Lending a Helping Hand?: A Guide to Kentucky’s New Predatory Lending Law

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NOTES

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BY KENT H. BARNETT*

INTRODUCTION

Predatory lending practices have plagued the poor since Biblical times, through the Renaissance to the modern day. Although governments have long outlawed or limited usurious lending, the American legislatures of the twentieth century have been trapped between two factions: the booming voices of lenders crying out for freedom of contract, and the stifled voices of the working class and the poor, whose mistreatment at the hands of unscrupulous lenders usually comes to the attention of legislatures only through the megaphone of advocacy groups. Addressing predatory lending practices has become more urgent as an increasing number of Americans buy homes.

Predatory lenders increased in size and number during the late 1980s and 1990s, encouraged in part by the 1986 changes to the federal tax code that favored second mortgages and credit spending. Moreover,

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As he sought to rebuild the Jewish wall, Nehemiah found that the rich were exploiting the poor. He admonished them for charging interest on debts and for mortgaging and foreclosing on the homes and fields of other Jews. Nehemiah 5:5–12. Other condemnations of usury exist. See, e.g., Matthew 18:21–35 (Jesus preaching that masters should be merciful with their debtors). Such passages led the Catholic Church to condemn the charging of interest for money and fueled Europeans’ longstanding suspicion of money lenders. See The Christian Church and its Promotion of Anti-Semitism (2005), at http://www.languedoc-france.info/a_jews.htm (noting that, although Deuteronomy 23:20 allowed Jews to lend money with interest to gentiles and these interest rates were a fraction of those that modern bankers impose, Christians accused Jews of usury).


ELIZABETH RENAURT & CAROLYN L. CARTER, NATIONAL CONSUMER LAW CENTER, TRUTH IN LENDING 200–01 (Supp. 2002). For readers who desire an introduction to

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mainstream lending institutions abandoned poorer areas during the same period, creating a void that predatory lenders quickly filled. These predatory lenders became the community's only financial resource. With these lenders cornering the market, subprime home equity loans nearly doubled, swelling "from $274 billion in 1994 to $470 billion in 1998." While these subprime loans could have resulted in a boon to low-income communities, they were not always benign. Instead, they were often predatory loans—subprime loans with additional unfavorable terms not found in prime-rate mortgages.

Even as legislatures encourage subprime lending because it allows people with lower incomes and troubled credit histories to obtain loans, they seek to prevent predatory lending, which unfairly harms these same people. In 1993, Congress held hearings on lending practices and found that "[a]busive practices continue to exist in some segments of the home equity lending market, demonstrating the need for additional protections. . . . [I]mproved disclosures [required for most home loans under the Truth in Lending Act] may not aid comparison shopping significantly in underserved markets where there is less competition." Federal legislation concerning predatory lending, Truth in Lending provides a comprehensive (and comprehensible) overview for advocates. The 2002 supplement details all of the latest changes to the Home Ownership and Equity Protection Act ("HOEPA"), codified at 15 U.S.C. § 1639 (1994).

Subprime home equity loans have interest rates above market rates. See Joseph A. Smith, Jr., North Carolina's Predatory Lending Law: Its Adoption and Implementation, presented at the National Conference of State Legislators Annual Meeting (July 26, 2002).

Although Smith, the North Carolina Commissioner of Banks, argued that banks must address predatory lending practices themselves, he stressed the difference between subprime and predatory lending. While subprime loans charge more interest than the market rate, the additional interest is necessary to compensate the lender for the additional risk. Predatory lenders not only charge high interest rates, they also include unfair terms that overcompensate the lender and make the loan disadvantageous to the borrower. See id.

See generally Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs, 103d Cong. (1993) [hereinafter Problems in Community Development Banking]; The Home Ownership and Equity Protection Act of 1993, Hearing on S.294 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 103d Cong. (1993). To motivate Congress to pass protective legislation, supporters from across the country traveled to the hearings by bus and sang spirituals and civil rights standards. RENUART & CARTER, supra note 3, at 202.

To remedy problematic lending practices, in 1994 Congress passed the Home Ownership and Equity Protection Act ("HOEPA") as an addendum to the Truth in Lending Act ("TILA"). TILA requires disclosure of loan information so that borrowers can easily comparison shop among lenders. Congress, however, found that these disclosures were insufficient to prevent predatory lending problems and passed HOEPA to address these insufficiencies. Unfortunately, HOEPA did not eradicate predatory lending. In fact, "[t]he subprime... mortgage lending industry [grew] significantly..., expanding from a $35 billion industry in 1994 into a $140 billion industry in 2000." In response, Congress amended HOEPA in 2001, requiring additional disclosures, placing certain substantive limits on home equity loans, and casting its net over additional types of loans.

Prior to 1994, federal laws preempted state usury ceilings and regulations regarding balloon payments, negative amortization, and prepayment penalties. States naturally had become less involved in regulating lending markets. With the passage of HOEPA in 1994, Congress repealed its proscription of state-law regulation by explaining that HOEPA should be interpreted "to allow states to enact more protective provisions than those in this legislation." State legislatures began attacking predatory lending during the late 1990s, passing more specific laws with harsher penalties than those under HOEPA.

In 2000, North Carolina became the first state to enact a predatory lending law. The North Carolina law requires, among other things, that lenders consider borrowers' ability to pay and that borrowers undergo...
credit counseling with a certified credit counselor.\textsuperscript{21} North Carolina’s Commissioner of Banks, Joseph Smith, said that states were compelled to legislate because federal legislation was insufficient to remedy predatory lending.\textsuperscript{22} Two years after passage of the new state law, Smith said that the law seemed to have had very little effect on credit availability in the state.\textsuperscript{23} North Carolina’s experience, which showed that protective legislation did not hinder the ability of poorer citizens to obtain loans, prompted several other states to follow its lead. Among the states that have recently enacted predatory lending laws or ordinances are California,\textsuperscript{24} the District of Columbia,\textsuperscript{25} Georgia,\textsuperscript{26} Illinois,\textsuperscript{27} Massachusetts,\textsuperscript{28} New York,\textsuperscript{29} Pennsylvania,\textsuperscript{30} and Texas.\textsuperscript{31} By 2003, New Mexico\textsuperscript{32} and Arkansas\textsuperscript{33} had also joined this group.\textsuperscript{34} Moreover, the AARP (formerly known as the American Association of Retired Persons) promulgated the Model Home Loan Protection Act in 2001.\textsuperscript{35} The Model Act extracts the best parts of various states’ legislation and provides valuable commentary concerning its provisions.\textsuperscript{36}

During the 2003 legislative session, the Kentucky General Assembly addressed predatory lending by proposing House Bill 240.\textsuperscript{37} The bill called for high-cost home loans to have a reasonable benefit to the

\textsuperscript{21} See id. at 50.
\textsuperscript{22} See Smith, supra note 5.
\textsuperscript{23} See id. at 4.
\textsuperscript{24} CAL. FIN. CODE §§ 4970-4979.8 (West 2002).
\textsuperscript{25} D.C. CODE ANN. §§ 26-1151.01 to -1155.01 (2001).
\textsuperscript{26} GA. CODE ANN. §§ 7-6A-1 to -13 (2004).
\textsuperscript{27} ILL. ADMIN. CODE tit. 38, §§ 1050.100-.2195 (2004).
\textsuperscript{28} MASS. GEN. ANN. ch. 183, §§ 1-18 (West 2004).
\textsuperscript{29} N.Y. BANKING LAW § 6-l (McKinney 2003).
\textsuperscript{30} PA. STAT. ANN. tit. 63, §§ 456.101-.3101 (West 2004).
\textsuperscript{31} RENUART, supra note 15, at 50. Not all of these states have followed North Carolina by passing specific legislation against predatory lending. For instance, Massachusetts adopted TILA so that victims of predatory lending have a cause of action under state law. But Massachusetts went further, applying its new law not only to closed-end transactions, (those where one borrows a set amount, such as with a traditional bank loan) but also to open-end transactions (those where one can borrow up to a certain limit, such as with a credit card). Texas, instead of passing legislation, amended its constitution. See TEX. CONST. art. 16, § 50(a)(6) (preventing foreclosure on homesteads with mortgages whose principal, when added to all other preexisting liens on the home, exceeds 80% of the fair market value of the home, and also protecting homeowners from several other predatory practices).
\textsuperscript{32} N.M. STAT. ANN. §§ 58-21A-1 to -14 (Michie 2004).
\textsuperscript{33} ARK. CODE ANN. §§ 23-53-101 to -106 (Michie 2003).
\textsuperscript{35} MODEL HOME LOAN PROT. ACT, supra note 14.
\textsuperscript{36} See id.
borrower and to be closed only at the "office of the lender, loan broker, attorney, title insurance company, or similar place of business."  It also excluded mandatory arbitration clauses (and any other type of clause that would foreclose borrowers from pursuing class-action remedies) and held assignees liable for any statutory violations. Most importantly, it demanded that the borrower undergo credit counseling, a requirement that was prominent in North Carolina's legislation. Unfortunately, however, this aggressive bill failed to make it out of the House Banking and Insurance Committee. Some representatives, such as Rep. Robert Damron, an investment banker, opposed it as "overly broad[.,]" destined to "[shut] people out of homeownership." Opponents not only attacked the counseling requirement based on the lack of credit counselors in the state, but they also condemned the provision providing assignee liability because they feared that the promissory notes would not be as valuable on investment markets.

