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## **DISCLAIMER AND STATEMENT**

**This report has solely been written for the purpose of providing information only. The author and/or publisher is not giving advice (not advising) on any subject, and is particularly not giving legal, or financial advice to anyone, in any way, shape or form.**

**This report is presented to make available to those who may need accurate information on the subjects covered within. Even though the information has been carefully researched and assimilated from the best available sources, the author and/or publisher cannot and does not guarantee the accuracy or correctness of the information and or suggestions provided and set forth herein.**

**We provide assistance and document preparation for consumers seeking to gain control of their assets.**

**We have several programs that will assist people in regaining their financial freedom.**

**We do not claim to be legal professionals nor do we give legal advice. We merely help people understand what their options are and assist them with document preparation.**

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## **THE TRUTH IN LENDING ACT**

T.I.L.A. is to be liberally construed in favor of consumers, with creditors who fail to comply with T.I.L.A. in any respect becoming liable to consumer regardless of nature of violation or creditors' intent.

The federal Truth In Lending Act was originally enacted by Congress in 1968 as a part of the Consumer Protection Act. The law is designed to protect consumers in credit transactions by requiring clear disclosure of key terms of the lending arrangement and all costs. The law was simplified and reformed as a part the Depository Institutions Deregulations and Monetary Control Act of 1980.

The Truth in Lending Act is important for Banks and Lenders involved in consumer credit transactions or consumer leasing.

### **Regulations Z and M**

The law has been implemented by the Federal Reserve Board through two key regulations:

**Regulation Z** explains how to comply with the consumer credit parts of the law.

Regulation Z applies to each individual or business that offers or extends consumer credit if four conditions are met:

1. The credit is offered to consumers.
2. Credit is offered on a regular basis.
3. The credit is subject to a finance charge (i.e. interest) or must be paid in more than four installments according to a written agreement.
4. The credit is primarily for personal, family or household purposes.

If credit is extended to business, commercial or agricultural purposes, Regulation Z does not apply.

### **Regulation M**

Includes all the rules for consumer leasing transactions. Regulation M applies to contracts in the form of a lease where the use of personal property by a person primarily for personal, family or household purposes.

The lease period must exceed four months, and the total contractual obligations must not exceed \$25,000, regardless of whether the lessee has the option to purchase the property at the end of the lease term.

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## **Other Agencies**

In addition to the Federal Reserve Board, other federal agencies may have regulations for certain special lines of business.

For example, the Department of Transportation has certain Truth In Lending Act regulations applicable to airlines. The Veterans Administration, the Department of Housing and Urban Development, the Federal Home Loan Bank Board and the National Credit Union Administration are also involved in the enforcement of the Truth In Lending Act. The Truth In Lending Act is designed to reduce confusion among consumers resulting from the different methods of computing interest. It does not require creditors to calculate their credit charges in any particular way. However, whatever alternative they use, they must disclose certain basic information so that the consumer can understand exactly what the credit costs.

## **Home Mortgages**

One of the biggest lending transactions any individual is likely to enter is borrowing to purchase a home. These transactions have become more complicated in recent years. Historically, someone trying to buy a home had very few options. Often, only a traditional thirty year loan was available.

Now, loans of various duration and interest rate variations are available to every home buyer. The Federal Reserve Board and the Federal Home Loan Bank Board have published a book entitled "Consumer Handbook on Adjustable Rate Mortgages " to help consumers understand the purpose and uses of adjustable rate mortgage loans. Regulation Z requires that creditors offering adjustable rate mortgage loans make this booklet, or a similar one, available to consumers.

You can get a free copy of "Consumer Handbook on Adjustable Rate Mortgages" at the following website. (see resources page for the URL to obtain this handbook)

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## **Disclosure**

Disclosure is generally required before credit is extended. In certain cases, it must also be made in periodic billing statements. Regulation M includes similar rules for disclosing terms when leasing personal property for personal, family or household purposes, if the obligations total less than \$25,000.

In general, disclosure is required before any "closed end credit transaction" is completed. There is an exception where credit is extended over the telephone or by the mails. In

those cases, a disclosure may be made after the fact. Disclosure is also required before the first transaction under an open end account, and again at the time the periodic billing statement is sent.

The term "closed end credit transaction" is defined by exclusion. That is, it includes any credit arrangement (either a consumer loan or credit sale) that does not fall within the definition of an "open end credit transaction". Open end credit includes credit arrangements like revolving credit cards, where the "borrower" (that is the credit card holder) is not required to pay off the principal amount by any particular point in time. Rather, the borrower is simply charged interest periodically and is usually required only to make some minimum payment.

