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Empowering Subprime Borrowers: Mandatory Unsecured Credit Payoffs as Finance Charges

STEVEN R. SHARPE*

INTRODUCTION

Predatory lending law combines imprecise, policy-driven standards with technical, closely crafted regulations. This discussion touches on both the theoretical and technical aspects of the law. In the narrow context, this Note argues that when a lender forces a borrower to pay off unsecured, third-party loans as a condition of receiving a refinanced or home equity mortgage loan, the amount of that payoff should count as a finance charge. In the broad context, it arrives at this conclusion by illustrating a connection between predatory lending statutes. This connection is significant, as predatory tactics remain prevalent in an expanding subprime market.

Mortgage debt is a risky undertaking that changes borrowers’ lives. Despite the risk inherent in mortgage lending, especially for those with poor credit histories, borrowers

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*J.D. Candidate, 2005, Indiana University School of Law—Bloomington; B.A., 2002, University of Michigan—Ann Arbor. I would like to thank Professor Sarah Jane Hughes for sharpening my ideas; her help was invaluable. Moreover, Jamie Andree, Marcy Wenzler, and all the people at Indiana Legal Services—Bloomington provided incredible insight into predatory lending law, as did Jim Sugarman from the AARP. Professor Dee Pridgen’s comments and suggestions also proved to be vital. Special thanks to Ursula for everything and to my family for their constant support.

1. For a discussion of the Federal Trade Commission’s unfairness standard, see infra notes 23–39 and accompanying text. For a discussion of the recent predatory lending statutes and federal regulations, see infra notes 129–159 and accompanying text.

2. Subprime borrowers are those who, due to income uncertainty, blennished credit, or no credit, are not eligible for a conventional loan package. “Subprime loans are significantly more expensive than prime loans to borrowers, both in terms of interest rates and points and fees.” Kurt Eggert, Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine, 35 CREIGHTON L. REV. 503, 573 (2002).

3. Professor Willis R. Bryant, in his mid-century guide for mortgage lenders, acutely captures the import of mortgage lending: “An application for a home loan is usually the largest financial undertaking in the life of the average homeowner, and great care must be exercised in analyzing the financial aspects of the transaction . . . .” WILLIS R. BRYANT, MORTGAGE LENDING 95–96 (2d ed. 1962).

4. The drastic increase in foreclosure rates, especially in the subprime lending market, illustrates the dangers inherent in mortgage lending. See Janet Kidd Stewart, Costly Loans Fuel Foreclosure Wave: Study Says Filings Up 74% in 8 Years; Minorities Hit Hard, CHI. TRIB., Feb. 27, 2003, at N1 (discussing the 500% increase in foreclosures in Chicago’s subprime market); see also Kristina Shevory, More Homeowners Selling Houses for Less than They Owe;
still disregard some mortgage charges. Even an additional $200 added to a refinanced mortgage debt causes a large financial impact. Over a thirty-year term, an added $200 will quadruple if financed at a 15% fixed annual rate. Borrowers should analyze closely any practice that adds even a seemingly insignificant sum to the mortgage debt.

When a lender forces a borrower to pay off small, third-party debts as a condition of receiving credit, the additional charge may seem negligible in comparison to other mortgage charges, such as interest. The lender will give the borrower capital to pay off other creditors, and this relatively small sum is then consolidated into the much larger mortgage principal. Although the lender forces the payoff, some borrowers do not challenge the requirement, finding that this requirement makes their credit payments more convenient. Instead of writing checks to several different lenders, the mortgagor need only pay the mortgagee.

These seemingly innocuous payoffs, however, convert the mortgagor’s unsecured and often unfinanced debts into financed debts secured to her home. As illustrated below, this conversion places a hefty burden on the borrower that outweighs the benefits of loan consolidation.

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5. Fifteen percent is not an uncommon interest rate in the subprime market. See generally CONSUMERS UNION, ELDERLY IN THE SUBPRIME MARKET 3–4 (2002) (recounting as normal cases in which one person in the subprime market had a 14% interest rate and another had a rate of almost 16%), at http://www.consumersunion.org/pdf/elderly-sub.pdf. The total payment for an additional $200 is $903.20:

<table>
<thead>
<tr>
<th>Amount Added to Principle</th>
<th>Total Interest</th>
<th>Total Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200 at 15% annual rate</td>
<td>$703.20</td>
<td>$903.20</td>
</tr>
</tbody>
</table>

6. I am thinking of debts such as cell phone bills, utility bills, and small judgments. While these debts are not small to those who cannot pay them off, they do not compare in magnitude with mortgage debt.

7. For a discussion concerning the common traits of forced credit payoffs, including the consolidation of the payoff sums with the borrower’s mortgage debt, see infra note 11. In some instances, of course, the borrower can simply pay the debts without the lender’s help; therefore, the payoff amount is not consolidated onto the debt. But as my discussion with Jim Sugarman suggests, see infra note 11, this self-payoff does not often occur in the subprime market because of the borrower’s limited finances.

8. Credit card payoffs provide a typical example of a forced payoff of a financed debt. Even though some of the unfairness arguments this Note presents only apply to the payoff of unfinanced debt, it still asserts that forced payoffs of financed debt are unfair because the payoff transforms the unsecured debt into a secured debt. See infra notes 77–88 and accompanying text. Importantly, the scope of my argument is limited to small credit card payoffs.

9. See infra notes 86–99 and accompanying text.
Furthermore, these costly payoffs are common. The National Consumer Law Center’s *Truth in Lending* notes: “It is fairly common for creditors to require that the consumer pay other debts as a condition of obtaining the loan.” Lenders in the subprime market often require these payoffs before they will refinance a mortgage or sell a home equity loan. Due to the financial harm this common practice causes borrowers, advocates should consider remedies available in federal consumer protection statutes.

This Note contends that federal law can provide a remedial course for subprime borrowers forced to pay off unsecured third-party debts as a condition of a refinanced or home equity mortgage loan. In order to simplify the discussion, these forced payoffs are called “unsecured credit payoffs” throughout the Note. The argument proceeds as follows: (1) Unsecured credit payoffs fit the definition of an “unfair trade practice” under the Federal Trade Commission (“FTC”) Act; because the FTC has not regulated this practice and because the FTC Act provides no private avenue to remedy the unfairness, borrowers should seek a remedy in other statutes; (3) an unsecured credit payoff fits the statutory definition of a finance charge under the Home Ownership and Equity Protection Act (“HOEPA”) (by classifying the payoff sum as a HOEPA finance charge, a court could supply an avenue to remedy the unfairness;


11. According to Jim Sugarman, an attorney with the AARP’s Legal Counsel for the Elderly:

Most of my clients are required to pay off even their unsecured consumer debts with a refinance loan. . . . The borrower is not informed which debts are being paid until those debts are listed on the HUD-1 settlement statement. . . . If they do know that other debts are being paid, they are told that this debt consolidation is in their financial interest.

E-mail from Jim Sugarman, Legal Counsel, AARP, to Steven R. Sharpe (Nov. 19, 2003, 10:35:19 EST) (on file with author). Commentators have also noted the common nature of this practice in the refinancing context. See Odette Williamson, *Protecting Elderly Homeowners from Predatory Mortgage Lenders*, 34 CLEARINGHOUSE REV. 297, 302 (2000) (discussing “refinancing unsecured debt” as a common predatory lending practice). For a description of the subprime market, see supra note 2.

The lender’s actions at issue in *Thorp Loan & Thrift Co. v. Buckles (In re Buckles)*, 189 B.R. 752 (Bankr. D. Minn. 1995), illustrate how borrowers end up making these payoffs. Although the borrower in *Buckles* never contemplated paying off her JC Penney’s account through her mortgage, the lender found out about the preexisting debt through a questionnaire. *Id.* at 756. “[The lender] induced the Debtor to agree to obtaining this component of the advance; the Debtor did not ask for it, and had never contemplated receiving it.” *Id.* at 757.

12. I also employ the term “unsecured credit payoffs” to distinguish between credit payoffs that do not involve collateral, which are the subject of this Note, and payoffs in which the lender forces the payment of third-party liens on the collateral. The latter type of credit payoffs is not considered unfair and is not considered a “finance charge” under the federal regulations. Smith v. Fidelity Consumer Disc. Co., 898 F.2d 896 (3d Cir. 1990).

13. See *infra* notes 40–113 and accompanying text.

14. See *infra* notes 113–24 and accompanying text.
however, courts have not yet addressed this issue\textsuperscript{15}; (4) the unremedied unfairness (as defined by the FTC Act) that borrowers forced into unsecured credit payoffs face should provide judges a sufficient policy incentive to classify the payoffs as HOEPA finance charges;\textsuperscript{16} and (5) therefore, the HOEPA framework can provide the borrower a private remedial course that the FTC Act lacks.\textsuperscript{17}

The HOEPA-FTC Act link illustrated in this Note has relevance beyond unsecured credit payoffs. Plaintiffs in other contexts can utilize the strong connections between HOEPA and the FTC Act in order to strengthen their predatory lending claims. Accepting this argument, however, will not lead to a slippery slope where all potentially unfair practices will produce finance charges. Unsecured credit payoffs already meet the definition of a finance charge. The HOEPA-FTC Act argument simply provides judges with an incentive to follow the definition in the absence of any on-point precedent.