In place of House Bill 240, the legislature unanimously passed House Bill 287, now codified as K.R.S. § 360.100. While not as protective as House Bill 240, this legislation still requires substantial disclosures and places substantive limits on high-cost home loans.

The purpose of this note is to furnish the consumer advocate with an in-depth analysis of Kentucky's new predatory lending law by examining the basic structure of the statute, and its ambiguities, faults, and remedies. Practitioners will understand the impact the law may have on high-cost home loans, the potential traps that await their clients, and the provisions that require amending. Part I discusses the applicability of the statute. Part II focuses on Kentucky's limitations that dovetail HOEPA requirements for high-cost home loans. Part III discusses provisions of the Kentucky law that require much more than, or in some cases something slightly different than, the federal legislation. Part IV considers causes of action and potential remedies.

38 Id.
39 Id.
40 Id.
41 Id. The world-wide-web version of House Bill 240 provides the latest progression of each bill considered by the Kentucky General Assembly. House Bill 240 was posted to committee on February 5, 2003, and the committee apparently took no further action.
42 Deborah Yetter, Proposed (Ky.) Bill Would Reel in Predatory-Lending [sic], COURIER-JOURNAL (Louisville), Feb. 5, 2003, at F1.
43 Id.
45 See id.
46 See infra notes 50–67 and accompanying text.
47 See infra notes 68–128 and accompanying text.
48 See infra notes 129–178 and accompanying text.
49 See infra notes 179–208 and accompanying text.
After parsing the statute and reading this note, advocates will understand the issues and arguments that are likely to arise and that the effect of K.R.S. § 360.100 will largely depend upon the construction given to it by the courts. Ultimately, K.R.S. § 360.100 could become a powerful weapon against predatory lending if consumer advocates, during the developmental phase of the statute, argue for liberal judicial interpretation and petition the legislature for amendments that will better effectuate the purpose of the legislation.

I. APPLICABILITY OF K.R.S. § 360.100

Before investigating the applicability of K.R.S. § 360.100, advocates for both sides must determine whether the legislation should be narrowly or liberally construed. Unlike the Model Home Loan Protection Act, which states that it "shall be liberally construed to effectuate its purpose[,]" the Kentucky law fails to mention the method of construction the courts should adopt. Until the courts make such a determination, lenders will likely argue that it should be strictly construed because the more liberal House Bill 240 failed and because the legislature did not expressly instruct the courts to interpret it liberally. Consumer advocates, on the other hand, may counter that the Act should be liberally construed in the same manner as the Kentucky Consumer Protection Act ("KCPA"), which is referenced in K.R.S. § 360.100, because both seek to protect consumers from dishonest business practices. The courts should accept the consumer advocates' position because, without liberal interpretation, lenders may be able to fulfill the letter of the law while ignoring its reformatory purpose. In fact, if the courts fail to read the statute broadly, they will overlook both the purpose of the statute and its actual wording. By punishing any "subterfuge" that would make a mockery of the predatory lending statute, the legislature has considered and condemned the possibility of literal compliance that fails to comply with its purpose.

To qualify for the protections of K.R.S. § 360.100, the loan at issue must be a "high-cost home loan." Such a loan is created when 1) "[t]he principal amount of the loan is greater than . . . $15,000 and does not exceed . . . $200,000"; 2) "[t]he borrower is a natural person"; 3) "[t]he debt is incurred by the borrower primarily for personal, family, or household purposes"; 4) the security interest is in the borrower's principal dwelling place; and 5) the mortgage is a "mortgage" as defined.

50 MODEL HOME LOAN PROT. ACT, supra note 14, § 1(c).
52 See § 360.100(3).
53 § 360.100(2).
by HOEPA. A "mortgage" under HOEPA must 1) be a consumer credit transaction, 2) have a security in the borrower’s principal dwelling place, and 3) have either more than 8% points of yield on comparable Treasury securities on the fifteenth day of the month immediately preceding the month in which the application is received by the creditor or total fees and points that exceed the greater of 8% of the total loan amount or $400. In 2001, Congress decreased the percentage requirements from 10% to 8% for first-lien mortgages (the first lien on the home mortgage); subsequent-lien mortgages still do not fall under HOEPA unless the rate is 10% greater than Treasury yields.

Under HOEPA, the term "mortgage" specifically excludes those mortgages qualifying as "residential mortgage transaction[s]" and thus covers only subsequent mortgages on consumer property. K.R.S. § 360.100, however, includes "residential mortgages" in its definition of "high-cost home loan" and applies, therefore, to both initial and subsequent mortgages. This seemingly small alteration greatly expands the reach of the Kentucky statute and demonstrates the legislature’s willingness to protect low–income borrowers from the problems faced throughout the home-buying process.

After determining that a high–cost home loan exists, one must next ascertain whether the lending party qualifies as a “lender” under the statute. The definition of “lender” under K.R.S. § 360.100 is extremely inclusive, referring to “any person who funds or negotiates the terms of a high–cost home loan or acts as a mortgage broker or lender, finance company, or retail installment seller with respect to a high–cost home loan.” Thus, almost any original lender will be subject to K.R.S. § 360.100. But since mortgages are frequently assigned and traded as

54 § 360.100(1)(a)(1)-(5).
55 12 C.F.R. § 226.32(a)(1)(i)-(ii) (2005). Congress gave the Federal Reserve Board the authority to clarify the requirements and applicability of TILA (including HOEPA). In response, the Board promulgated Regulation Z, 12 C.F.R. pt. 226 (2005). In Ford Motor Credit Co. v. Milhollin, 444 U.S. 555 (1980), the Supreme Court instructed the lower courts to defer completely to the Board and its regulations, unless the regulations were “demonstrably irrational.” Id. at 565.
56 Truth in Lending Act, 66 Fed. Reg. 65,604 and 65,606 (Dec. 20, 2001) (codified at 12 C.F.R. pt. 226). The Board lowered these rates because it had evidence that lenders would pursue predatory practices with loans just under the HOEPA limits. There was nothing to suggest that the reduction would have an impact on the ability of those with tarnished credit ratings to receive credit. See id. at 65,607.
58 See K.R.S. § 360.100(1)(a).
59 § 360.100(1)(b).
commodities, it is noteworthy that Kentucky's law applies to assignees only when an error "is apparent on the face of the disclosure or the underlying promissory note." Although Kentucky's law greatly reduces assignee liability and therefore reduces the pressure on original lenders to ensure that their mortgages comply with K.R.S. § 360.100, assignees still have significant liability under HOEPA.

HOEPA applies to creditors who provide more than one "mortgage" in a twelve-month period or, alternatively, one "mortgage" with a mortgage broker. While a lender who makes only one high-cost home loan a year without a mortgage broker can evade HOEPA, the lender cannot escape K.R.S. § 360.100. Nevertheless, Kentucky's law may not capture all lenders. Since K.R.S. § 360.100(1)(b) explicitly defines who is a lender at length, it is possible that, if a certain creditor does not fit the statute's definition, courts could conclude that the lender at issue does not fall under the statute. In the majority of instances, this definition will be sufficient to cover most lenders of high-cost home loans because "commercial banks are the primary source of home equity loans, although the other types of depositories as well as finance companies have significant market shares."

Finally, one must determine whether the Kentucky statute can confer jurisdiction over a particular case. K.R.S. § 360.100, with its far-reaching "long-arm" statute, should easily provide jurisdiction in most cases. The provision extends to any offer made or accepted in Kentucky

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60 See Robin Paul Malloy, The Secondary Mortgage Market—A Catalyst for Change in Real Estate Transactions, 39 Sw. L.J. 991, 1003 (1986) (finding that 65% to 70% of all mortgages are sold in the secondary market).

61 Id. The limited nature of assignees' liability in Kentucky has not gone unnoticed by the market. See Standard & Poor's, Predatory—Lending Provisions of Kentucky Law Reviewed (June 20, 2003), at www.mbaa.org/industry/reports/03/sp_re_ky287(2).pdf (determining that, even though punitive damages for assignee liability may be uncapped, assignee liability is limited enough that original lenders need only demonstrate that compliance procedures can identify any high-cost home loans that must conform to K.R.S. § 360.100).

Any person who purchases or is otherwise assigned a mortgage referred to in section 1602(aa) of this title shall be subject to all claims and defenses with respect to that mortgage that the consumer could assert against the creditor of the mortgage, unless the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by this subchapter, the itemization of the amount financed, and other disclosure of disbursements that the mortgage was a mortgage referred to in section 1602(aa) of this title.

63 § 1602(f).
involving a Kentucky resident with respect to real property within Kentucky, regardless of the situs of the contract or the location of the lender.\textsuperscript{65} If the parties so elect, jurisdiction may even apply to offers made or accepted in Kentucky by non-Kentucky residents.\textsuperscript{66} With such a broad jurisdictional reach, out-of-state lenders would be subject to the statute when making any “solicitation or communication to lend originating outside of Kentucky” that is forwarded to a Kentucky resident or when accepting any solicitation to borrow which originated in Kentucky.\textsuperscript{67} This long reach is wise because it captures offers made by national mortgage companies, which have easier access to Kentucky residents via the Internet and telemarketing.

