quickly. That, in turn, would allow them to lend to more borrowers and generate a volume of investment that should allow sufficient diversification to protect the banks from loan-specific risk. For large banks, high volume of loans is the goal.

Smaller operations can focus more on the quality and specific characteristics of the loans they make because they will not be able to compete with banks on volume. They will be able to gain an advantage in different parts of the market by identifying alternative ways of doing business that may be more appealing to borrowers and investors. Innovation is how small firms compete with large, multinational banks. They have the appetite for risk-taking, as well as the flexibility to shift directions quickly to adapt to changing circumstances or setbacks.

The chief benefit BSIs can market to lenders is the identification of creditworthy borrowers. The cost of acquiring borrowers is part of a bank's lending business. BSIs would have to acquire new borrowers for banks at either a lower cost than the bank could alone or at a cost preserving the profitability of lending money to those borrowers. There has to be a reason to pay to subscribe to a BSI's stream of borrowers. BSIs should start by identifying corners of the market in which they can specialize by producing borrowers that lenders may otherwise have trouble identifying or reaching. For instance, a BSI would go to lenders and pitch its ability to identify particularly creditworthy, but perhaps hesitant-to-buy, first-time homebuyers.[172] A BSI may be able to draw lenders in with its specialty in a particular kind of desirable borrower and then offer to connect the lender with carefully-vetted subprime or Alt-A borrowers. The goal would be to develop an ability to identify and cultivate borrowers and to offer to connect lenders to that part of the market in ways they may not otherwise be able to connect themselves.

Then, just as securities underwriter would do, the BSI would negotiate the terms of the loans the lender would offer its borrowers. For example, a BSI might negotiate three loan products with each of three banks. A BSI could match its borrowers to loans from a number of lenders, but may only have one kind of loan it offers to borrowers with particular characteristics. That is, a borrower with a credit score of 600 who is buying a home for the first time and has selected a home well within her budget would be a good match for Loan One from Lender A, while the same borrower spending more money on her home might be a better fit for Loan Three from Lender B. BSIs would negotiate the loan products it recommends to its borrowers, organize those borrowers into groups according to their individual financial characteristics—determined by the BSI's proprietary modeling of borrowers—and then match borrowers from the various groups to the loans that suit them best. Once the BSI finds the right match for that loan product, it puts the borrower and lender in touch so they can complete the transaction, having vetted each for the other and having advised the borrower about what the loan terms mean and how to proceed.

The BSI provides a service for the lender as well as the borrower by negotiating a loan product it thinks it can place with the right kind of borrowers. The BSI's superior knowledge of borrowers helps the lender create a loan product with particular buyers in mind. The BSI also performs a service for borrowers by negotiating appropriate loans on their behalf, saving them from having to navigate loan terms they can't understand or accurately price for themselves. They may still have a choice among multiple-loan-products, but the BSI will be able to put those choices in

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[172] Millennials are an example of such a market. The hesitation of young adults to buy homes, particularly as compared with the home-buying practices of prior generations, is well-documented. *See, e.g.*, Don Lee, *Why Millennials are Staying Away from Homeownership Despite an Improving Economy*, L.A. TIMES, Mar. 1, 2016, http://www.latimes.com/business/la-fi-0301-housing-economy-20160301-story.html (outlining a variety of unique issues millennials face as a result of coming of age during the Great Recession and its impact on the housing market); Gail MarksJarvis, *Why Millennials are Finally Starting to Settle Down and Buy Homes*, CHI. TRIB. (Apr. 7, 2017, 4:07 PM), http://www.chicagotribune.com/business/ct-millennials-finally-buy-homes-0409-20170407-story.html ("Weighed down by massive student debt and job struggles, the generation brutalized by the Great Recession has lacked both the money and the desire to buy homes. They've been a generation of renters."); Derek Thompson, *Millennials: The Mobile and the Stuck*, ATLANTIC (Aug. 24, 2016), https://www.theatlantic.com/business/archive/2016/08/millennials-the-mobile-and-the-stuck/497255/ (arguing "that the decline in homeownership is a bifurcated phenomenon, with two extreme adulthood tracks . . . the supermobile and the stuck[,]" with the supermobile coming from richer districts with more access to education, and the stuck being those who grew up in poor neighborhoods).

perspective so the borrower can understand. For instance, sharing with the borrower anticipated risk of default for loan options can provide the borrower confidence about which choices would be responsible and affordable.