I. UNSECURED CREDIT PAYOFFS—A HYPOTHETICAL

To illustrate the impact of unsecured credit payoffs, this Note employs a hypothetical situation drawn from an actual case.

Ms. Smith, a sixty-year-old woman, decided to refinance her mortgage. She had held an 8\% fixed-interest loan. However, after refinancing her mortgage, her interest rate climbed to 13\%. Moreover, as a condition of the refinancing, the lender forced her to pay off a $600 wireless phone bill, a $200 judgment debt,\textsuperscript{18} and a $200 electricity bill. The lender consolidated these amounts into her debt after paying off her creditors. Each debt was previously unfinanced and unsecured.\textsuperscript{19} This Note employs this fact pattern below in order to illustrate the unfair elements of unsecured credit payoffs.

\begin{itemize}
\item[15.] See infra notes 129--91 and accompanying text. Much, if not all, of the argument presented should apply to the characterization of unsecured credit payoffs in non-HOEPA Truth in Lending actions, especially in the mortgage lending context. See supra notes 129-32 and accompanying text. Because this Note focuses solely on subprime mortgage lending, however, the discussion will be limited to HOEPA.
\item[16.] See infra notes 192--213 and accompanying text. I am not arguing that fees charged in connection with the payment of a loan, like a prepayment penalty, should count as a finance charge. See Stutman v. Chemical Bank, 94 Civ. 5013 (MBM), 1996 WL 539845 (S.D.N.Y. Sept. 24, 1996) (finding that a prepayment penalty is not a finance charge).
\item[17.] See infra note 191 and accompanying text. It is important to note, however, that the FTC could always remedy the unfairness under its enforcement power under the FTC Act. As I noted, the agency has not considered unsecured credit payoffs.
\item[18.] In this case, the woman paid off this debt despite being judgment-proof. In Indiana, a judgment creditor automatically gains a lien on the debtor’s real property once the decision is docketed. See, e.g., IND. CODE § 34-55-9-2 (1998); see also 46 AM. JUR. 2d Judgments § 371 (1994) (“A judgment lien ordinarily is not a lien on any specific real estate of the judgment debtor but is a general lien on all of the debtor’s real property.”). However, because Ms. Smith did not hold non-exempt equity in her real property (or any other non-exempt property), according to the Indiana exemption statute, IND. CODE § 34-55-10-2 (1998), the judgment creditor could not recover that $200 debt. Yet, she still was forced to pay off the $200.
\item[19.] This summary is simplified in order to facilitate easy calculation. The actual facts of this case are much worse. The prime borrower in the actual case did not owe the debt;
II. THE UNFAIRNESS OF UNSECURED CREDIT PAYOFFS

A. The FTC Act and the FTC's Policy Against Unfair Practices

In 1938, Congress broadened the scope of the FTC Act, a statute that provides government agencies the power to punish entities engaged in illegitimate commercial practices. Prior to the 1938 amendment, the FTC Act invalidated only "unfair methods of competition." The revised statute made "unfair or deceptive acts or practices in and affecting commerce" unlawful.

The FTC Act evaluates potential "unfair" acts using a different standard than the one used to evaluate potentially "deceptive" acts. In other words, an agency may find a practice unfair but not deceptive. This Note is concerned only with the scope of the unfairness standard.

Congress split the regulatory power of the FTC Act among several governmental bodies. It provided the Federal Trade Commission the chief authority to punish entities engaged in unfair trade practices. The legislature, however, reserved the power to curb unfair practices in the banking industry to the federal agencies that regulate banks. Moreover, after the relevant agency adjudicates the unfairness of a practice, the defendant may appeal in federal court.

Instead, the borrower's thirty-year-old daughter held the debt. The daughter was simply planning to drive her mother to the lender's office to finalize the deal. However, when she arrived, the lender convinced her not only to cosign the debt, but also to include her outside debts in the loan amount. Furthermore, the amount of the third-party debt added up to well over $1000.

22. 15 U.S.C. § 45(a)(1). This particular section of the United States Code is also commonly referred to as Section 5(a) of the FTC Act. Am. Fin. Servs., 767 F.2d at 972. After the amendment, the Supreme Court, in FTC v. Sperry & Hutchinson Co., 405 U.S. 233 (1972), validated the ability of the Federal Trade Commission and other agencies to determine whether or not a particular act was sufficiently unfair or deceptive to lead to a penalty.
26. Id. §§ 45(a)(2), 57(g). There are several federal agencies that regulate banks in the United States. The Federal Reserve regulates state-chartered banks that are members of the...
Despite this split in power, agencies and courts have not burdened lawyers with incongruous definitions of unfairness. The entities each analyze unfairness under a common approach; they rely on the framework established by the 1980 FTC Policy Statement. The consistency in the unfairness standard across agencies prevents undue confusion.

Although the government agencies and courts use the same concepts to evaluate unfairness, the enumerated standards do not provide clear-cut rules. Professor Calkins succinctly explains this point:

The Supreme Court has not spoken. No new court of appeals has weighed in. No opinion of the Commission addresses FTC Act Section 5(n). The Commission has not based any new Trade Regulation Rule on the unfairness authority.

In part due to the dearth of binding precedent, the law of FTC unfairness remains indeterminate. Observers recognized that the 1980 Unfairness Statement, while a significant analytic contribution, failed to draw bright lines delineating unfair practices.

Despite its vagueness, the 1980 FTC Policy Statement still anchors any unfairness analysis. The FTC issued its statement as a letter addressed to the Consumer Subcommittee of the Senate Committee on Commerce, Science, and Technology. After studying the FTC Act jurisprudence, the FTC found that it was able to isolate the factors used to determine unfairness.


29. Calkins, supra note 27, at 1960–61 (internal footnotes omitted); see also Schechter, supra note 23, at 1770–72 ("The concept of 'injury' in the law of unfairness is surprisingly underdeveloped.").

30. See 1980 Policy Statement, supra note 23, at ¶ 20,907 ("Rather than merely reciting the law, we have attempted to provide the Committee with a concrete indication of the manner in which the Commission has enforced, and will continue to enforce, its unfairness mandate.").

31. Id. at ¶ 20,908. The agency fit its important summary squarely within the boundaries of prior Supreme Court cases. See, e.g., FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 249 (1972).
The FTC’s statement emphasized the role of consumer injury as the primary indicator of an “unfair practice.”32 Prior to the policy, consumer injury was one factor, among others, in an unfairness analysis.33 The FTC, however, recognized a shift in the concept of unfairness. “Unjustified consumer injury is the primary focus of the FTC Act . . . . By itself it can be sufficient to warrant a finding of unfairness.”34 The contemporary unfairness jurisprudence focuses solely on a finding of consumer injury.35

This emphasis on consumer injury led to the development of the three-prong test for unfairness that courts and agencies now uniformly employ.36 In fact, Congress has explicitly codified the three-prong standard into the FTC Act.37 While neither the Federal Reserve nor the FTC has promulgated regulations that explicitly define specific mortgage lending practices as unfair,38 the agencies apply the FTC Act’s three-prong unfairness test in the home lending area.39

B. Unsecured Credit Payoffs Satisfy the Three-Prong Test for FTC Act Unfairness

To constitute an unfair practice under the FTC Act, the consumer injury must satisfy three requirements: “[T]he injury must be substantial; it must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided.”40 The injury caused by unsecured credit payoffs sufficiently satisfies each prong of the FTC test.

33. Id. at ¶ 20,908. The three factors for unfairness were “(1) whether the practice injures consumers; (2) whether it violates established public policy; (3) whether it is unethical or unscrupulous.” Id. (internal footnotes omitted).
34. Id. The FTC also deemphasized the two other factors, basically leaving consumer injury as the main ingredient for a finding of unfairness. See Calkins, supra note 27, at 1953–55.
35. See Schechter, supra note 23, at 1765 (discussing the primacy of “consumer injury”).
36. See, e.g., Orkin Exterminating Co. v. FTC, 849 F.2d 1354, 1364–65 (11th Cir. 1988) (discussing in detail the three-prong status and the primacy of the “consumer injury” factor).
It is important to recognize at the outset, however, that this analysis will vary somewhat from the FTC’s standard case-by-case analysis. Normally when the FTC engages in the three-prong analysis, it evaluates a single fact pattern. While this case-by-case analysis is necessary to determine whether a particular entity should face a sanction, the context of this Note requires an analysis independent from a specific controversy. Rather than focusing on the actions of a particular corporation, it uses this three-part test to demonstrate the unfair elements that inhere in unsecured credit payoffs. The hypothetical situation outlined above is employed in order to avoid an entirely abstract analysis.