II. LIMITATIONS ON HIGH-COST HOME LOANS THAT RELATE TO HOEPA

To examine the myriad requirements of K.R.S. § 360.100, Part II first discusses the requirements that relate to those of HOEPA, and Part III examines those requirements that are unique to Kentucky’s statute. Each requirement that falls under these two subdivisions is then discussed individually so that advocates may quickly locate information relevant to their particular issue. While some of the K.R.S. § 360.100 requirements that overlap with HOEPA are superfluous, most are helpful because they provide a state cause of action for certain predatory lending practices. Providing a separate cause of action demonstrates that the Kentucky General Assembly takes the predatory lending problem seriously.

A. Disclosures

HOEPA requires only two short disclosures\textsuperscript{68} in addition to the standard annual percentage rate and monthly payment disclosures that TILA mandates.\textsuperscript{69} The lender must disclose the principal amount of the

\textsuperscript{65} See K.R.S. § 360.100(5).
\textsuperscript{66} Id.
\textsuperscript{67} Id.
\textsuperscript{68} 15 U.S.C. § 1639(a)(1). The required disclosures read as follows:
\hspace{1em} (A) “You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application.”
\hspace{1em} (B) “If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you may have put in to it, if you do not meet your obligations under the loan.”
\textsuperscript{69} § 1639(a)(2).
loan and whether the borrower purchased credit or debt cancellation insurance for loans made on or after October 1, 2002.\textsuperscript{70}

Besides these simple HOEPA requirements, K.R.S. § 360.100 adds four more lengthy, written disclosures regarding comparison shopping, credit counseling, taxes, and payment of existing debt.\textsuperscript{71} Under the Kentucky statute, the lender must use the form of notice provided in the statute or one that is “substantially similar.”\textsuperscript{72} Lenders must make K.R.S. § 360.100 disclosures at the same time they provide HOEPA disclosures, which the Federal Reserve Board currently requires three days before consummation of the loan.\textsuperscript{73} The timing of the federal and state disclosures is critical because the lender cannot correct a late disclosure after consummation. This three-day period is meant to allow the borrower to contemplate the seriousness and necessity of borrowing on such terms.\textsuperscript{74}

While Kentucky’s additional disclosures are designed to provide the borrower with valuable information, they are unlikely to do so. First, the six disclosures required under K.R.S. § 360.100 are too verbose, taking up over a half page of single-spaced type.\textsuperscript{75} Like boilerplate language in standardized contracts, the parties are likely to disregard the writing as mere “legalese.” Second, Kentucky’s statutory notice is in all capital letters, while HOEPA’s is written in plain font.\textsuperscript{76} Capitalization of all the words makes the notice harder to read. Because people recognize letter groups when reading by abstracting the letters into differently sized rectangles, squares, and circles, a text written in all capital letters, which form rectangles all of the same size, prevents one from easily deciphering word shapes.\textsuperscript{77} It is, therefore, likely that buyers will not fully read these notices, instead passing over and disregarding the hard-to-read typeface.

The legislature might have been more successful if the statute required that the notice only be “conspicuous,” in the same manner

\begin{itemize}
\item \textsuperscript{70} 12 C.F.R. § 226.32(c)(3), (5) (2005); see also RENAURT & CARTER, supra note 3, at 220.
\item \textsuperscript{71} K.R.S. § 360.100(2)(h).
\item \textsuperscript{72} Id.
\item \textsuperscript{73} 12 C.F.R. § 226.31(c). K.R.S. § 360.100 requires that disclosures occur whenever the Federal Reserve Board requires HOEPA disclosures to occur, not necessarily three days before. K.R.S. § 360.100(2)(h). Other TILA disclosures need only be given “before consummation” of the loan. 12 C.F.R. § 226.17(b).
\item \textsuperscript{74} REUART & CARTER, supra note 3, at 218.
\item \textsuperscript{75} K.R.S. § 360.100(h).
\item \textsuperscript{76} Compare id., with 15 U.S.C. § 1639(a)(1) (2005).
\item \textsuperscript{77} PATRICK J. LYNCH & SARAH HORTON, WEB STYLE GUIDE 133 (2d ed. 2001), available at www.webstyleguide.com/type/empahsis.html (last visited Oct. 29, 2004). Although this guide is intended for website design, its reasoning is equally compelling for any typed print.
\end{itemize}
required under Uniform Commercial Code section 2-316(2)\textsuperscript{78} or HOEPA.\textsuperscript{79} Courts, such as the Supreme Judicial Court of Massachusetts in \textit{Hunt v. Perkins Machinery Co.}, have said that "[a] term . . . is conspicuous when it is so written that a reasonable person against whom it is to operate \textit{ought to have noticed it}."\textsuperscript{80} The court went on to say that when a disclaimer is in larger font or contrasting color or type, it is more likely to be conspicuous.\textsuperscript{81}

The Kentucky statute, moreover, does not require the borrower to initial that he has read the notice.\textsuperscript{82} This omission makes it easier for lenders to "hide" the notice in a shuffle of papers and lead the borrower to believe that the notice is just a bunch of "legal stuff" that has no real effect on the transaction. Cautious lenders would be well advised to have borrowers initial next to the disclosures for additional proof that the disclosures were in fact made and noticed by the borrower.

Unlike the North Carolina law and the Model Home Loan Protection Act, Kentucky does not require credit counseling in its legislative scheme.\textsuperscript{83} Counseling is likely the most effective way to ensure that the borrower understands the terms and impact of the loan and recognizes the importance of the disclosures.\textsuperscript{84} Counselors can spot abusive practices or terms before the loan is consummated, which would ultimately prevent expensive litigation, and explain the disclosures' relevance to the borrower. Having the counselor explain to the borrower that the disclosures are required because past borrowers have not appreciated the risk that the high-cost loans entail may better impose the gravity of the transaction upon the current borrower.

\textbf{B. Prepayment Penalties}

Lenders assess prepayment penalties against the borrower if the borrower pays off the loan before the time upon which the parties agreed

\textsuperscript{78}{}U.C.C. § 2–316(2) (2003).


\textsuperscript{81}{}Id. The court also quoted part of U.C.C. section 1-201, which says that a term is conspicuous if written in all capital letters. The court, however, was considering how brief terms could catch a party's attention. It was not deciding how an entire page of information should be conveyed to another party. With the disclosures required by Kentucky's statute, other devices for making a term conspicuous are more appropriate than the use of all capital letters.

\textsuperscript{82}{}See K.R.S. § 360.100(h).

\textsuperscript{83}{}See N.C. GEN. STAT. § 24-1.1E(c)(1) (2003); \textit{MODEL HOME LOAN PROT. ACT}, supra note 14, § 4(h). See also supra notes 16–23 and accompanying text.

\textsuperscript{84}{}See \textit{MODEL HOME LOAN PROT. ACT}, supra note 14, § 4 cmt. (h).
when they entered into the transaction. Such a fee may seem reasonable at first blush because it binds the borrower to the contract into which he or she has entered, but lenders possess the power to threaten borrowers with prepayment penalties to ensure that borrowers do not refinance under better terms with a different lender. Most prime-rate mortgage lenders need not add prepayment penalties because prime-rate mortgages, dictated by market forces, have low interest rates. Because these low rates are comparable to those of other lenders, there is little risk that the consumer will quickly refinance, leaving the lender without enough interest paid to cover its closing costs. In fact, only 2% of prime mortgages include a prepayment penalty, while 70% of subprime mortgages have prepayment penalties.

By charging prepayment penalties, the original lending institution is guaranteed to receive the money needed to pay the considerable fee of the mortgage broker who secured the subprime loan. If these prepayment penalties were not allowed, the main lender could not afford to make high-cost loans; instead, it would be forced to make loans at rates closer to prime because the borrower would more likely be able to refinance.

Kentucky has wisely taken advantage of a federal rule that allows the state to restrict prepayment penalties. Prepayment fees are not allowed under HOEPA, with one five-part exception: for a prepayment penalty fee to be allowed, 1) the indebtedness of the consumer must account for less than 50% of monthly gross income; 2) the lender must verify both the borrower's income and expenses; 3) the mortgage cannot be a refinancing with the creditor (or one of its affiliates) who gave the initial mortgage; 4) the prepayment penalty may be imposed for only the first five years after the loan's consummation; and 5) the penalty must be legal "under other applicable law." This fifth requirement permits the states to disallow prepayment penalties completely. In K.R.S. § 360.100, the Kentucky legislature chose instead to limit the time frame of such penalties.

Kentucky's approach may be termed the "3–2–1 rule." Under this approach, the lender can change penalties only during the first 36 months after the closing of the high-cost home loan. During the first 12 months, the penalty cannot exceed 3% of the amount prepaid. During the second

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85 RENUART, supra note 15, at 45.
86 See id. at 27.
87 Id.
88 Id.
89 See id. at 27.
91 § 1639(c)(2).
92 See K.R.S. § 360.100(2)(a) (Michie 2004).
12 months of the 36-month period, the penalty cannot exceed 2% of the amount prepaid. Finally, during the third 12 months of the 36-month period, the penalty cannot exceed 1% of the amount prepaid. The Kentucky statute also reiterates the federal condition that prepayment penalties can be assessed only if the high-cost home loan at issue does not refinance a previous high-cost home loan with the same lender.