The borrowers would benefit from being "discovered" by the BSI, and the stamp of approval from the BSI may help them borrow on better terms than may be available to them otherwise. BSIs would do well to maintain long-term relationships with their borrowers when they can. Not only does that provide a counterbalance to their long-term relationships with lenders, but it also provides multiple opportunities to conduct business with the borrowers as they borrow money over the course of their lives. BSIs would not be limited to helping borrowers with mortgages. Borrowers would benefit from being "BSI Borrowers" as that may give them access to more and better loans and help them navigate the credit markets in a more sophisticated way. With a trustworthy source of advice and access to appropriate loans, "BSI Borrowers" may find access to the comforts of the middle class without losing everything for obligating themselves to debt they cannot service.

A BSI should develop a reliable model that measures the riskiness of the loans offered to each borrower. That kind of transparency would be useful to both borrowers and lenders. Borrowers could easily understand how risky their loans are, which will give them valuable information about whether to borrow under particular terms. Borrowers could choose from a variety of home price, APR, and payment term combinations and easily see which combination would be the most challenging and how likely they are to be able to repay each option. If APR were more accurate, the relative riskiness of various options might be even clearer to borrowers. But many borrowers focus on monthly payments in the near term and may not understand how risky a payment may become in the longer term.[173] Bond issuers receive a rating before the offering that tells them, and the market, how risky the bonds are. Mortgage borrowers would benefit from similarly clear information about the risks loans present, not just to lenders, but to the borrowers themselves. The subjective harms of home foreclosure are much more significant to a borrower than the risk of default is to a well-diversified lender. Of course, some borrowers and lenders will still choose to take big risks. The market should work more efficiently if everyone understands how big of a risk they are choosing with their investment decisions. Transparency, not just disclosure—and perhaps, as opposed to disclosure—is the goal.

Of course, as Levitin has pointed out, such information is only truly useful to lenders and investors if the BSI can accurately model the credit risk

[173] Bar-Gill, *Consumer Contracts*, *supra* note 46, at 776.

posed by borrowers with those attributes.[174] One problem with developing such models is that they can take time to devise and refine before they are reliable, and the factors affecting them may change too quickly for the model to keep up.[175] The riskiness of investments in mortgages is a dynamic variable. It is difficult to pinpoint the stability of the market or the riskiness of investments in it even when considering only traditional loans and securities. Defining classes of borrowers who would not necessarily receive loans on the traditional market would present a new difficulty. BSIs' borrowers would not necessarily have the same risk profile as other subprime borrowers because BSIs would take care to find borrowers with special characteristics and match them to appropriate loans, making them more likely than other subprime borrowers to repay. BSIs would also, ideally, design or lead borrowers to loans that would improve the chance of repayment.

While BSIs would be able to develop useful, individualized profiles of borrowers, they would not take the time or effort nor incur the costs of long-term personalized counseling. That is, they would offer generalized advice appropriate to a borrower with a specific financial profile and would be available to offer individual advice when needed. But BSIs are not hand-holders. To extend the metaphor a bit, a BSI advises on a good match, but is not the borrower's best friend and confidant. To update the metaphor, a BSI is eHarmony to banks' Tinder.[176] A BSI's strength is its propriety modeling of borrowers, collecting particular information and weighting it appropriately to arrive at a better assessment of the borrower's finances than is otherwise available. That information can help the BSI provide general advice for all borrowers with similar financial attributes and also to provide specific advice as needed based on the financial characteristics the BSI has ascertained. BSIs are not likely to invest in hours-long conversations with borrowers over the course of months or years about the benefits of particular homes to buy, particular financial decisions outside of the mortgage or other loan being matched, or life generally.

A chief difficulty facing BSIs as small-scale, "specialist" actors in the mortgage market would be finding metrics to identify the borrower

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[174] Adam J. Levitin et al., *The Dodd-Frank Act and Housing Finance: Can It Restore Private Risk Capital to the Securitization Market?*, 29 YALE J. ON REG. 155, 160 (2012).

[175] Geetesh Bhardwaj & Rajdeep Sengupta, *Credit Scoring and Loan Default*, 2–4 (Research Div., Fed. Reserve Bank St. Louis, Working Paper No. 2011-040A, 2011), https://research.stlouisfed.org/wp/2011/2011-040.pdf.