1. The Practice Causes Substantial Consumer Injury

For a practice to be deemed unfair, it must cause consumers substantial injury. The magnitude of the injury is measured from an objective standpoint and typically involves a consumer’s financial loss. “In most cases a substantial injury involves monetary harm, as when sellers coerce consumers into purchasing unwanted goods or services...” Simply put, “[t]o qualify as substantial, an injury must be real, and it must be large compared to the offsetting benefits.”

An early D.C. Circuit case, reviewing an FTC action, discussed various types of injury that courts consider in the “substantial injury” inquiry. In American Financial Services v. FTC, the agency challenged two of the defendant’s credit practices as unfair. First, the defendant required consumers to “give a non-possessory security interest in their household goods and personal effects” in exchange for credit. This practice, while providing limited economic security to the creditor, had devastating economic and psychological effects on the debtor. For instance, it allowed the creditor to exploit the debtor’s emotional connection to his goods and, consequently, coerce the debtor into accepting the creditor’s terms.

Second, the defendant imposed wage assignments that allowed it to receive all or a portion of the debtor’s wages directly from his employer. These assignments occurred

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41. See Schechter, supra note 23, at 1770 (discussing the general approach of the FTC in evaluating unfairness in trade).
43. J. Howard Beales, III, FTC’s Use of Unfairness Authority: Its Rise, Fall, and Resurrection (unpublished manuscript), at www.ftc.gov/speeches/beales/unfair0603.htm (last visited Sept. 4, 2004). Beales is the director of the Bureau of Consumer Protection at the Federal Trade Commission. Id. While his article does not officially state the positions of the FTC, it provides a strong insight into the history and use of the test. I will utilize this work throughout this Note.
45. Beales, supra note 43 (footnote omitted).
46. 767 F.2d 957 (D.C. Cir. 1985).
47. Id. at 973.
48. Id. (“While the monetary gain realized by the creditor upon seizure... is minimal to nonexistent, the replacement cost to the consumer is substantial, not to mention the sentimental value of the possessions and the psychological impact of the loss on the consumer.”).
49. Id. at 974.
50. Id.
without a hearing; the debtor had no ability to present a defense. Aside from the procedural unfairness to the debtor, wage assignments had devastating effects on the debtor's economic situation. Furthermore, the assignments usually occurred at a time of financial hardship and "tend[ed] to cause further disruption of family finances and . . . even put at risk a wage earner's ability to provide necessities for the family." In another landmark case, *Orkin Exterminating Co. v. FTC*, the substantial injury flowed from the financial consequences of the challenged practice. Through its policy of unilaterally breaching contracts with customers, Orkin generated more than $7,000,000 in revenue from 200,000 breached contracts. The court found that this high level of consumer loss compelled a finding of substantial injury.

A recent FTC enforcement action similarly focused on financial injuries. In that case, the government required a major lending entity to return $40,000,000 to consumers. The FTC attorneys charged Fairbanks Capital Corporation, one of the country's largest subprime lenders, "with engaging in a variety of unfair, deceptive, and illegal practices in the servicing of subprime mortgage loans." The agency closely scrutinized Fairbanks's protocol for charging service fees. The complaint noted that:

Fairbanks profits from money it "advances" to the consumer to pay for items that Fairbanks deems necessary to protect its rights in the property. These "corporate advances" include fees for property inspections, demand letters, [and] broker’s price options . . . . These corporate advances are added to the loan balance, and Fairbanks profits from interest charged on the advances.

51. Id.
52. Id.
53. See id. ("Employers are hostile to wage assignments due to added administrative costs and burdens and the fear that the employee's job motivation and performance will suffer as a result of the reduction of wages. Moreover, employers tend to view the consumer's failure to repay the debt as a sign of irresponsibility.") (citations omitted).
54. Id. at 975.
55. 849 F.2d 1354 (11th Cir. 1988).
56. The FTC's report stated that "[t]he harm resulting from Orkin's conduct consists of increased costs for services previously bargained for and includes the intangible loss of the certainty of the fixed price term in the contract." Id. at 1354–65 (quoting *In re Orkin Exterminating Co.*, 108 F.T.C. 263, 362 (1986)); see also Schechter, *supra* note 23, at 1771.
57. *Orkin*, 849 F.2d at 1356, 65.
58. Id. at 1365.
60. Id.
62. Id. at 4.
Furthermore, the agency discovered that the defendant charged late fees in an illegal manner. The FTC alleged that the defendant violated the unfairness provision in the FTC Act by levying unwarranted servicing fees and illegal late fees. The complaint further alleged that Fairbanks caused financial harm to its mortgage consumers by forcing them to purchase unnecessary insurance. "[D]efendants in numerous instances have force placed casualty insurance on consumers' homes when such insurance was already in place." Not only was this "force placed" insurance unnecessary, but it was also more expensive than insurance purchased by the consumer. The court in Fairbanks found a substantial harm and approved the consent order.

As in Fairbanks and Orkin, the substantial injury that flows from unsecured credit payoffs is a financial one. The practice damages the borrower's finances in two ways. First, the conversion of an unfinanced sum into a financed sum substantially increases the borrower's formerly interest-free debt. Second, the conversion of unsecured debt into secured debt heightens the risk in default.

Unsecured credit payoffs generally attach high interest rates to previously unfinanced debts. Like the fees that caused substantial injury in Fairbanks, these debts "are added to the loan balance, and [the lender] profits from [the] interest charged." The lender extends the reach of the loan's high interest beyond the mortgage amount and into the borrower's unrelated debts.

The Smith hypothetical will further illustrate the depth of the borrower's financial loss. Prior to the loan agreement, Ms. Smith held $1000 in various unsecured and unfinanced debts. The lender forced Ms. Smith to pay off those debts and, consequently, the additional $1000 was consolidated with her financed debt. Because of this transaction, the original $1000 debt, when financed at thirteen percent annual rate over thirty years, will transform into approximately $4000. The borrower, likely unaware of the effects of the payoff, is forced to unduly pay for debts unrelated to the mortgage. The lender, therefore, not only controls the cost of its mortgage service, it also controls the cost of the borrowers' other loans. The FTC, in its complaint in Fairbanks, has recognized the unfairness of this manipulation.

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63. Id. at 5–6.
64. FTC, Fairbanks Capital Settles, supra note 59.
65. Fairbanks, Complaint for Injunction, supra note 61, at 8.
66. Id. at 5.
67. FTC, Fairbanks Capital Settles, supra note 59.
68. See supra notes 8–11 and accompanying text. Again, for those instances, like credit card payoffs, in which the debt amount was already financed before the payoff, the substantial injury flows from the transformation of unsecured debts into secured debts. See infra notes 73–84 and accompanying text.
69. Fairbanks, Complaint for Injunction, supra note 61, at 4.
70. See supra text accompanying notes 18–19.
71. At the above interest rate, Ms. Smith would have to pay $2990.42 in interest:

<table>
<thead>
<tr>
<th>Amount Added to Principle</th>
<th>Total Interest Cost</th>
<th>Total Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1000 at 13% annual rate</td>
<td>$2990.42</td>
<td>$3990.42</td>
</tr>
</tbody>
</table>

72. See supra notes 59–67 and accompanying text.
The unsecured credit payoffs further injure plaintiffs by securing formerly unsecured debts. The injury involved in payoffs of unsecured yet financed debts (such as credit cards) follows from this transformation. Commentators have noted that forcing a person to refinance unsecured debt is unfair and predatory. In her analysis of predatory lending, Odette Williamson notes that lenders who suggest consolidation “do not mention that the higher debt burden increases the risk of foreclosure and the long-term costs of debt repayment.”

The transformation of the debts’ secured status causes three distinct injuries. First, as Williamson notes, it increases the likelihood of the borrower losing her house through foreclosure. When the borrower’s unsecured, third-party debts are added to the loan, the formerly unsecured sum becomes part of the secured mortgage debt. Before the transaction, the borrower’s third-party, unsecured debt was not tied to any particular asset. However, once the debt becomes secured, a relationship is formed between the added debt and the collateral (namely, the borrower’s home). If the borrower defaults on this formerly unsecured sum, as part of the mortgage debt, the creditor can reach the home. By increasing the amount of secured debt attached to her home, the transformation “increases the [borrower’s] risk of foreclosure.”

Second, the transformation of the debts to secured status makes the debtor more susceptible to collection on those debts than before the transformation. An unsecured creditor has limited collection ability. The unsecured creditor’s path to payment is narrow. Not only does the law provide procedures for the collection of unsecured debts, it regulates or bars outright many alternatives. On the other hand, the secured creditor enjoys a more powerful position. The secured creditor does not have to hunt for sufficient assets like an unsecured creditor; rather, he can foreclose on the collateral upon the borrower’s default. Given the inequality in collection power, the borrower whose debts become secured loses a significant advantage that he had previously held over the unsecured creditor. After the change in the debts’ secured status, he is much more susceptible to collection on those debts.