The Kentucky provision is uncomplicated and shows lenders in Kentucky how to meet the HOEPA exception for prepayment penalties. The stepped percentages allow lenders to ensure that they can cover their costs and potentially profit from the loan if the borrower pays early, while still encouraging borrowers to prepay or refinance. Prepayment allows low-income borrowers to escape disastrous loans if they have the opportunity, possibly by refinancing, and thus terminate their cycle of indebtedness.

C. Negative Amortization and Balloon Payments

Negative amortization is proscribed by HOEPA and K.R.S. § 360.100. When a loan is negatively amortized, borrowers do not pay enough each payment period to pay off the interest that accrued during that period; therefore, their balance is always increasing. From a policy standpoint, prohibiting negative amortization with high-cost home loans makes sense because many borrowers can barely afford their monthly payment. If borrowers can barely afford their monthly payment, they are unlikely to be able to pay an accumulated lump sum at the end of the loan when the extra accrued interest becomes due. Moreover, subprime loans, by their very nature, already charge high rates of interest. By constantly increasing the balance of the loan, the lender is able to increase its profit because the interest rate will be applied against an increasingly larger balance. Under both applicable statutes, advocates for both parties should make sure that the borrower receives an amortization schedule so that all parties can be certain that the loan is not negatively amortized.

Balloon payments are closely tied to negative amortization. This type of payment is either a final payment that is much larger than preceding payments or the only payment required under the terms of the loan.

93 Id.
94 § 360.100(j).
96 K.R.S. § 360.100(2)(d).
97 See Renuart, supra note 15, at 39 n.83.
(usually years after the consummation of the loan).\textsuperscript{98} HOEPA prohibits any balloon payment with loans having less than a five-year term by requiring that the payments "fully amortize the outstanding principal balance."\textsuperscript{99} Because HOEPA proscribes negative amortization, HOEPA necessarily limits the balloon payment for loans with terms longer than five years to the initial balance plus interest accumulated during the last payment period of the loan; regularly scheduled payments must, at a minimum, cover the interest assessed for each payment period.

K.R.S. § 360.100 prohibits any scheduled payment that is more than twice as large as the average of earlier regularly scheduled payments.\textsuperscript{100} Significantly, this limitation decreases the size of the largest possible balloon payment that would have been allowed under HOEPA (because paying the principal plus last interest payment is surely more than twice the size of earlier payments). Most importantly, this limitation decreases the likelihood of foreclosures. Balloon payments do not provide low-income borrowers with better rates. They merely provide these borrowers time to stay in their homes or the illusion of significantly less expensive financing. Many lenders promise to refinance when the balloon payment comes due, but instead they foreclose on the property when the borrower is unable to make the payment.\textsuperscript{101} Kentucky's law, which recognizes that the social cost of foreclosure is much too high to justify the benefit to the borrower of reduced payments or extra time in his or her home, prevents lenders from using this potentially deceptive device.

D. Prohibition of Provisions that Increase Interest Rates Upon Default

In the past, upon default of a loan, some lenders have increased interest rates to as high as 42%, practically guaranteeing foreclosure of the property.\textsuperscript{102} Both HOEPA and K.R.S. § 360.100 prohibit any loan term that increases the interest rate upon default.\textsuperscript{103} Kentucky also requires that the lender provide notice of the default to the borrower, which 1) must be provided in writing and mention impending foreclosure or other legal action thirty days before initiation of any action and 2) must specify the amount owed "to cure the default and the date by which the payment is due."\textsuperscript{104} Both of these state and federal prohibitions

\textsuperscript{98} Id. at 45.
\textsuperscript{100} K.R.S. § 360.100(2)(c). The statute creates an exception for payment schedules that adjust "to the seasonal or irregular income of the borrower." Id.
\textsuperscript{101} Renuart, supra note 15, at 38 n.82.
\textsuperscript{102} Problems in Community Development Banking, supra note 9, at 314 n.9.
\textsuperscript{103} These no-increase provisions can be found, respectively, at 15 U.S.C. § 1639(d) and K.R.S. § 360.100(2)(e).
\textsuperscript{104} K.R.S. § 360.100(2)(s).
seek to prevent foreclosure. Since the lender is legally prohibited from increasing the interest rate upon default, the lender has more incentive to help the borrower restructure the payment schedule. Kentucky’s notice requirements also increase communication between the parties and allow borrowers to cure their default before the lender threatens legal action or assesses exorbitantly high default rates.

E. Acceleration of Indebtedness

Most loans contain a term that accelerates the maturity of the loan upon the borrower’s default, sometimes rendering it due immediately. HOEPA allows this type of measure. K.R.S. § 360.100 generally appears to disallow it, but there are major exceptions. K.R.S. § 360.100 creates exceptions when “the loan has been accelerated by default, pursuant to a due-on-sale provision, or pursuant to some other provision of the loan documents unrelated to the payment schedule.” These exceptions ultimately swallow the rule and render the Kentucky law more permissive than HOEPA.

While it is unclear whether HOEPA allows the date of maturity to accelerate because of a due-on-sale clause or other similar provision, HOEPA appears to prohibit only acceleration of indebtedness related to the payment schedule and increased interest rates upon default. Yet, because HOEPA does not explicitly deal with due-on-sale and other provisions, K.R.S. § 360.100 prevents a state cause of action for this federal ambiguity. Ironically, while K.R.S. § 360.100 on its face seems to prohibit almost all acceleration, upon closer inspection it provides exceptions that HOEPA fails to consider, thus allowing acceleration when the federal law does not provide an explicit exception.

Although K.R.S. § 360.100 is more permissive, a due-on-sale provision is reasonable because it prevents the lender from having to worry whether the new owner will maintain the collateral while the borrower pays the loan. What is troubling about this exception is that it covers “some other provision[s]” not related to the payment schedule.

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105 See generally Renuart, supra note 15, at 65 (noting that a "creditor's decision to accelerate and foreclose on collateral . . . has been held to be subject to the duty of good faith and fair dealing").
107 See K.R.S. § 360.100(2)(b).
108 Id. A due-on-sale provision allows the lender to accelerate the date of the loan's maturity when the borrower sells the home upon which that the lender has a mortgage. Kathleen E. Keest & Elizabeth Renuart, National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges 206 (2d ed. 2000).
110 K.R.S. § 360.100(2)(b).
It is unclear how broad this language is (does it mean other provisions similar to due-on-sale and default provisions?) and under what other circumstances the borrower can accelerate the loan. Despite the prohibition in the first sentence against the lender’s sole-discretion to accelerate, can the buyer still accelerate the loan whenever it, in its sole discretion, deems itself insecure? Whether the lender feels insecure may have nothing to do with the payment schedule. Instead, it could depend upon the state of the collateral, zoning changes, or other factors beyond the borrower’s control.

F. Prepayments

Both HOEPA and K.R.S. § 360.100 allow no more than two consolidated prepayments paid in advance out of the borrower’s loan proceeds. This limitation is intended to stop unethical lenders from being able to invest that money without crediting any interest to the consumer’s account. If the lender fails to credit the borrower’s account for the prepayments, the prepayments can also disguise the true amount of money financed and thus increase the amount of interest that the borrower must pay on the loan.

G. Consideration of Borrowers’ Ability to Pay

HOEPA requires lenders to evaluate whether the borrower has the ability to repay the loan. This requirement is met by reviewing a signed financial statement, a credit report, and employment-income records to verify that the consumer’s monthly obligations do not exceed 50% of his or her monthly gross income. This provision requires lenders to look past the potential borrower’s home equity and demonstrate that the borrower can meet his payments. Lenders are liable, however, only when they engage in a “pattern or practice of extending credit” without evaluating the borrower’s ability to pay. Therefore, in the event of litigation, the plaintiff–borrower cannot rely merely on his

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112 K.R.S. § 360.100(2)(f).
113 REUART & CARTER, supra note 3, at 228.
114 REUART, supra note 15, at 46; see also REUART & CARTER, supra note 3, at 228.
own inability to pay; instead, to meet his burden of proving the existence of a "pattern or practice," he must engage in costly and lengthy discovery of the lender’s business practices. How many other similarly situated borrowers must the plaintiff find to establish a pattern? What counts as “similarly situated?” While this involved discovery might seem to affect only the plaintiff–borrowers, it also concerns the defendant–lenders, which presumably would rather their lending practices not be made public through discovery procedures.

K.R.S. § 360.100 attempts to ameliorate this discovery nightmare by looking at individual loans, not “patterns and practices.” Under Kentucky’s method, lenders are potentially liable for each individual transaction. Because lenders must “reasonably believe[] . . . that one . . . or more of the borrowers, when considered individually or collectively, will be able to make the scheduled payments[,]” lenders must be more diligent in ascertaining whether borrowers can repay the loan. The Kentucky statute requires lenders to evaluate the following criteria: 1) “current and expected income”; 2) “current obligations”; 3) “current employment status”; and 4) “other financial resources, other than the borrower’s equity in the dwelling which secures repayment of the loan.”