[176] I am indebted to Manuel Utset for this observation. For those who don't know, eHarmony uses a long questionnaire to evaluate its users and match them to each other based on carefully calculated assessments of personality traits, and what traits may be compatible. Tinder simply provides a platform for users to see photographs of other users and then match to each other quickly to begin a conversation. Tinder users make their first assessments based on appearance and are not aided by an algorithmic modeling of their personalities or their compatibility with other users.

population that the traditional banks are missing. As Kathryn Judge pointed out in an article about fintech lending, P2P lenders that started with the goal of disrupting lending actually fell back to using traditional metrics and lending to traditional prime borrowers.[177] Enticing investors to lend outside of the mainstream can be difficult. Safe investments are generally easier to market. But more personalized lending could help to resolve market failures. The potential is there if only the right entrepreneurs figure out how best to calculate and execute the risk.

BSIs, as described here, would not be classified as mortgage brokers because they would not originate loans. That would allow them to avoid a large swath of expensive regulation and open up the ways in which they could communicate and negotiate with lenders in the interests of borrowers. The next Section details elements of BSI compensation that will be important to help avoid the perverse incentives other intermediaries have given into in the past.

B. *BSI Compensation*

Maintaining a BSI's independence would be crucial to providing a new market actor that could avoid many of the dangerous pitfalls that seem inevitably to lead large-scale consumer lending to failure. A BSI must not have incentives to make improvident loans or to put borrowers in the riskiest, most expensive loans their incomes and credit scores can possibly justify. This section suggests contract-based mechanisms to ensure a BSI's independence. A BSI's independence will depend, in large part, on how the BSI is paid. Any number of contracts with borrowers and lenders could define a BSI's pay in a manner to preserve its independence or to provide it with the "right" incentives, whatever the borrowers and lenders decide those incentives should be. One could imagine a variety of schemes competing before determining which incentives and pay structures attract the most borrowers and lenders to the BSI's services.

In one possible payment arrangement, the BSI would collect flat fees from the borrower and the lender. The borrower would pay a small fee that might vary depending on the *complexity*, but not necessarily the dollar value of the loan. Loans with variable interest rates, interest-only loans, loans that require private mortgage insurance, loans with no or low down payments, jumbo loans, etc. would qualify as more complex than, say, twenty percent down, thirty-year fixed rate mortgages. A borrower could be given a choice among different loans—a simple, easily affordable loan and more complex, more expensive loans. The fee paid to the BSI would be higher for the more complex loans, both to discourage the borrower from taking the more complex loan and to signal the higher risk the borrower would be taking by choosing the more expensive loan. More complex loans may also require

[177] Judge, *supra* note 137, at 605.

more work on the part of the BSI, both administratively and in finding a matching lender, so the higher fee could also be justified that way.

Lenders could "subscribe" to a BSI's services by paying a subscription fee for making their loans available to the BSI's borrowers. The fee could vary in size depending on how many borrowers the lender is matched to or how many loans the lender negotiates with the BSI for offer to the BSI's borrowers. In order to convince lenders to take new risks on BSI borrowers, BSIs may have to guarantee some early loans, at least for a few years. While that would align the BSI's interests with a lender's interest in being repaid, it would not give BSIs incentives to match borrowers to excessively risky loans and would also align the BSI's interests with the borrower's interest in not suffering a foreclosure. In order to maintain independence, it is important that the BSI's pay be connected to neither the amount of the loan nor the riskiness of the loan.[178] The effect of the higher fee BSIs would receive for complex, and so perhaps riskier, loans should be overcome by borrower preferences not to pay a higher fee and the BSI's responsibility for guaranteeing some early loans.

An important feature of the arrangement between lenders and BSIs would be a reduction in the fees lenders pay for loans that default or are in arrears at the end of the given time period. Such a term would enhance the BSI's incentives to make loans borrowers can afford and to vet borrowers carefully, and it would give lenders some assurance that the BSI is, in fact, being careful. In a way, the BSI would have to stand by its product, compensating the lender for harms resulting from putting the wrong borrowers in the wrong loans. As mentioned above, a BSI may have to guarantee some or all of the loans it matches at the outset. But after that period is over and lenders have more confidence in the BSI's track record, this kind of fee arrangement could ensure that BSIs have some skin in the game.