Third, the borrower loses the protection of state exemption statutes. State exemption statutes classify some of a borrower’s property as exempt from collection upon default of an unsecured debt. In other words, the statute sets aside some property as immune from attachment. For example, suppose the three unsecured creditors from the

73. See, e.g., Williamson, supra note 11.
74. Id. at 302.
75. Id.
77. Id. at 21.
78. Williamson, supra note 11, at 302.
79. RAYMOND T. NIMMER ET AL., COMMERCIAL TRANSACTIONS: SECURED FINANCING CASES, MATERIALS, PROBLEMS 18 (2d ed. 1999) (“[The unsecured creditor’s] ultimate success is dicey at best.”).
80. LOPUCKI & WARREN, supra note 76, at 4.
81. NIMMER ET AL., supra note 79, at 18 (“[Success] will depend on whether the sheriff can locate sufficient nonexempt, unencumbered assets to satisfy your judgment.”).
82. LOPUCKI & WARREN, supra note 76, at 29.
83. These exemption statutes exist in all fifty states. Id. at 15.
hypothetical above attempt to collect from Ms. Smith before the mortgage agreement. Suppose further that Ms. Smith lives in Indiana and that she holds only the following assets: $3000 in personal goods and $4000 in home equity. Due to the Indiana exemption statute, which protects up to $4000 in personal goods and up to $7500 in home equity from unsecured creditors, the three creditors cannot collect any part of the debt until Ms. Smith obtains some non-exempt assets. Once Ms. Smith's debts become secured, she loses this protection.

The lender that mandates unsecured credit payoffs causes substantial injury to the borrower by attaching significant interest to small, unfinanced loans and by increasing the danger inherent in those loans. This conclusion follows logically from the FTC's Fairbanks complaint.

2. The Benefits Do Not Outweigh the Substantial Injury

For a practice to classify as unfair under the FTC Act, the substantial injury must outweigh any benefits to the consumer or to the competitive market. "The Commission is aware of... tradeoffs and will not find that a practice unfairly injures consumers unless it is injurious in its net effects." The FTC primarily takes into account the practice's economic effect; however, it can also consider non-economic factors in its balancing equation.

As I have stated above, commentators have recognized the predatory nature of unsecured credit payoffs. In line with this analysis, this Note contends that the benefits of these payoffs do not outweigh the substantial injury that the practice causes.

Opponents may argue that the consumer receives a valuable consolidation service for the additional interest he pays. It is true that the consumer might enjoy the consolidated payments. Yet, one must view this potential benefit in the full context—it was forced on the borrower by the lender. Therefore, the benefit from the consolidation does not flow from an optional term selected by the borrower in negotiations; such spin doctoring obscures the coercive nature of the practice. Moreover, the debt consolidation is costly. The consumer receives the ease of consolidation only after giving up unfinanced, unsecured debt. She does not receive the reduced interest rate offered by many loan consolidation packages, which are advertised in the media. Rather, the borrower pays a higher interest rate than before consolidation.

85. FTC, Fairbanks Capital Settles, supra note 59.
86. 1980 Policy Statement, supra note 23, at 20,909; see also Beales, supra note 43 ("[T]he next step is to determine whether the harm is outweighed by countervailing benefits to consumers or competition.").
88. Id. The FTC policy statement on unfairness gives several examples of the non-economic considerations used by the FTC: "[These other considerations] include not only the costs to the parties directly before the agency, but also the burdens on society in general in the form of increased paperwork, increased regulatory burdens on the flow of information, reduced incentives to innovation and capital formation, and similar matters." Id. Clearly this list is not exclusive.
89. See Williamson, supra note 11, at 302.
One could also argue that unsecured credit payoffs benefit low-income borrowers in the competitive market. The practice encourages more subprime lending by reducing the risk the lenders face. The payoffs reduce risk by relieving the borrower's outside debt obligations. Once the payoffs free the borrower, he can focus on paying the mortgage debt. Nevertheless, this practice does not reduce risk inherent in the borrower's third-party debt. It is true that the payoffs will cause the borrower to focus solely on the mortgage lender. The practice, however, does not alleviate the risk from the paid-off debts because the borrower still has to pay the debt amount herself. The mortgagee's payment did not relieve the mortgagor's outside obligations; the debt simply changed hands.

An advocate for the lenders' position might also claim that the payoffs reduce risk in the early, crucial stage of the mortgage period by increasing the likelihood that the borrower will make the first payments. Lenders arguably bear the most risk during the early stages of the mortgage agreement. Therefore, they force the credit payoffs so that the borrower has no encumbrances that may keep her from making the first mortgage payments. While these payoffs do not relieve the borrower's debt burden, the payoffs guarantee that money formerly earmarked for other creditors will be available for use early in the mortgage term. This practice will increase the likelihood of early payment and, therefore, significantly decrease the risk involved.

In practice, however, these payoffs do not free up money already earmarked for unsecured debts. The argument is premised on the assertion that the borrower's obligation to the unsecured debt in the early stages may interfere with his mortgage obligation. This premise is faulty for several reasons. First, due to the increased danger inherent in secured transactions, the borrower already has an incentive to pay off secured creditors before unsecured creditors, even without the credit payoffs. The mortgage creditor can foreclose on his house; the unsecured creditor does not have such compelling collateral. The unsecured creditor's comparative disadvantage in debt collection gives the borrower a further reason to pay off his secured debts before his unsecured debts. He knows that the secured creditor can collect upon default. Therefore, the forced payment of unsecured debt does not provide a significantly higher likelihood of an early payment on secured debts.

90. See supra note 2 and accompanying text.
91. As the borrower's equity in the security increases, the risk of default decreases. Therefore, the risk of default is highest during the early stages of the mortgage loan. See ROBERT SCHAFFER & HELEN F. LADD, DISCRIMINATION IN MORTGAGE LENDING 16 (1981) ("Default risk ... should decrease as the borrower's equity in the mortgaged property increases."). On the other hand, the fact that borrowers pay mostly interest in the early stages may suggest that borrowers account for the risk.
92. For instance, if the payoff amount is $1000 and the monthly mortgage payment is $500, it can be argued that the payoff clears up the money for two mortgage payments.
93. See supra notes 73--83 and accompanying text.
94. LOPUCKI & WARREN, supra note 76, at 22 ("The recognition of enhanced collection rights for secured creditors necessarily diminishes the effectiveness of the collection rights of general unsecured creditors.").
95. Id. at 21--22.
3. The Injury is Not Reasonably Avoidable

A practice is not unfair unless the consumer could not have reasonably avoided the injury. The FTC generally assumes it should not act against the decisions of consumers and that a competitive market will rid itself of most injurious practices. "We anticipate that consumers will survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory." Practices that reduce an individual's ability to choose alternatives and that withstand market forces require intervention. Therefore, the FTC focuses on practices that prevent consumers from freely exercising their decisionmaking power. For example, the FTC will aim at sellers that "engage in overt coercion . . . [or sellers that] exercise an undue influence over highly susceptible classes of purchasers."

In the subprime market, a consumer's poor credit history diminishes his mortgage options. Consequently, lenders employ rates, fees, and terms that consumers in the standard credit market would not tolerate. The benefits of many of these costly subprime practices outweigh the injury to the consumer. Without them, the risk inherent in the market would prevent anyone from providing credit services to subprime borrowers. Unsecured credit payoffs, however, do not provide lenders risk protection that outweighs the injury to consumers. Yet, despite the financial injury flowing from forced payoffs, unsecured credit payoffs are still common in the subprime market. Because borrowers stuck in subprime have limited options, lenders

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96. 1980 Policy Statement, supra note 23, at 20,909; see also Beales, supra note 43 ("[T]he concept of reasonable avoidance keeps the Commission from substituting its paternalistic choices for those of informed customers.").
98. Id.
99. Id.; see also Beales, supra note 43 ("If consumers could have made a different choice, but did not, the Commission should respect that choice.").
100. 1980 Policy Statement, supra note 23, at 20,909; see also Beales, supra note 43 ("The primary purpose of the Commission's modern unfairness authority continues to be to protect consumer sovereignty by attacking practices that impede consumers' ability to make informed decisions.").
102. Eggert, supra note 2, at 573–74.
104. Eggert, supra note 2, at 573–74 ("Lenders argue that they charge higher interest rates and fees for subprime loans because of the increased risk characteristics of subprime borrowers.").
105. See supra notes 86–95 and accompanying text (discussing the balancing of benefits).
106. See supra notes 42–85 and accompanying text.
107. See RENUART & KEEST, supra note 10, at 89; see also Williamson, supra note 11, at 302. For an in-depth discussion of the persistence of predatory lending practices in the marketplace (including unsecured credit payoffs), see Kathleen C. Engel & Patricia A. McCoy,
have no incentive to stop mandating unsecured credit payoffs. The market will not eliminate unsecured credit payoffs by itself, and this practice cannot be reasonably avoidable to consumers.