While Kentucky’s requirements demand a less involved discovery process and appear to favor the plaintiff–borrower, the statute also includes presumptions that favor lenders. If the borrower’s obligations are below 50% of his total gross income, the statute presumes (in favor of the lender) that the borrower can meet his payment. If the borrower’s obligations exceed 50% of his total gross income there is no presumption, implying that the borrower cannot meet his obligations. Thus, since the plaintiff–borrower already has the burden of proof and since in neither instance can he receive a presumption in his favor, the presumption, or lack thereof, always favors the defendant–lender. In the end, this provision eases the burden of discovery but fails to hold lenders sufficiently accountable for ensuring that potential borrowers can afford the payments.

118 See RENUART & CARTER, supra note 3, at 231.
120 Id.
121 Id.
122 Id. Interestingly, HOEPA makes the opposite presumption if the borrower’s obligations exceed 50% of his gross monthly income. 12 C.F.R. § 226.32(d)(7)(iii) (2005). The plaintiff, thus, never really receives a benefit: HOEPA, which presumes the plaintiff’s inability to pay, requires that he or she show “a pattern or practice”; the Kentucky statute, which does not require the plaintiff to demonstrate a “pattern or practice,” does not create a presumption regarding his or her inability to pay. K.R.S. § 360.100(2)(i).
H. Home Improvement Contracts

Borrowers often take out high-cost home loans when they need to make home improvements. HOEPA\textsuperscript{123} and K.R.S. § 360.100\textsuperscript{124} place restrictions on payments made from the lender to the home-improvement contractor. These restrictions require that payments must be made 1) to the consumer, 2) jointly to the consumer and the contractor, or 3), at the election of the borrower, to “a third-party escrow agent in accordance with terms established in a written agreement signed by the borrower, the lender, and the contractor.”\textsuperscript{125} The purpose of this provision is to discourage lenders from paying contractors before the home improvements are complete and to provide the borrower with more control over his transactions with the contractor.\textsuperscript{126}

Timing differences exist between the escrow options under the federal and Kentucky statutes. HOEPA requires that the written instrument be signed “before the date of payment,”\textsuperscript{127} while K.R.S. § 360.100 requires that the writing be signed “prior to the disbursement.”\textsuperscript{128} To illustrate the effect of these provisions: if the parties first sign the writing on the date of payment and then the lender makes the payment to the borrower ten minutes later, the lender violates HOEPA (because the writing was signed on, not before, the date of payment) but not K.R.S. § 360.100 (since the writing was indeed signed before disbursement of the payment). Because HOEPA’s requirement is more specific, it is impossible to violate K.R.S. § 360.100 without also violating HOEPA. Thus, the Kentucky provision is without teeth, providing a state remedy only if there is a gross violation of federal law. The statute should have followed HOEPA so that a state cause of action would follow all federal violations. Moreover, by not requiring a day between the signing of the writing and payment, Kentucky’s statute allows the existence of high-pressured, fast-paced situations where the borrower can be cajoled into choosing the escrow option or accepting disadvantageous escrow terms.

\textsuperscript{124} K.R.S. § 360.100(2)(l).
\textsuperscript{125} 15 U.S.C. § 1639(i); see § 360.100(2)(l).
\textsuperscript{126} See RENUART & CARTER, supra note 3, at 233.
\textsuperscript{127} 15 U.S.C. § 1639(i) (emphasis added).
\textsuperscript{128} K.R.S. § 360.100(2)(l) (emphasis added).
III. LIMITATIONS ON HIGH-COST HOME LOANS
SPECIFIC TO K.R.S. § 360.100

Not all provisions of K.R.S. § 360.100 are derived from HOEPA. Kentucky’s statute includes additional substantive requirements for high-cost home loans and seeks to prevent problems that HOEPA fails to address. For both lenders and borrowers, the following provisions specific to Kentucky will remain fraught with uncertainty until the courts clarify the ambiguities and define the scope of these provisions. Without the ability to rely on HOEPA as an interpretive starting point, the court should interpret the provisions broadly and rely on the statutory scheme to effectuate the legislature’s intent.

A. Refinancing

While refinancing a loan can be advantageous when market interest rates drop or when the borrower needs to make home improvements, unscrupulous lenders have persuaded borrowers to refinance repeatedly, a practice known as “flipping.” Flipping occurs when the borrower, who is assessed large fees, refines a loan many times over a short period without any real benefit. The net result is that the exorbitant fees strip the mortgaged home of its equity.

To halt the practice of flipping, sections (j) and (k) of K.R.S. § 360.100 limit the amount of fees that a lender can charge when refinancing. The sections are extremely intricate and confusing, but they can be better understood when separated into two categories: 1) when the lender provides both the existing high-cost home loan and the high-cost refinancing and 2) when the lender provides only the high-cost refinancing. Note that both the original loan and the refinancing must qualify as “high-cost.” Advocates should first determine whether both the existing loan and the refinancing qualify as high-cost home loans, and then whether one lender provided one or both loans.

When the lender provides both the existing high-cost home loan and the high-cost refinancing, the statute places several limitations on the terms of the refinancing. First, the lender may not include “any prepayment fees or penalties.” But does “penalties” mean “prepayment penalties” or “any penalty whatsoever?” Consumer advocates will argue that the legislature meant to exclude both prepayment fees and various other penalties when the borrower is refinancing a high-cost home loan.

129 See MODEL HOME LOAN PROT. ACT, supra note 14, § 3 cmt. (b).
130 See id.
131 See K.R.S. § 360.100(j)-(k).
132 § 360.100(j)(1).
with another high-cost home loan because both types of penalties will certainly contain disadvantageous terms for the borrower. Lenders will argue that "penalties" is merely an appositive of "fees" because "penalties" is mentioned in the same phrase as "prepayment fees." The lenders may have the stronger argument because certain penalties, such as those associated with default, may be necessary for a lender to risk refinancing under certain circumstances. The prohibition of prepayment penalties actually encourages repayment, while a prohibition of all penalties would deny the lender its usual mechanisms to ensure repayment. Moreover, an absolute prohibition of fees would render later references to maximum allowable fees for refinancing nugatory.\(^{133}\)

Next, the statute distinguishes between situations in which points or fees were assessed under the original high-cost home loan, and those in which they were not. If points were charged under the original high-cost home loan, no fees besides those allowed by Regulation Z\(^ {134} \) may be charged on the proceeds used to pay the existing high-cost home loan.\(^ {135} \) The lender can assess fees on any proceeds from the refinancing that exceed the amount of the existing loan,\(^ {136} \) but fees on the excess amount cannot exceed 4% of the total amount financed.\(^ {137} \) If points were not charged under the original high-cost home loan, the lender may charge points and fees up to 4% of the amount refinanced, excluding those fees allowed under Regulation Z.\(^ {138} \)

Where the lender provides only the high-cost refinancing, it may charge points and fees for any proceeds used to pay off the previous high-cost home loan and for any fees allowed by Regulation Z, subject to some limitations.\(^ {139} \) If points and fees were assessed against the existing high-cost home loan, the lender may not charge any fees or points on proceeds used to pay a high-cost home loan within one year of the consummation of the high-cost refinancing.\(^ {140} \) There is no 4% restriction on the fee charged on the total amount financed. Any fees on

\(^{133}\) See, e.g., §§ 360.100(k) (referring to points and fees for a refinancing of a high-cost home loan) & (j)(2) (allowing points and fees that are not in excess of 4% of the amount financed).

\(^{134}\) Regulation Z allows lenders to include fees for title examination, title insurance, property surveys, preparation of loan documents, credit reports, notaries, appraisals, certain escrow accounts, and determinations for pest infestation and flood hazard. 12 C.F.R. § 226.4(c)(7) (2005).

\(^{135}\) See K.R.S. § 360.100(k).

\(^{136}\) Id.

\(^{137}\) Id. § 360.100(j)(2).

\(^{138}\) See § 360.100(k).

\(^{139}\) Id.

\(^{140}\) Id.
money in excess of the proceeds for the existing high-cost home loan may be assessed at any time.\(^\text{141}\)

Ultimately, the refinancing requirements and prohibitions in K.R.S. § 360.100 are needlessly confusing. In fact, the Kentucky statute is so complicated that a lender could easily violate it, even if acting in good faith and with the aid of counsel. A much simpler option would be to follow the AARP’s Model Home Loan Protection Act, which states, “No creditor making a high-cost home loan shall directly or indirectly finance any points or fees.”\(^\text{142}\) While lenders may argue that such a broad prohibition may impede them from providing necessary refinancing, these fears are unwarranted. North Carolina adopted this simple language,\(^\text{143}\) and its Commissioner of Banks stated that there has been little effect on the availability of subprime lending in that state.\(^\text{144}\)

B. Modification Fees

K.R.S. § 360.100(2)(g) requires that, when modifying the terms of a high-cost home loan or deferring payments, the lender can charge fees only if 1) “the fees are less than one-half . . . of any fees that would be charged for a refinance” or 2) “the borrower is in default and it is in the borrower’s best interest.”\(^\text{145}\) The legislature appears to have inserted this provision to prevent lenders from classifying a refinancing as a “modification”; any lender who does so will receive only one-half of the allowable fees for a refinancing. Moreover, when a loan is simply modified or extended rather than completely refinanced, the statute places a limit on the amount of fees that the lender can charge for these less involved services.\(^\text{146}\)

To avoid any problems under this provision, lenders should simply comply with the first option when modifying financing, ensuring that whatever fee is charged is less than one-half of the fee that could be charged for a refinancing. However, there may be situations where a larger fee is warranted. For instance, when a borrower is in default, the statute’s scheme encourages lenders to seek payment from defaulting borrowers, which may require larger fees, rather than accelerate the date of payment and begin foreclosure proceedings. However, to charge

\(^{141}\) See id.