C. *New Ways to Help Borrowers*

One way to pursue the goal of maintaining long-term relationships with borrowers would be to help them with more than just borrowing. BSIs could help borrowers save for a down payment and perhaps use that saving function as a way to give itself borrower-side incentives. For example, a BSI could set up low interest savings accounts that borrowers could then use as down payments for homes. Interest earned by the BSI from the deposits would help fund the work BSIs do on borrowers' behalf. Then, perhaps,

[178] However, the lender and BSI may define a loan of a particular size, say a "jumbo" loan, that might pay the BSI more. Loans that are large are unlikely to be given to borrowers who are not prime and who are not able to put down considerable amounts. While there may still be a potential for abuse, it is much smaller and borrowers shopping in that neighborhood are likely to be wealthier and more sophisticated than average.

from the same pool of returns, BSIs could offer some degree of matching when the money is used for a down payment, thereby giving the borrower incentives to go through with buying a home and using that money for the down payment.

Funds distributed from a Roth IRA will not be taxed as income if they are used for a down payment on a first home.[179] A similar tax exemption could apply to funds withdrawn from similar BSI accounts. Such legislative incentives to use BSIs would be akin to the regulatory breaks companies like Uber can get by serving underserved populations.[180] In order to maintain the favorable tax treatment, BSIs could commit to focusing a certain percentage of their business on certain underserved borrowers.

Another step BSIs might take is to insure the *borrower* against the risk of foreclosure. Private mortgage insurance currently protects lenders against the risk default of underwater mortgages.[181] Borrowers have even more to lose from an inability to pay their mortgages and have no similar protection. Of course, protection against an inability to pay one's mortgage could create a serious moral hazard, discouraging people from paying even if they can, but that result would just be a matter of arriving at the right price and the right terms for the right benefit. For example, the borrower could be insured up to a certain amount of the down payment, which represents many people's life savings up to that point in their lives. So, if a home is foreclosed upon, the borrower might be able to collect from the insurance a certain amount of that cash outlay to allow them to find and get into a new place to live. BSIs would have to set premiums and the circumstances under which the insurance would pay out carefully, perhaps working in conjunction with lenders to find the right balance. But such a scheme might really help the honest but unfortunate homeowner.

BSIs would add value to the mortgage lending market in several ways. First, small, relatively nimble internet companies with low overhead would be able to devote time and attention to finding borrowers who would otherwise be locked out of the mortgage loan market. Recent regulation may have left some worthy borrowers without banks willing to lend to them and BSIs can fill that gap.[182] Most importantly, BSIs would have incentives to serve both borrowers and investors in the loans. To attract the best borrowers, a BSI would have to develop a reputation for designing

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[179] Sean W. Mullaney, *More Than Just a Diploma: Roth IRA Conversions Sheltered by the Lifetime Learning Credit*, 14 GEO. MASON L. REV. 413, 436–37 (2007) (citing I.R.C. § 72(t)(2)(F)).

[180] *See* Daniel E. Rauch & David Schleicher, *Like Uber, But for Local Government Law: The Future of Local Regulation of the Sharing Economy*, 76 OHIO ST. L.J. 901, 957 n.305 (2015) (providing examples of Uber exchanging regulatory exceptions with local governments for promises to provide services that taxis do not).

[181] *What is Private Mortgage Insurance*, CFPB, https://www.consumerfinance.gov/ask/cfpb/what-is-private-mortgage-insurance-en-122/ (last updated Jul. 28, 2017).

[182] *See supra* Part II.

consumer-friendly loans—loans that the borrower could reasonably be expected to repay on reasonable terms the borrower can easily understand. In order to attract equity investors, BSIs would have to attract lenders to have loan products to offer their borrowers on favorable terms. BSIs would have to be able to describe the risk presented by an investment in each kind of loan it offers. As with any matchmaking situation, the BSI is only successful if the parties are happy to have found each other.

VI. LEGAL FRAMEWORK TO SUPPORT BSIS

If BSIs catch on, they will surely be regulated. Significant players in financial markets always are. Fintech firms and other starts-ups often meet with regulators early in the lives of their new businesses to lobby for regulations that will keep them honest, but allow them to operate profitably and compete with existing firms.[183] It is important for any new player to have an idea of how regulation could protect and affect its business model. This Part will consider legal rules, both common law and potential regulation, that would support a BSI's mission while protecting consumers from the risks they face in interacting with an intermediary in the mortgage market. It is important that common law doctrines of contract enforcement and fiduciary duty be allowed to dominate to the extent possible. Specifically regulating a new intermediary locks in certain aspects of that intermediary's business, whether good or bad for consumers, and stifles innovation and change.

Relationships between BSIs and borrowers and BSIs and lenders would be contractual. Contracts with lenders would be negotiated by sophisticated parties and are not likely to require special attention. Gaps in those contracts would be filled by the covenant of good faith and fair dealing.