In *American Financial Services Inc. v. FTC*, the D.C. Circuit Court forcefully depicted the unavoidable nature of certain injurious credit practices in the high-risk, subprime arena. The challenged consumer finance company required two harmful contract terms of its prospective borrowers: wage assignments and a security interest in household goods. Recognizing the difficult position of people in the high-risk lending market, the court found the practices reasonably unavoidable:

As noted, standard form contracts are presented on a take it or leave it basis. While there are differences in the kinds of contracts offered by different creditors, certain creditors, namely finance companies serving higher-risk borrowers, are most likely to include HHG [household goods] security interests and wage assignments. Furthermore while the incidence of use of these provisions may differ across different regions of the country, contracts offered by creditors of a given class in local areas are often substantially identical. Given the substantial similarity of contracts, consumers have little ability or incentive to shop for a better contract.

Like the high-risk borrowers in *American Financial Services*, the borrowers at issue in this Note are forced to either take the contracts with the injurious provision or leave them. Because of their subprime position, they "have little ability or incentive to shop for a better contract." The practice is not reasonably avoidable to those subprime borrowers.

Furthermore, the mandatory nature of unsecured credit payoffs illustrates the similarities between them and the unfair, reasonably unavoidable practice in *Fairbanks*. As with the unnecessary insurance required by the lender in *Fairbanks*, these payoffs are not offered as an option for borrowers in exchange for higher rates. The borrower's inability to meaningfully bargain amplifies his limited choices. Because unsecured credit payoffs cause substantial injury that is neither reasonably avoidable nor outweighed by counterveiling benefits, the practice is unfair under the FTC Act.

C. Plaintiffs Suffering from the Unfairness of Unsecured Credit Payoffs Do Not Have an FTC Act Remedy

When an entity engages in an unfair commercial practice, the FTC Act empowers the relevant government agency to rectify the situation. "The [Federal Trade] Commission is hereby empowered and directed to prevent persons, partnerships, or corporations... from using unfair methods of competition... and unfair or deceptive
acts or practices . . . ."\textsuperscript{113} The statute further stipulates the procedures that the FTC should follow in pursuing a violation of the act.\textsuperscript{114}

While the FTC Act does not explicitly provide government agencies the sole ability to bring an unfairness action, courts have almost unanimously held that the act does not give an individual a private right of action. Prior to the 1938 amendment, which sanctioned entities engaging in unfair trade practices,\textsuperscript{115} the Supreme Court denied private plaintiffs the right to bring an unfair competition action under the FTC Act in \textit{Moore v. New York Cotton Exchange}.\textsuperscript{116} The court dismissed the plaintiffs’ claim, stating that “[t]here is an attempt to allege unfair methods of competition, which may be put aside at once, since relief in such cases under the Trade Commission Act must be afforded in the first instance by the commission.”\textsuperscript{117}

Lower courts have extended this prohibition beyond the context of unfair competition into the realm of unfair and deceptive practices. In \textit{Holloway v. Bristol-Meyers Corp.},\textsuperscript{118} the D.C. Circuit held that “consumers and members of the public at large” could not “bring . . . private action[s] to enforce §5 . . . of the [FTC] Act . . . which prohibit[s] unfair or deceptive acts or practices in commerce.”\textsuperscript{119} With the exception of a single federal district court,\textsuperscript{120} the federal courts have consistently followed the D.C. Circuit’s lead.\textsuperscript{121}

The FTC has not considered the fairness of unsecured credit payoffs, and consequently those injured by the practice have received no remedy. Moreover, the absence of a private right of action leaves a borrower whose lender forced such a credit payoff in an unfair lending situation with no clear remedial path. While the consumer should inform the FTC of the unfair credit practice, it is also in her best interest to inquire into alternative remedies. She should start by examining state unfairness acts or “Little FTC” acts.\textsuperscript{122} These statutes typically include a private right of action\textsuperscript{123} and are

\begin{thebibliography}{99}
\item \textsuperscript{113} 15 U.S.C. § 45(a)(2) (2000). Congress also provided a similar power to the Federal Reserve Board and other agencies to curb unfair practices in the banking context. 15 U.S.C. § 57(a).
\item \textsuperscript{114} 15 U.S.C. § 45(b)–(m).
\item \textsuperscript{115} See supra notes 20–22 and accompanying text.
\item \textsuperscript{116} 270 U.S. 593 (1926); see Allan B. Currie, \textit{A Private Right of Action Under Section Five of the Federal Trade Commission Act}, 22 HASTINGS L.J. 1268, 1269 (1971) (discussing the origins of the rule against a private right of action under the FTC Act). Currie claims that, at the time of \textit{Moore}, the ruling was not as devastating to private actors because the old federal common law provided a cause of action. \textit{Id}. However, when the federal common law was abolished by \textit{Erie R.R. v. Tompkins}, 304 U.S. 64 (1938), the full force of this decision was felt. Currie, supra at 1269–70.
\item \textsuperscript{117} \textit{Moore}, 270 U.S. at 603.
\item \textsuperscript{118} 485 F.2d 986 (D.C. Cir. 1973).
\item \textsuperscript{119} \textit{Id}. at 988 (internal footnotes and quotations omitted).
\item \textsuperscript{120} See \textit{Guernsey v. Rich Plan of Midwest}, 408 F. Supp. 582 (N.D. Ind. 1976) (recognizing a private right of action under the FTC Act).
\item \textsuperscript{121} See, e.g., Dreisbach v. Murphy, 658 F.2d 720 (9th Cir. 1981); Naylor v. Case & McGrath, Inc., 585 F.2d 720 (2d Cir. 1978); Freedman v. Meldy’s, Inc., 587 F. Supp. 658, 659–60 (E.D. Pa. 1984) (discussing in detail the case law against a private right of action).
\item \textsuperscript{122} See generally Donald M. Zupanec, \textit{Annotation, Practices Forbidden by State Deceptive Trade Practice and Consumer Protection Acts}, 89 A.L.R.3d 449 (1979) (discussing in depth the state statutes designed to curb unfair and deceptive acts).
\end{thebibliography}
often similar to the FTC Act. However, the borrower should not limit herself to a state cause of action that may not exist in a particular jurisdiction and that may be construed narrowly.

The Home Ownership and Equity Protection Act ("HOEPA") provides a potential avenue for subprime borrowers looking to remedy the FTC Act as it defined unfairness. HOEPA and the FTC Act have a close logical connection as both statutes target a similar problem—predatory lending. According to the Office of the Comptroller of the Currency ("OCC"), "[p]redatory lending practices [which may be unfair under the FTC Act] also may violate other laws, such as HOEPA, which covers certain high-cost mortgage loans." 127

HOEPA provides an avenue to remedy the unfairness in unsecured credit payoffs that the FTC Act does not. However, the finding of unfairness under the FTC Act is not irrelevant. Rather, the unremedied unfairness provides judges a policy incentive to fit the practice into the HOEPA remedial framework. As explained further below, this strategy of employing a statutory violation to fit a practice into another statute is legitimate as the FTC itself used it in a case that involved both HOEPA and the FTC Act.128

III. UNSECURED CREDIT PAYOFFS AS A HOEPA FINANCE CHARGE: PROVIDING A REMEDIAL COURSE FOR THE FTC ACT-DEFINED UNFAIRNESS

A. The HOEPA Amendment to the Truth in Lending Act

In 1968, Congress enacted the Truth in Lending Act ("TILA"). The original TILA, which applies to almost every consumer credit transaction, requires the lender to follow a uniform disclosure framework in which the borrower can see the cost of the transaction before deciding to enter into an agreement. Congress passed the law in

124. See Zupanec, supra note 122, § 2[b], at 462 ("[C]ounsel seeking guidance [with the state acts] . . . are advised to refer to the large number of federal judicial and administrative decisions which consider the question of the lawfulness of particular acts or practices under the Federal Trade Commission Act, inasmuch as the language utilized in many state deceptive trade practice and consumer protection statutes is similar to the language of the federal act.").
128. See infra notes 192–213 and accompanying text.
130. RALPH J. ROHNER & FRED H. MILLER, TRUTH IN LENDING 3 (2000).
order to "promote the informed use of consumer credit." In its findings, it determined that "economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit."

In 1994, Congress passed HOEPA as an amendment to the TILA in order to address specifically the predatory aspects of subprime mortgage loans. Not all mortgage transactions, however, fit within the scope of HOEPA. If the loan qualifies, HOEPA requires lenders to disclose more information than the initial TILA required and it places substantive limitations on the terms of the loan.

The loan must satisfy two basic requirements to garner HOEPA coverage. First, the statute only covers "consumer credit transaction[s] that [are] secured by the consumer's principal dwelling." Moreover, it exempts mortgages that finance the acquisition or initial construction of a dwelling, reverse mortgage transactions, and open-ended credit plans. "Thus, most covered transactions will be refinancing loans or home improvement loans and credit sales." HOEPA does cover both first and subordinate lien loans, as long as the loan is secured by the creditor's residence.