\(^{142}\) MODEL HOME LOAN PROT. ACT, supra note 14, § 4(a).

\(^{143}\) See N.C. GEN. STAT. § 24–1.1E(c)(3) (2003) for North Carolina’s language, which mirrors the Model Home Loan Protection Act.

\(^{144}\) Smith, supra note 5.

\(^{145}\) K.R.S. § 360.100(2)(g).

\(^{146}\) Id.
higher fees, the borrower [must be] in default, and it must be "in the borrower's best interest."\textsuperscript{147}

Ambiguity engulfs this statutory standard. For example, which word or phrase is the antecedent of "it?" Does "it" refer to the fee, the amended high-cost home loan, or the default? Only the amended high-cost home loan makes any sense because a default or a fee charged for modification rarely will be in any borrower's best interest. But there still are problems with the "in-the-borrower's-best-interest" standard. Specifically, it begs the question: who decides what is in the borrower's best interest? What are the criteria for determining it? Is the determination based on the borrower's long- or short-term interest? Faced with such ambiguities, the courts will likely decide each case on its facts; a case-specific approach gives the courts more room to declare certain fees unreasonable and others appropriate. The problem with such case-specific analysis is that lenders would have little notice of whether a particular fee is "in the borrower's best interest."

To protect borrowers and give lenders some measure of certainty, courts should adopt a reasonable-person standard to examine all factors incident to the modification, especially the fairness of the terms of the modified high-cost home loan and the entire financial condition of the borrower at the time of the modification. Such a standard would bring some (but, admittedly, not much) objectivity to an amorphous touchstone until enough cases have been decided to delineate the contours of "best interest."

C. Consolidation of Low-Interest Loans

K.R.S. § 360.100 says that "[a] lender shall not refinance, replace, or consolidate a zero interest rate or low interest rate loan made by a government or nonprofit lender with a high-cost home loan.\textsuperscript{148} Some unscrupulous lenders have convinced borrowers that they must include these beneficial loans in the high-cost home loan to obtain it or that they will benefit by consolidating it into the high-cost home loan. Few borrowers understand that the fees and interest rate that apply to the rest of the loan also apply to the no- or low-interest loan. For example, in Georgetown, Kentucky, Sue Cook faced foreclosure after Household International Corporation ("Household") consolidated her zero-interest

\textsuperscript{147} Id.

\textsuperscript{148} § 360.100(2)(m). A low-interest loan is defined as "a loan that carries a current interest rate that is two ... percentage points or more below the current yield on United States Treasury securities with a comparable maturity." \textit{Id.}
loan from Habitat for Humanity into a 13.25% mortgage.\textsuperscript{149} Household paid all of Cook’s expenses dealing with the debacle but only after they received substantial pressure and bad publicity. In fact, Household did this so frequently that “a sizable bloc of shareholders, in London[, Kentucky,] for their annual meeting, supported the implementation of safeguards against unfair lending practices.”\textsuperscript{150}

Prohibiting the consolidation of low-interest loans is an important addition to consumer-protection law. By padding the high-cost home loan with no- or low-interest loans, the loan broker increases the amount financed, which in turn increases his or her commission from arranging the loan. The statute, however, assumes either 1) that the borrower is able to make his payment to the benevolent lender of the no- or low-interest loan when he consolidates that loan with the high-cost loan or 2) that the benevolent lender has mechanisms in place to deal with defaulting borrowers. If these assumptions prove untrue, then the paternalism of the law may lead a borrower unnecessarily to default or to declare bankruptcy.

The downside of the Kentucky restriction appears when a borrower cannot make his payments to the benevolent lender. The statute does not allow the lender to incorporate the low-interest loan into a new loan, even if the lender does not charge extra interest on the low-interest loan.\textsuperscript{151} In this way the statute, perhaps unintentionally, deprives the borrower of the opportunity to turn to private lenders, who could offer a loan with lower monthly payments over a longer period of time, when the borrower cannot meet her no- or low-interest obligations. The statute may better effectuate its purpose by stating that a lender of a high-cost loan may not consolidate a no- or low-interest loan unless the buyer provides proof from the benevolent lender that it has no mechanisms in place to deal with default and proof that the borrower is unable to meet the obligations under the no- or low-cost loan.

\textit{D. Single-Premium Insurance}

K.R.S. § 360.100 prohibits a lender from financing “single premium credit life, credit accident, credit health, credit disability, or credit loss of income insurance in connection with a high-cost home loan.”\textsuperscript{152} This

\textsuperscript{149} Laura Yeun, \textit{Reparations Mask Widespread Lender Problems}, \textit{LEXINGTON HERALD-LEADER}, June 8, 2002, at C6, available at \url{http://www.predatorylending.org/newsheadlines/lexingtonkyherldr060802.cfm}.

\textsuperscript{150} Id.

\textsuperscript{151} K.R.S. § 360.100(2)(m).

\textsuperscript{152} § 360.100(2)(n).
subsection is meant to protect vulnerable borrowers from expensive insurance, which has been extremely profitable to the financial industry and has padded loan brokers’ commissions, all at the borrower’s expense. Some consumer advocates believe that the proscription of such credit insurance “would save 500,000 families $2.1 billion each year” because the payment for the insurance is added to the amount financed and because the borrower pays the interest on the augmented amount financed. Ultimately, it may take up to five years before any equity in the home is purchased. Besides the financial disincentive of single-premium insurance for borrowers, such insurance has often been linked to fraudulent practices because many lenders do not disclose the fact that they have added insurance premiums into the loan amount. Thus, with the financial disincentives and fraudulent practices that surround such insurance products, it is reasonable for the legislature to ban the sale of such products completely.

It bears noting that multiple-premium credit insurance is not implicated by K.R.S. § 360.100. The exclusion for multiple-premium policies is beneficial for both borrowers and lenders. Monthly insurance premiums are much more advantageous for the consumer because the consumer can cancel the policy at will and because the policies are usually much cheaper than single-premium policies. The Center for Economic Justice compared the cost of financed, single-premium insurance to a monthly premium insurance product using standard insurance rates on a hypothetical $30,000 loan with a ten-year term and a 15% interest rate. Over the lifetime of the loan, while the borrower paid $6,515 for single-premium insurance and associated finance charges, she paid only $1,747 for the monthly-premium insurance.

Lenders also benefit from multiple-premium insurance because it protects the credit extended and remains very profitable.

Unfortunately, the legislature did not prohibit credit property insurance, which is one of the most lucrative types of credit insurance for lenders. Credit property insurance is insurance on the property that acts as collateral for the loan. This type of insurance commands exceptionally high commissions for loan brokers from the insurance company because it can have a loss ratio as small as 7% (in other words,}

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154 See id. at 5–6.

155 Id. at 6–7.

156 See K.R.S. § 360.100(2)(n).

157 MODEL HOME LOAN PROTECTION ACT, supra note 14, § 3 cmt. (a).

only $7 of every $100 is ever paid out) and thus a huge profit ratio of 93%. Consumer advocates should recognize that borrowers, therefore, are not completely protected from overly expensive, and potentially fraudulent, credit insurance.

E. Videos/DVDs

K.R.S. § 360.100 requires that lenders of high-cost home loans make “available to the borrower a videotape, or other similar audio-video format . . ., approved by the Department of Financial Institutions, which explains the borrower’s rights and responsibilities with regard to . . . high-cost home loans;” there must be “at least one . . . copy of the video in the principal office and each branch office of the lender.” This well intentioned, but unclearly written, subsection appears to be a legislative compromise between requiring involved credit counseling and merely providing often-overlooked disclosures. The statute requires that the lender make the video “available” to the borrower, but there is no guidance as to what “available” means. Does it mean that the lender is required merely to have the video on the premises; that the lender must notify the borrower of the existence of the video; or that the lender must have a place and mode available for the borrower to view the video?

Even if lenders are not required to have a viewing area for borrowers, they would be wise to make one available. The statute states that “[a] lender shall have available for viewing at least one . . . copy of the video.” Thus, if the broker lends the video to a potential borrower to view the video at home, the statute may be construed to require that the lender have another copy at the office. Likewise, if the lender has multiple borrowers needing to view the medium, it would need to have several copies in the office. The existence of an in–office viewing area would reduce not only the lender’s confusion regarding to whom the copies of the video are lent and the number of copies required, but also the potential expense of buying multiple copies.