The primary relationship that requires attention and protection is the fiduciary relationship between BSIs and borrowers. Because BSIs will be agents and advisors of borrowers, they must be held to fiduciary standards. A *buyers'* side intermediary must unequivocally represent and work for *buyers*. Fiduciary obligation will bar BSIs from conflicts of interest for which they do not have the borrower's consent.[184] It will work to allow courts to rule against and provide remedies for deals BSIs may make with lenders that compromise borrowers' interests. Because fiduciary enforcement is flexible and post hoc, it provides a means to address any kind of arrangement that gives BSIs interests that conflict with those of borrowers, however unpredictable. The flexibility the common law doctrine of fiduciary obligation provides is ideal for an emerging industry that may

[183] Pollman & Barry, *supra* note 12, at 406–08.

[184] Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 224 (2005) (arguing that fiduciaries consent to forego self-interested behavior); Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 926 (2006).

grow and change faster than regulation can be enacted. It also allows BSIs to experiment with a variety of arrangements while sorting the good from the bad.

Though fiduciary duties can be considered catch-all gap-fillers, fiduciary relationships can benefit from broad, expressive regulatory guidance. Professional responsibility standards, for example, inform fiduciary relationships between doctors and lawyers and their patients and clients.[185] Regulation of BSIs could state what goals a BSI should pursue in good faith and also specify the kinds of conflicts of interest BSIs would be prohibited from engaging in and from waiving. A regulatory statement of BSIs' purposes would have expressive value by guiding the industry to comply with norms for its behavior.[186] BSIs should work in good faith to find affordable loans for the borrowers they help, to match borrowers to loans that are suitable for the borrower's financial condition, to provide borrowers a realistic view of their individual budgets, and to negotiate loan products with simple terms are that are appropriate for that borrower's financial literacy. The notion of suitability has a securities regulation analog—brokers must only recommend securities that are suitable for a given client's financial circumstances.[187] Once these standards are articulated, they can give shape to a borrower cause of action to remedy injuries suffered as a result of sharp dealing by a BSI.

The legal framework suggested here should serve as a useful starting place that will not burden a new industry with overly-specific rules. I intentionally do not suggest specific standards for determining who may serve as a BSI or how a firm might "qualify" to become a BSI. Lenders and venture capitalists are likely to provide a good check on inexperienced or inappropriate entities trying to become BSIs. Lenders simply will not do business with unqualified entities. Licensing requirements also tend to be overly burdensome and expensive, and there is no indication yet that detailed licensing rules would be necessary here. Such regulation should be considered if and when it becomes necessary, and by then the precise nature of that regulation would be more apparent.

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[185] For the AMA Code of Ethics, see AM. MED. ASS'N, AMA CODE OF MEDICAL ETHICS (2016), https://www.ama-assn.org/delivering-care/ama-code-medical-ethics (last visited Oct. 14, 2018). For the American Bar Association Model Rules of Professional Conduct, see AM. BAR ASS'N, MODEL RULES OF PROFESSIONAL CONDUCT (2016), https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents/ (last visited Oct. 14, 2018).

[186] Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1701 (2000).

[187] FIN. INDUS. REGULATORY AUTH., FINRA RULES § 2111 (2014), available at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=15663&element_id=9859&highlight=2111#r15663 (requiring that a broker-dealer or associated person "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer . . .").

CONCLUSION

Consumer borrowers are largely unprepared for the complex financial transaction that accompanies buying a home. Consumer regulation has been enacted to try to help borrowers understand mortgage loans better, but those regulations have fallen short and are likely to be repealed in the near term. Low-income borrowers are underserved, and banks have failed to find innovative ways to reach them without engaging in the irresponsible lending that led to the last financial crisis. The market is ripe for a business to step in to solve this problem—to serve and help borrowers and to connect them to lenders through carefully chosen loan products that consumers can understand and afford.

The BSIs suggested by this Article would be a market solution to this problem. Tech companies and firms that operate in the consumer financial markets have devised new ways to serve consumer borrowers. A BSI can help borrowers overcome their relative lack of sophistication while putting borrowers in mortgages they have a good chance of repaying as agreed. The flexible common law provides the necessary tools to protect borrowers and allow growth and innovation in the new industry. Regulation should only broadly supplement the common law, not replace it. Regulation should not step in to specifically define BSIs or the rules they must follow. Such specific regulation tends to entrench high costs and to create a harmful path dependence that keeps markets in intermediaries from adjusting to better suit the needs of the less sophisticated parties they purport to represent.