Second, a loan must satisfy one of the two statistical tests before the borrower can enjoy HOEPA protection. A loan will satisfy the second element of HOEPA coverage if "[t]he annual percentage rate at consummation will exceed by more than 8 percentage points for first-lien loans, or by more than 10 percentage points for subordinate-lien loans, the yield on Treasury securities having comparable periods of maturity to the loan maturity." The loan may also fulfill the second element if the

131. Id. at 4 (citing Regulation Z, 12 C.F.R. § 226.1 (2003)).
135. See Cooper, 238 F. Supp. 2d at 54.
136. 15 U.S.C. § 1602(aa); see Cooper, 238 F. Supp. 2d at 54 ("Congress intended HOEPA to result in greater disclosure to borrowers involved in high cost loans and to stop certain loan terms and practices."); see also Rohner & Miller, supra note 130, at 452–57.
137. 12 C.F.R. § 226.32(a)(1); Rohner & Miller, supra note 130, at 453. Some courts break this first requirement into four subparts. "More specifically, a high cost or HOEPA loan is: 1) a consumer credit transaction 2) with a creditor 3) that is secured by the consumer's principal dwelling 4) and is a second or subordinate residential mortgage . . . " Cooper, 238 F. Supp. 2d at 53 (D.D.C. 2002); see also Lopez v. Delta Funding Corp., No. CV 98-7204, 1998 WL 1537755, at *4 (E.D.N.Y. Dec. 23, 1998).
138. 12 C.F.R. § 226.2(24) (defining "residential mortgage transaction"); id. at § 226.32(a)(2)(i) (exempting "residential mortgage transactions").
139. Rohner & Miller, supra note 130, at 453. As Williamson states, "[r]efinancing and home equity loans are covered." Williamson, supra note 11, at 304.
140. 12 C.F.R. § 226.32(a).
141. Id. § 226.32(a)(1)(i).
total "points and fees"\textsuperscript{142} payable by the consumer at or before closing will exceed 8% of the total loan amount.\textsuperscript{143} The amount an unsecured credit payoff should help satisfy this "points and fees" test.\textsuperscript{144}

If a loan satisfies both elements of the HOEPA statutory framework, it is then subject to restrictive rules for credit disclosure and to substantive limitations in the terms of the loan.\textsuperscript{145} Along with the standard disclosure required by TILA,\textsuperscript{146} HOEPA lenders must provide a warning notice about the transaction, the annual percentage rate, the amount of a regular monthly payment and the amount of a balloon payment, a statement that the interest rate and monthly rate might vary (in a variable-rate mortgage), and the amount borrowed.\textsuperscript{147} The terms of a HOEPA-qualifying loan cannot include balloon payments,\textsuperscript{148} negative amortization,\textsuperscript{149} advance payments,\textsuperscript{150} an increased interest rate after default,\textsuperscript{151} a refund calculated by the statutory actuarial method,\textsuperscript{152} prepayment penalties,\textsuperscript{153} a due-on-demand clause,\textsuperscript{154} or any other unfair or deceptive practices.\textsuperscript{155}

If a lender violates either the disclosure requirements or the substantive term limitations of HOEPA, the borrower can take advantage of "powerful" private remedies.\textsuperscript{156} "HOEPA explicitly provided that violations of its special protection

\textsuperscript{142} For the description of which amounts qualify as a point or fee, see infra notes 160–73 and accompanying text. As defined by HUD, a point is "normally paid at closing and [is] generally calculated to be equivalent to 1% of the total loan amount... [Points] are paid to reduce the interest rate on a loan." HUD Housing Glossary, at http://www.hud.gov/offices/hsg/sfh/buying/glossary.cfm (last updated June 14, 2002) (last visited Jan. 15, 2005).

\textsuperscript{143} 12 C.F.R. \$ 226.32(a)(1)(ii). According to the statute, this "points and fees" amount must exceed at least $400. \textit{Id.} This $400 minimum actually is "adjusted annually on January 1 by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1." \textit{Id.; see also} Williamson, supra note 11, at 303–04.

\textsuperscript{144} For a very thorough demonstration of the "points and fees" calculation, see Cooper v. First Gov't Mortgage & Investors Corp., 238 F. Supp. 2d 50, 58–61 (D.D.C. 2002).

\textsuperscript{145} 12 C.F.R. \$ 226.32(c)–(d); \textit{see also} Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans, 6 Fed. Banking L. Rep. (CCH) \# 64–126, at 73,849–16 (Aug. 15, 2003) (discussing HOEPA along with other consumer protection statutes) [hereinafter Avoiding Predatory and Abusive Lending].

\textsuperscript{146} \textit{See} ROHNER \& MILLER, supra note 130, at 457 (describing the disclosures required for HOEPA loans as "special").

\textsuperscript{147} 12 C.F.R. \$ 226.32(c)(1)–(5).

\textsuperscript{148} \textit{Id.} \$ 226.32(d)(1)(i). There is a narrow exception to the ban on balloon payments. \textit{See id.} \$ 226.32(d)(1)(ii).

\textsuperscript{149} \textit{Id.} \$ 226.32(d)(2).

\textsuperscript{150} \textit{Id.} \$ 226.32(d)(3).

\textsuperscript{151} \textit{Id.} \$ 226.32(d)(4).

\textsuperscript{152} \textit{Id.} \$ 226.32(d)(5) (citing 15 U.S.C. \$ 1615(d) (2000)).

\textsuperscript{153} \textit{Id.} \$ 226.32(d)(6). The statute lists exceptions to the ban on prepayment penalties. \textit{Id.} \$ 226.32(d)(7).

\textsuperscript{154} \textit{Id.} \$ 226.32(d)(8).

\textsuperscript{155} ROHNER \& MILLER, supra note 130, at 466 ("The Board is authorized by HOEPA to prohibit other acts or practices in connection with covered loans that it finds to be unfair, deceptive, or designed to evade the special rules.") (citing 15 U.S.C. \$ 1639(l)(2)(A) (2000)).

\textsuperscript{156} Williamson, supra note 11, at 303–05.
provisions would entitle consumers to rescind mortgage loans and to recover the TILA statutory penalties.\textsuperscript{157} The borrower's power of rescission lasts either for three years after the agreement or until she sells the property.\textsuperscript{158} In addition, the borrower may recover the finance charges and fees connected to the extension of a loan that includes the improper terms.\textsuperscript{159}

Because of the remedies available under HOEPA, a borrower has a strong reason to fit his loan into the statutory framework. Thus, HOEPA can provide a remedial course currently lacking under the FTC Act. This Note argues that the amount of an unsecured credit payoff should count toward the satisfaction of the "points and fees" trigger test.

\textbf{B. The Finance Charge as a Component in the HOEPA Points and Fees Test}

As stated above, the second element for HOEPA coverage is satisfied if the "points and fees" payable by the borrower exceed 8% of the loan amount.\textsuperscript{160} This requires a person to calculate two figures. He must first compute the threshold that satisfies the test (the 8% of the loan amount). He must then compare this figure to the points and fees he has been charged. In order to determine these points and fees, he must include the following four components:

\begin{itemize}
  \item[i)] all items required to be disclosed under § 226.4(a) and § 226.4(b) [which includes finance charges], except interest or time-price differential;
  \item[ii)] all compensation paid to mortgage brokers;
  \item[iii)] all items listed in § 227.4(c)(7) ... unless charge is reasonable ...;
  \item[iv)] premiums or other charges ...\textsuperscript{161}
\end{itemize}

If the points and fees, including finance charges, reach the threshold, then the borrower's loan satisfies the second element.\textsuperscript{162}

The finance charges of a loan comprise a major component of the points and fees amount.\textsuperscript{163} The total finance charge of a loan, simply put, "is the consumer's cost of

\begin{itemize}
  \item \textsuperscript{158} 12 C.F.R. § 226.23(a)(3); see also Rohner & Miller, supra note 130, at 467 (discussing the remedies available under HOEPA).
  \item \textsuperscript{159} 15 U.S.C. § 1640(a)(4) (2000); see also Newton, 24 F. Supp. 2d at 451; Avoiding Predatory and Abusive Lending, supra note 145, at 73,849–16; Williamson, supra note 11, at 304.
  \item \textsuperscript{160} As I noted above, the total points and fees amount still must be over the minimum threshold that is adjusted each year ($400 at the time HOEPA was passed). See supra note 143. For a clear description of finance charges in the TILA/HOEPA framework, see Dee Pridgen, Consumer Credit and the Law § 6:2 (2003 ed.).
  \item \textsuperscript{161} 12 C.F.R. § 226.32(b)(1); see also Johnson v. The Know Fin. Group, No. CIV.A.03-378, 2004 WL 1179335, at *5–7 (E.D. Pa. May 20, 2004) (calculating points and fees amount).
  \item \textsuperscript{162} This description gives the gist of the HOEPA analysis. However, the actual calculation can be a bit more difficult. See Elizabeth Renuart, National Consumer Law Center, Stop Predatory Lending: A Guide for Legal Advocates § 7.4.6, at 144–46 (2002) (discussing in great detail the steps needed to calculate the point and fees amount).
  \item \textsuperscript{163} See 12 C.F.R. § 226.4 (describing which charges and fees in connection with a credit transaction are considered finance charges).
credit."  The federal regulation interpreting TILA/HOEPA, Regulation Z, specifies which charges qualify as finance charges. If an amount is considered a finance charge under the regulatory definition, the borrower nears the qualification threshold for HOEPA. Because lenders often try to levy finance charges that near, but do not exceed, the 8% mark, a small additional amount can lead to HOEPA classification.