Another problem concerns the audio–visual medium chosen by the lender. What happens if the lender, who does not have a viewing area, has a DVD (one of the suggested media in the statute) for viewing, but the borrower does not have access to a DVD player? In this way, lenders could intentionally make it difficult for borrowers by selecting a media format that requires an advanced technological device that most of the clientele for high-cost home loans may not be able to afford. The lender,

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159 Id. at 293.
160 K.R.S. § 360.100(2)(o).
161 Id.
162 Id.
therefore, could make available only the audio-visual medium, not the important information it contains. While lenders may argue that the statute requires that they make only the medium available, such a narrow reading would flout the intention of the legislature. Because the statute is designed to inform and protect borrowers, courts should require that lenders not only notify borrowers of the existence of the medium but also verify that borrowers have access to the information contained in the audio-visual medium.

F. Arbitration Clauses

K.R.S. § 360.100 prohibits mandatory arbitration clauses that are "oppressive, unfair, unconscionable, or substantially in derogation of the rights of consumers." Arbitration clauses that comply with the "Statement of Principles of the National Consumer Dispute Advisory Committee of the American Arbitration Association in effect on June 24, 2003" are presumed not to violate the Kentucky statute. Kentucky has long favored arbitration, but, given the widespread use of one-sided clauses, the legislature should reevaluate its choice.

Arbitration clauses have become increasingly complex and have become more likely to favor lenders, who view these clauses as mechanisms for avoiding expensive litigation. For instance, these clauses most often prohibit certain remedies, class actions, and arbitrators not selected by the lender. Because these clauses tend to favor the lender, the Model Home Loan Protection Act proscribes all mandatory arbitration clauses. But consumer advocates should be forewarned that the Supreme Court of the United States has interpreted the Federal Arbitration Act broadly. The Court's interpretation allows the Act to preempt certain state laws concerning arbitration, especially those that disfavor it, leaving state legislatures without much room to attack arbitration clauses. If a lender later pressures a borrower to enter

163 § 360.100(2)(p).
164 Id. The Statement of Principles of the National Consumer Disputes Advisory Committee is available at http://www.adr.org/sp.asp?id=22019#STATEMENT_OF_PRINCIPLES.
165 See Fayette County Farm Bureau Fed'n v. Martin, 758 S.W.2d 713 (Ky. Ct. App. 1988) (interpreting a Kentucky statute regarding arbitration as espousing "the policy that arbitration is to be encouraged").
166 MODEL HOME LOAN PROT. ACT, supra note 14, § 4 cmt. (g).
167 Id. § 4(g).
169 See RENUART, supra note 15, at 186.
arbitration, consumer advocates can argue that the arbitration clause at issue in their case is unconscionable under state law \(^{170}\) and therefore should not be enforced. \(^{171}\)

**G. Late Payment Fees**

While K.R.S. § 360.100 has several subsections that seek to prevent foreclosure upon default, most defaults do not result in foreclosure. Instead, the borrower often remedies the default and compensates the lender for the late payment with a late payment fee. \(^{172}\) Because lenders often prefer late payment fees to foreclosure, they may abuse the use of penalties as a way to generate additional income. K.R.S. § 360.100 disallows any late payment fees unless the fee is 1) limited to the greater of either ten dollars or 5% of the amount past due; 2) assessed only once on any single late payment; and 3) assessed only for a payment that is past due by fifteen days or more. \(^{173}\) This necessary provision prevents lenders from using late payment fees as a way to increase revenue to the point that borrowers are unable to make their payments. For instance, if a 5% fee could be charged on a fifteen-day late payment of $1,000, under the terms of K.R.S. § 360.100, the highest amount owed would be $1,050. \(^{174}\) Without this statute, however, the lender could charge at least another 5% on the amount owed within another few days, bringing the total to at least $1,102.50. If a borrower is temporarily out of work or on a strict budget when an emergency arises, a payment that increases by $100 or more could ultimately result in foreclosure.

Consumer advocates should also be aware of another questionable practice whereby lenders hold payments in their offices and post them late to collect late payment fees. Unlike the Model Home Loan Protection Act, which requires lenders to treat each payment as posted to their accounts on the day the payment is received, \(^{175}\) Kentucky has no such requirement. Thus, dishonest lenders are still able to charge late fees even when the borrower made a timely payment. To combat this potential abuse, Kentucky should follow the lead of the Model Home

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\(^{170}\) This is a ground that the Court has not explicitly found preempted by federal law. \(^{171}\) See RENAURT, supra note 15, at 190. \(^{172}\) See id. at 26. \(^{173}\) K.R.S. § 360.100(2)(q) (Michie 2004). \(^{174}\) This result is obtained because fifty dollars, as 5% of the total amount owed, would be the highest attainable fee and because the lender could only charge the fee once. See id. \(^{175}\) MODEL HOME LOAN PROT. ACT, supra note 14, § 3(d)(5).
Loan Protection Act by requiring lenders to post payment on the date payment is received.

H. Payoff-Request Charges

Borrowers may ask the lender to provide a detailed amortization of the loan, including the amount of money left to be paid, the interest assessed, etc. K.R.S. § 360.100 allows lenders to charge the greater of ten dollars or "actual costs" for each of the borrower's first two requests for a written payoff calculation in a calendar year. Because of the "or" in the statute's language, the lender cannot charge both a ten dollar fee and the actual cost. Thus, ten dollars will usually be the highest charge for any written payoff calculation request, except in the rare instances where the actual cost exceeds ten dollars (which would be unusual because the lender merely prints out information already contained in a computer). By allowing the borrower to have access to his account information for a reasonable fee, the statute encourages borrowers to communicate with the lender about the effect of finance charges on their loan. But after the first two requests in any calendar year, this statute sets no limitation on the amount a lender may charge for the calculation. This limitation appears reasonable to prevent borrowers from harassing lenders for multiple payout calculations that do not change significantly from one six–month period to another.

I. Encouraging Default

In the past, dishonest lenders have encouraged potential borrowers to default on a loan that the lender hopes to refinance. By defaulting, the borrower may be subjected to immense pressure to accept the terms of a potentially unnecessary and more costly refinancing in order to escape foreclosure under the original obligation under default. North Carolina, the District of Columbia, Massachusetts, and Virginia all have provisions prohibiting lenders from encouraging default. Kentucky, following these other jurisdictions' leads, bars lenders from encouraging or recommending "default on an existing loan . . . in connection with the closing of a high–cost home loan that refines all or a portion of the existing loan or debt." Consumer advocates should ask their clients whether the lender encouraged defaulting on loans to be refinanced. Such evidence could demonstrate a violation of both Kentucky's statute and

176 K.R.S. § 360.100(2)(r).
177 MODEL HOME LOAN PROT. ACT, supra note 14, § 3 cmt. (c).
178 K.R.S. § 360.100(2)(t).
the common law, as the lender potentially obtained the loan through duress.

IV. CAUSES OF ACTION AND LIABILITY

A. Causes of Action

K.R.S. § 360.100(3) allows a cause of action by the Attorney General, the commissioner of the Department of Financial Institutions, and parties to the high-cost home loan for any violations of the provisions in subsection (2). Any violation of 360.100(2) is deemed usurious and unlawful. Further, such violations constitute “an unfair and deceptive act or practice” in violation of the KCPA. K.R.S. § 360.100(3) also applies to anyone who in bad faith: 1) structures a high-cost home loan as an open-end credit transaction; 2) divides any loan into parts to avoid the provisions of this statute; or 3) engages “in any other such subterfuge.” These catch-all provisions allow borrowers to maintain a cause of action even when the lender arranges the terms of the loan in order to escape the literal terms of the statute.

Peculiarly, subsection (3) begins by excluding causes of action based on interest-rate increases, not due to default, on variable-rate loans. Why subsection (3) reiterates this exception, already created in subsection (2)(e), but not the myriad other exceptions created throughout the statute is unclear. Possibly, the reference to “paragraph (e) of subsection (2) of this section” was meant to refer to previously deleted material contained in that section or to subsection (4), which creates defenses to causes of action.

At least with the first few cases brought under K.R.S. § 360.100, the parties are likely to argue over whether a private cause of action is even allowed under the statute. Because the statute states that a violation is “an unfair and deceptive act or practice . . . in violation of the provisions” of the KCPA, a question arises whether the plaintiff-borrower must meet the KCPA’s requirements to have a private right of action.

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179 § 360.100(3)(e).
180 § 360.100(3).
181 Id. (citing the Kentucky Consumer Protection Act, codified at K.R.S. § 367.170); see also supra note 51 and accompanying text.
182 As of October 1, 2001, a lender who structures a high-cost home loan as an open-end credit transaction also violates HOEPA. See 12 C.F.R. § 226.34(b) (2004).
183 K.R.S. § 360.100(3).
184 See id.
185 See id.
186 Id.
Under the KCPA, plaintiff-borrowers bringing a private action must purchase "goods or services primarily for personal, family or household purposes and thereby suffer[] any ascertainable loss of money or property, real or personal, as a result of the use or employment by another person of a method, act or practice declared unlawful by K.R.S. § 367.170." Since the high-cost home loan must concern a home, these requirements are substantially similar to those required to maintain a cause of action under K.R.S. § 360.100. In most cases, there will be an ascertainable loss of money or property resulting from another's deceptive practice since the predatory lending tactic causes the borrower to pay more interest or other fees than under a non-predatory subprime loan.

However, it is unclear whether a cause of action exists when there is no clearly ascertainable loss and when plaintiff is not seeking actual damages. In this case, a lender could argue that the plaintiff-borrower has failed to meet all of the requirements established by the KCPA. On the other hand, the plaintiff-borrower could argue that he or she does not have to meet the criteria for the KCPA because K.R.S. § 360.100(3) explicitly states that any violation of subsection (2) is an automatic violation of the KCPA; it does not require that plaintiffs meet any further requirements for a cause of action under the KCPA. The plaintiff, then, would have a cause of action under both K.R.S. § 360.100 and the KCPA.

B. Loophole: Good-Faith Provisions

While upon first reading the legislature appears to apply a strict liability standard to any violation of subsection (2), the statute allows lenders to escape liability through two large loopholes. The first is the "30-day rule," which allows lenders to correct any violation within thirty days of the loan's closing, as long as the lender made the mistake (any kind of mistake) in good faith. The second loophole allows the lender sixty days from the date of the discovery of noncompliance to correct only "bona fide" mistakes. Examples of bona fide mistakes include unintentional ones like "clerical, calculation, computer malfunction, computer programming, and printing errors." Besides the requirement

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187 § 367.220(1).
188 See § 360.100(1)(a)(3).
189 See § 367.220(1).
190 § 360.100(3).
191 § 360.100(4)(a).
192 § 360.100(4)(b).
193 Id.
that the error be bona fide, the lender will escape liability under this loophole only if it has adopted reasonable procedures to avoid bona fide mistakes. Thus, the type of mistake that the lender makes is inapposite if made with good faith and caught within 30 days; the type of mistake must meet the stricter definition of "bona fide" if the lender catches it between 30 and 60 days later. To benefit from both of these loopholes, lenders would be wise to set up systems designed to catch and correct any errors within thirty days.

If a lender does fall within either statutory exception, it must make "appropriate restitution," which the statute defines as "reimbursement by the lender of any points, fees, interest, or other charges made by the lender and received from the borrower necessary to put the borrower in the same position as he or she would have been had the loan, as adjusted in accordance with paragraphs (a) and (b) of this subsection, been originally made." In addition to making restitution, the lender must also make the loan comply with K.R.S. § 360.100(2) or, at the election of the "[b]orrower, change the terms of the loan . . . so that the loan will no longer be considered a high-cost home loan." Both parties should notice the importance of the statutory mandate requiring the lender to change the terms of the loan: since subsection (3) tells lenders that they cannot engage in subterfuge to disguise the high-cost home loan, lenders cannot make a mere cosmetic change to the loan. Instead, if the borrower requests that the loan no longer be a high-cost home loan, the lender must change not only the terms that violated K.R.S. § 360.100 but also other substantive terms of the loan, like the interest rate, to render the loan a non-high-cost home loan. Such compulsory alteration greatly reduces the profitability of the loan and provides an appropriate incentive for lenders to put safeguards in place to prevent statutory violations.

C. Statute of Limitations and Liability

Because K.R.S. § 360.100 does not provide a statute of limitations, it is unclear what the period of limitation is. Most likely, the KCPA's limitation period is applicable, since K.R.S. § 360.100, when discussing

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194 See id.
195 § 360.100(4).
196 § 360.100(4)(c).
197 § 360.100(4)(a) & (b).
198 Contrary to K.R.S. § 360.100, the Model Home Loan Protection Act only allows lenders (and assignees, who have liability under the Act) to remedy violations if the lender itself discovers the violation. See MODEL HOME LOAN PROT. ACT, supra note 14, § 7(c). Such a requirement even more strongly encourages lenders to design safeguards to uncover potential violations than Kentucky's exceptions.
199 See K.R.S. § 360.100.
causes of action, expressly references the KCPA.\textsuperscript{200} The KCPA requires a plaintiff to file an action within two years of a violation or within one year after the termination of an action brought by the Attorney General.\textsuperscript{201}

Oddly, K.R.S. § 360.100(3) states that "[a]ny person seeking damages or penalties under the provisions of this section may recover damages under either this chapter or K.R.S. Chapter 367, but not both."\textsuperscript{202} Since damages are not mentioned under K.R.S. § 360.100, it is unclear why a borrower would seek remedies under this statute, rather than simply using it to establish statutory violations to collect damages under the KCPA. By suggesting that one may recover under K.R.S. § 360.100, the legislature may have meant that courts are free to award any equitable or otherwise appropriate remedy.\textsuperscript{203} Although the KCPA provides injunctive relief,\textsuperscript{204} attorney's fees,\textsuperscript{205} actual damages, and punitive damages "where appropriate,"\textsuperscript{206} the legislature should provide damages directly under K.R.S. § 360.100 to avoid any confusion.

The Model Home Loan Protection Act provides for recovery of costs, attorney's fees, actual damages, statutory damages, and equitable relief.\textsuperscript{207} Attorney's fees are especially important because they allow practicing attorneys to act as "private attorney generals" when representing clients who often do not have the resources to pay court costs and fees. Moreover, statutory damages, which under the Model Home Loan Protection Act are "equal to the finance charges . . . plus ten percent . . . of the amount financed,"\textsuperscript{208} create a compelling enforcement mechanism that compels lenders to respect the predatory lending law, without requiring borrowers to prove an elevated scienter for damages that are essentially punitive.

\begin{footnotes}
\item[200] See § 360.100(3).
\item[201] § 367.220(5).
\item[202] § 360.100(3)(c).
\item[204] See K.R.S. § 367.220(4).
\item[205] § 367.220(3)
\item[206] § 367.220(1). In Gooch v. DuPont Co., 40 F. Supp. 2d 857 (W.D. Ky. 1998), the court stated that Kentucky requires gross negligence for an award of punitive damages. Id. at 862.
\item[207] MODEL HOME LOAN PROT. ACT, supra note 14, § 7(a).
\item[208] See id. § 7(a)(2)(B).
\end{footnotes}
V. CONCLUSION

Financial institutions are already reacting to K.R.S. § 360.100. Standard and Poor's issued a memo to the public stating that, after reviewing Kentucky's new law, it will require lenders who issue loans in Kentucky to demonstrate two things: that the loan at issue is not a high-cost home loan and that there are procedures in place to prevent a loan from being a high-cost home loan.\(^{209}\) If the issuer admits that the loan is a high-cost home loan, Standard and Poor's requires that the issuer review each note to be sure that it does not violate Kentucky's new law. The firm does, however, comfort assignees by mentioning that liability hinges on whether the violation is apparent on the face of the promissory note or disclosure.\(^{210}\) Such a lengthy evaluation of Kentucky's new law demonstrates that the financial community expects its members to prevent violations of the statute. Nonetheless, it also reveals that without sufficient assignee liability, assignees will not place the statute on equal footing with federal legislation, such as TILA.

Although the market has taken notice of Kentucky's new law, advocates must be conscious of which borrowers lenders will likely target. For example, residents of predominantly black neighborhoods are five times more likely to have subprime loans than are residents of predominantly white neighborhoods.\(^{211}\) Similarly, residents of low-income neighborhoods are three times more likely to be plagued by subprime lending than residents of high-income neighborhoods.\(^{212}\) Yet, predatory lenders' main target is the elderly, who are "cash-poor" but "asset-rich."\(^{213}\) The elderly often have substantial equity in their homes, but rarely have additional money for home improvements or emergencies. When they must cash out some of the equity in their homes, their limited finances or lack of basic financial knowledge often leads them to predatory lenders.\(^{214}\) Lawyers have a moral duty to take inventory of their clients, determine which ones may be at risk, and warn them of predatory lending practices. By keeping those at risk informed, lawyers can prevent many clients from turning to predatory lenders and

\(^{209}\) See Standard & Poor's, supra note 61.

\(^{210}\) See id.


\(^{212}\) Id.


\(^{214}\) Id.
can also recommend credit counselors who may be able to suggest solutions for their clients' financial problems.

If a client believes he or she has been the victim of predatory lending, but documentary evidence reveals no violations, advocates also have an obligation to ask clients whether the lender made representations not reflected in the documents. Forged documents are common in predatory lending. As a former employee of a predatory lender testified at a Senate hearing, "The pressure to produce loan volume and insurance sales is so great that on many occasions, I've seen finance company employees commit forgery on a massive scale. These employees have forged everything from insurance forms . . . [to] income verification forms, and even entire loan files." Kentucky's predatory lending law is not a panacea to all home-lending problems; it is merely a useful tool to protect the financial dignity of borrowers and allow them to recover from unscrupulous lenders.

With some minor adjustments and liberal judicial construction, K.R.S. § 360.100 could become a potent weapon against predatory lending. Although some lenders may argue that this legislation will have a negative impact upon the availability of credit for those with few assets or poor credit histories, the Center for Community Capitalism found that the North Carolina predatory lending law has "not [kept] people from becoming homeowners by constraining the flow of subprime credit." In fact, it concluded that the North Carolina law "is doing what it is supposed to do." North Carolina has also found that its law, even if it has not limited the number of predatory lending complaints filed, has changed the ability of advocates to "achieve settlements in cases where predatory lending is alleged." With diligent consumer advocates and responsible lenders, Kentucky's statute has the chance to be equally as successful, benefiting both borrowers and honest lenders.

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215 Id. at 5.
216 Id. (citation omitted).
217 QUERCIA ET AL., supra note 211, at 15.
218 Id. at 22.
219 Smith, supra note 5.