As a practical matter, the regulation provides two avenues for a borrower to classify an amount as a finance charge. First, the amount may satisfy the four-part definition of a finance charge. "The finance charge . . . includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or condition of the extension of credit." Second, the federal regulations may explicitly grant a particular type of charge finance charge status. Courts are more willing to consider an amount as a finance charge when it is listed in the regulation than when they have to apply the four-part definition. Still, courts have been willing to look outside the explicit examples.

C. Unsecured Credit Payoffs Fit the Regulatory Definition of a Finance Charge

Because the HOEPA regulations do not list unsecured credit payoffs as finance charges, a borrower must instead satisfy the following four-part test: a finance

164. ROHNER & MILLER, supra note 130, at 107.
166. RENUART, supra note 162, at 145.
167. For instance, in Johnson v. Banc One Acceptance Corp., 278 F. Supp. 2d 450, 459 n.8 (E.D. Pa. 2003), the lender argued that the "points and fees" amount totaled 7.9995% of the loan amount while the borrower argued that the amount totaled 8.0011%.
168. Judge Posner, in Cowen v. Bank United of Texas, FSB, 70 F.3d 937 (7th Cir. 1995), artificiated the importance of finance charge arguments. "[A] suit for $14 . . . may seem a quixotic project. Not so . . . [T]he plaintiffs, if they win, would be entitled to statutory damages of $1000 without any proof of injury, because [TILA] allows the recovery of twice the finance charge up to $1000, and the finance charge here exceeded $500." Id. at 941.
169. 12 C.F.R. § 226.4(a).
170. Id.
171. Id. § 226.4(b). Moreover, certain charges are explicitly excluded from finance charge status. Id. § 226.4(c).
172. Cf. JAMES H. PANNA BECKER, I TRUTH-IN-LENDING MANUAL ¶ 2.01–02 (rev. ed. 2003) (listing the outcomes of several cases decided both using the four-part test and using the explicit examples of a TILA finance charge).
173. See, e.g., First Acadiana Bank v. Fed. Deposit Ins. Corp., 833 F.2d 548, 549–50 (5th Cir. 1987) (holding that the attorneys' fees charged were finance charges under Regulation Z's standard definition); Bumpus v. Vandeford, No. 1:99CV070-SAA, 2002 U.S. Dist. LEXIS 20062, at *14–15 (N.D. Miss. Mar. 27, 2002) (finding that "weekly extension fees" satisfy the four-part test for finance charges); see also ROHNER & MILLER, supra note 130, at 114 ("Regulation Z lists a number of types of charges that are included, but makes clear that these are only examples and not an exhaustive list.") (internal citation omitted).
174. 12 C.F.R. § 226.4(b).
175. See supra notes 160–72 and accompanying text.
charge is (i) any charge; (ii) payable directly or indirectly by the consumer; (iii) imposed directly or indirectly by the creditor; (iv) as an incident to or a condition of the extension of credit. All mandatory third-party credit payoffs, including unsecured credit payoffs, meet this four-part definition of a finance charge. The first element requires analysis while the three other elements are satisfied by the definition of a forced credit payoff.

First, an unsecured credit payoff is a charge. While the federal regulations do not define the term, a "charge" is an expense faced by the borrower according to Black's Law Dictionary. The National Consumer Law Center's Truth in Lending Manual states that "[u]sually, a charge will be in the form of a cost added on to the borrower's obligation." An unsecured credit payoff meets these definitions, as it is an expense faced by the borrower in the credit transaction. The lender mandates the addition of the payoffs to the borrower's obligation.

The District of Nebraska's finding in Campbell v. Liberty Financial Planning supports the position that credit payoffs are "charges." According to the court, when a lender requires a borrower to pay off debts owed to the lender, the amount of the payoff is a finance charge. While Campbell does not address third-party credit payoffs in the context of the "charge" analysis, the practice in Campbell is indistinguishable from third-party credit payoffs. Both unsecured credit payoffs and the practice in Campbell are credit payoffs; the fact that the money may go to an outside party does not make its status as a "charge" different from the practice in Campbell. Each results in an additional expense for the borrower.

The other three elements are easily satisfied. The borrower pays the amount, satisfying the second element. Although the lender provides capital to the borrower, the borrower is still responsible for paying off the outside debt. The third requirement is fulfilled, as the creditor imposes the charge directly on the borrower. Finally, because the payoff is a condition of the extension of credit, the fourth requirement is satisfied. The borrower must agree to pay the amount before the lender will extend the credit.

While unsecured credit payoffs fit nicely into the four-part definition of a finance charge, no precedent exists to support or refute their inclusion in the definition—judges

176. This four-part formulation comes from the National Consumer Law Center. RENUART & KEEST, supra note 10, § 3.5, at 87. This formulation is useful in its simplicity and does not remove any important elements from the federal regulation. See 12 C.F.R. § 226.4(a).

177. The National Consumer Law Center's Truth in Lending supports this conclusion. "[R]equired pay-offs literally meet all the definitional elements of the finance charge: they are a cost/charge, payable by the consumer, imposed by the creditor as a condition of the extension of credit." RENUART & KEEST, supra note 10, § 3.6.1.1, at 88–89.

178. 12 C.F.R. § 226.4(a); RENUART & KEEST, supra note 10, § 3.6.1.1, at 88.


180. RENUART & KEEST, supra note 10, § 3.6.1.1, at 88.

181. See RENUART & KEEST, supra note 10, § 3.6.1.2, at 88.
have not analyzed this precise issue. Furthermore, courts have split in their evaluations of practices similar to unsecured credit payoffs. In a case in which a creditor forced a borrower to pay off loans owed to the creditor, a federal judge held a payoff amount to be a finance charge. Importantly, this case provides an example of a court willing to classify as a finance charge an amount that is not listed in the federal regulation. The court in Smith v. Fidelity Consumer Discount Co., however, determined that if a creditor forces a borrower to pay off a third-party lien on the collateral, the payoff amount does not count as a finance charge.

The practice in Smith can clearly be distinguished from unsecured credit payoffs. The creditor in Smith had an extremely high interest in guaranteeing that the collateral was free from outside liens before he entered into the credit contract. Such a lien directly threatened the creditor’s ability to recover upon default. The lender forcing unsecured credit payoffs, however, does not have a similar motivation when the third-party debts do not involve the collateral. If the borrower defaulted on the refinancing loan without paying off his unsecured outside debts, those outside unsecured creditors do not threaten the mortgage lender’s claim on the collateral.

Because precedent does not provide courts considering whether to classify unsecured credit payoffs as finance charges with a clear approach (even though the practice satisfies the regulatory definition), policy arguments should influence the courts. The unremedied FTC Act-defined unfairness of unsecured credit payoffs should give courts a sufficiently strong policy incentive to classify the payoff as a HOEPA “finance charge,” and thus provide an avenue to remedy the unfairness. Why should this unfairness provide an incentive to remedy the practice using HOEPA rather than a

184. In fact, very few courts have analyzed any type of credit payoff under TILA/HOEPA. See James D. Lockhart, Annotation, What Constitutes “Finance Charge” Under § 106(a) of the Truth in Lending Act (15 U.S.C.A. § 1605(a)) or Applicable Regulations, 154 A.L.R. FED. 431 (1999). Moreover, the Federal Reserve’s Official Staff Commentary interpreting Regulation Z does not address whether unsecured credit payoffs count as a finance charge. See 12 C.F.R. pt. 226 (2004). Finally, the newest Supreme Court case addressing finance charges, Household Credit Servs., Inc. v. Pfennig, 124 S. Ct. 1741 (2004), provides no guidance. In Pfennig, a consumer argued that Regulation Z wrongfully excluded “over-limit fees” from finance charge classification. Hence, the plaintiff mounted a challenge against the text of the Regulation. Id. at 1744. Credit payoffs, on the other hand, are not explicitly listed in Regulation Z and are instead evaluated using the four-part test. See supra notes 174–77 and accompanying text. Thus, unlike Pfennig, this Note assumes that Regulation Z is a perfectly valid exercise in rule-making.

185. See generally Renuart & Keest, supra note 10, § 3.6.1.2, at 89 (describing the different decisions involving credit payoffs); Lockhart, supra note 184, §§ 24–25 (same).


187. The court, finding the payoff amount to constitute a finance charge, stated: “The lack of clear precedent in this area notwithstanding, the Court is required by all of the above [statutory language] to find that the $100 payment by plaintiff on his mother’s account was an ‘incident to the extension of credit’ [and, therefore, a finance charge].” Id.

188. 898 F.2d 896, 906–07 (3d Cir. 1990).

189. After examining the federal regulations and the four-part test, the court stated: “Examining this list, we are left with the firm impression that prior liens are not within the definition of finance charge as that phrase was used by Congress.” Id. at 906.

190. See LoPucki & Warren, supra note 76, at 22.
different statutory framework? First, as demonstrated above, HOEPA can logically remedy the unfairness because HOEPA's definition of a finance charge encompasses unsecured credit payoffs. Second, two specific links between the statutes make HOEPA a suitable remedial choice. The FTC Act and HOEPA share public policy goals. Also, regulatory agencies have explicitly tied HOEPA and the FTC Act together in recent cases. In fact, the FTC has used a HOEPA violation as an incentive to find FTC Act unfairness.91 In light of this precedent, the use of FTC Act unfairness in the HOEPA scheme becomes a realistic strategy.

D. Justifying the Use of Incentives: The Theoretical Connection and Connection in Precedent Between HOEPA and the FTC Act

1. Policy Connection Between HOEPA and the FTC Act

Congress passed the FTC Act and HOEPA as two means of providing recourse to consumers facing the harsh world of unfettered markets.92 While the FTC Act generally aims at large-scale problems through agency action,93 HOEPA provides private actors the ability to recover.94 The two statutes, however, share a common goal—to curb abuses in subprime mortgage lending.95 Several federal agencies demonstrate this common policy thread by using both laws as weapons against predatory lending techniques. The FTC testified to Congress about the usefulness of the two statutes in reducing abusive lending.96 In an advisory letter, the OCC noted that HOEPA is not the only tool to fight predatory lending, but that "certain abusive lending can [also] involve unfair or deceptive practices and thus violate . . . the Federal Trade Commission Act."97 The OCC advises banks to comply

191. See infra notes 207–14 and accompanying text.
192. For the discussion of the increasing rate of foreclosures, especially in the subprime market, see supra note 2.
193. For instance, in Orkin Exterminating Co. v. FTC, 849 F.2d 1354 (11th Cir. 1988), the FTC acted in response to the unfair treatment of around 200,000 customers. In Fairbanks, the FTC brought an "unfairness" action against one of the nation's largest subprime lenders to curb persistent predatory lending. FTC, Fairbanks Capital Settles, supra note 59.
194. See supra notes 156–60 and accompanying text.
195. Clearly, the FTC Act has other goals besides curbing predatory lending. Reducing abuses in mortgage lending is one piece of the multi-prong act.
with both HOEPA and the FTC act in order to avoid predatory lending penalties. Furthermore, Alan Greenspan, in a letter to Congress, explained the Federal Reserve’s position that both statutes limit abuses in mortgage lending. The two statutes clearly aim to alleviate the same problem.

The shared policy goals of the two statutes demonstrate a close connection that justifies the statutory crossover that this Note suggests. Because the two statutes share a common aim, a judge will not overstep the policy boundaries of HOEPA when she uses it to remedy unfairness by classifying unsecured credit payoffs as finance charges.

2. Connection in Precedent Between HOEPA and FTC Act

Recent FTC enforcement actions illustrate a connection in precedent between the two statutes sufficient to justify the use of FTC Act unfairness as an incentive to employ HOEPA. An FTC action against Barry Cooper Properties, a subprime mortgage lender, displays the clearest example of this link. In Barry Cooper, the lender allegedly included a prepayment penalty prohibited by HOEPA. The FTC, recognizing in its complaint the connection between HOEPA and the FTC Act, stated that the HOEPA violation contributed to the unfairness of the alleged prepayment penalties. “By engaging in a pattern or practice of making HOEPA mortgage loans without regard to the payment ability of the consumers . . . the defendant has engaged, and continues to engage, in unfair acts or practices in violation of Section 5 (a) of the FTC Act, 15 U.S.C. § 45(a).” In its final order, the agency found that this HOEPA

198. The OCC also discussed the Real Estate Settlement Procedures Act (“RESPA”) and Equal Credit Opportunity Act (“ECOA”) as other statutes that attempt to curb predatory lending practices. The agency suggests that banks and other lending agencies need to consider each of these statutes when attempting to avoid predatory lending practices. Supervisory Guidance on Predatory Lending Practices Through Brokers or Other Intermediaries, 6 Fed. Banking L. Rep. (CCH) ¶ 64-126, at 73,849-16, 17 (Aug. 15, 2003); see also Press Release, OCC, OCC Chief Counsel Julie L. Williams Urges Banks to be Vigilant in Avoiding Unfair and Deceptive Marketing Practices (Mar. 22, 2002), at www.occ.treas.gov/2002/march.htm (last visited Jan. 15, 2005).

199. Letter from Alan Greenspan to John J. LaFalce, supra note 28 (discussing the Federal Reserve’s role in limiting predatory lending).

200. It is important to reiterate that this Note does not suggest that all “unfair” practices should qualify as finance charges.


202. Id. at 3; Press Release, Federal Trade Commission, Home Equity Lenders Settle Charges That They Engaged in Abusive Lending Practices; Over Half Million Dollars To Be Returned to Consumers (July 29, 1999), at http://www.ftc.gov/opa/1999/07/hoeopa.htm (last visited Jan. 15, 2005) [hereinafter FTC, Home Equity Lenders].

violation provided the FTC with an incentive to find an “unfair” trade practice. Only one of the five commissioners disagreed with this approach.

The FTC has not limited this argumentative technique to *Barry Cooper*. In fact, it has used a HOEPA violation as an incentive to find FTC unfairness in four other enforcement actions. As Commissioner Orson Swindle noted in his dissent, “[t]hese unfairness allegations are based on the theory that although these actions, standing alone without HOEPA, do not meet the test for unfairness, factoring in HOEPA as evidence of ‘established public policy’ tips the balance toward establishing unfairness.” These cases illustrate the strong bond in precedent between the two statutes.

Not only do these cases amplify the public policy connection between HOEPA and the FTC Act, illustrated above, but they also demonstrate a practical connection that the regulatory bodies use frequently. Moreover, the cases legitimate the argument that this Note employs to classify payoffs as finance charges. The agency actions have validated the use of a statutory violation as an incentive to employ a second, closely-related statute. The FTC, in fact, uses the same two statutes that this Note uses. *Barry Cooper* provides clear support for the argument presented.

Moreover, the FTC’s HOEPA-FTC Act argument in *Barry Cooper* provides vital precedent to a court considering whether to classify unsecured credit payoffs under HOEPA. As stated above, unsecured credit payoffs fit into the statutory definition of a HOEPA finance charge, yet no precedent existed to support such a classification. After *Barry Cooper*, courts can rely on established case law to classify the payoffs as finance charges. The FTC in *Barry Cooper* demonstrated that it is justifiable to use a statutory violation as an incentive to employ a connected statute. A judge who employs HOEPA after considering the FTC Act will not act in an unprecedented way.

One may argue *Barry Cooper* does not apply to my HOEPA-FTC Act argument because the case only discusses the use of a HOEPA violation as an incentive to find FTC Act unfairness. *Barry Cooper* does not suggest that a court can use unfairness to

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204. See FTC, Home Equity Lenders, supra note 202. Commissioner Orson Swindle explicitly stated, in dissent, that the FTC was using the HOEPA violation as an incentive.

205. As stated above, Commissioner Orson Swindle did not agree that HOEPA violations should be used as an incentive to find FTC unfairness. Id.


210. See supra note 184 and accompanying text.
employ HOEPA; nothing in the case supports linking the statutes in the other direction.  

Three arguments counter this suggestion. First, the shared policy goals of the two statutes facilitate the use of incentives in both directions. Second, Barry Cooper, and the later cases, did not discuss the use of the FTC Act violation as an incentive because the HOEPA violation was clear in those cases. The HOEPA arguments needed no boost. Finally, this Note's use of an incentives argument requires less of a stretch in statutory definitions than the use in Barry Cooper. While in Barry Cooper the HOEPA violation covered for a deficiency in the unfairness argument, no such deficiency exists in my HOEPA argument. Unsecured credit payoffs fit into the four-part statutory definition of a finance charge. The use of the FTC Act violation provides a supplemental policy incentive; even without this policy claim, a court could fit unsecured credit payoffs into HOEPA.

CONCLUSION

Due to the theoretical connection and the connection in precedent between the FTC Act and HOEPA, courts can employ the HOEPA framework as an avenue to remedy the unfairness present in unsecured credit payoffs. Classifying the sum as a finance charge will significantly increase the chance that the borrower will enjoy HOEPA's substantive protections. Importantly, remedying this credit practice within the HOEPA framework does not stretch the boundaries of the statute at all—the practice fits neatly in the definition of a finance charge. By applying the HOEPA framework to unsecured credit payoffs, courts can provide relief to borrowers facing unremedied FTC Act unfairness.

211. See supra notes 201-05 and accompanying text.
213. See supra notes 174-91 and accompanying text.