The term credit sale means a sale in which the seller is the creditor. That is, the amount of the purchase price is financed by the seller. This includes any consumer lease, unless the lease is terminable without penalty at any time by the consumer, or when:

1. The consumer agrees to pay an amount substantially equal to, or more than, the total value of the property or services involved.

2. The consumer has the opportunity to purchase the property for at least nominal consideration.

Under Regulation Z, disclosure must be made of the following important credit terms:

**Finance Charge** - This is perhaps the most important disclosure made. This is the amount charged to the consumer for the credit.

**Annual Percentage Rate** - This is the measure of the cost of the credit which must be disclosed on a yearly basis. The method for calculating this rate is determined the underlying transaction.

**Amount Financed** - This the amount that is being borrowed in a consumer loan transaction, or the amount of the sale price in a credit sale.

**Total of Payments** - This includes the total amount of the periodic payments by the borrower/buyer.

**Total Sales Price** - This is the total cost of the purchase on credit, including the down payment and periodic payments.

Evidence of compliance with the Truth In Lending requirements must be retained for at least two years after the date of disclosure. Disclosures must be clear and conspicuous and must appear on a document that the consumer may keep.

The Truth In Lending Act has other important features. If you elect to advertise credit terms, the law requires disclosure of key lending terms. Also, the law entitles the consumer the right to rescind certain credit transactions within a short period, such as home equity loans and Mortgages.

The penalties for failure to comply with the Truth In Lending Act can be substantial. A creditor who violates the disclosure requirements may be sued for twice the amount of the finance charge. Costs and attorney's fees may also be awarded to the consumer.

A lawsuit must be begun by the consumer within a year of the violation. However, if a creditor sues more than a year after their violation date, violations of the Truth In Lending Act can be asserted as a defense.

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### **Purpose of the Truth In Lending Act**

Economic stabilization and competition is strengthened by informed use of credit by consumers.

The Act is in Title I of the Consumer Credit Protection Act and is implemented by the Federal Reserve Board via Regulation Z (12 C.F.R. Part 226). The Regulation has effect and force of federal law.  
(see resources page to obtain official regulation)

### **Scope of truth in lending act**

#### **T.I.L.A. applies to:**

Each individual or business that offers or extends credit when four conditions are met:

1. The credit is offered or extended to consumers,
2. The offering or extension of credit is done "regularly" [extends credit more than 25 times (or more than 5 times for transactions secured by dwelling) per year]
3. The credit is subject to a finance charge or is payable by written agreement in more than four installments, and
4. The credit is primarily for personal, family, or household purposes.

Also, certain requirements apply to persons who are not creditors but who provide applications for home equity plans to consumers.

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## Truth In Lending Early and Final Regulation Z Disclosure Requirements

The Truth in Lending Act Title I of the Consumer Credit Protection Act, is aimed at promoting the informed use of consumer credit by requiring disclosures about its terms and costs.

T.I.L.A. requires lenders to make certain "material disclosures" on loans subject to the *Real Estate Settlement Procedures Act* (RESPA) within three business days after their receipt of a written application.

This early disclosure statement is partially based on the initial information provided by the consumer.

The term "**material disclosures**" means the disclosure, as required by this subchapter, of the annual percentage rate, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total of payments, the number and amount of payments, the due dates or periods of payments scheduled to repay the indebtedness, and the disclosures required by section 1639(a) of this title.

**A final disclosure statement** is provided at the time of loan closing. The disclosure is required to be in a specific format and typically include the following information:

1. Name and address of creditor
2. Amount financed
3. Itemization of amount financed (optional, if Good Faith Estimate is provided)
4. Finance charge
5. Annual percentage rate (APR)
6. Variable rate information
7. Payment schedule
8. Total of payments
9. Demand feature
10. Total sales price
11. Prepayment policy
12. Late payment policy
13. Security interest
14. Insurance requirements
15. Certain security interest charges
16. Contract reference
17. Assumption policy
18. Required deposit information

### NOTE:

**Regulation Z** specifically provides that the "finance charge" includes any "interest" and "points" charged in connection with a transaction. Therefore, if the intermediary is in fact acting on behalf of the lender, as is the case where the intermediary accepts secret compensation from the lender or

acts in the lender's interest to increase the amount paid by the borrower, all compensation received by the intermediary, including broker's fees charged to the borrower, are finance charges.

### **Truth In Lending Act: 3-day cooling off period**

In addition to remedies described above, consumers who enter home equity loans may also have rescission rights.

Under T.I.L.A., a consumer may rescind a consumer credit transaction involving a non-purchase-money security interest in the consumer's principal dwelling Within 3 business days if all T.I.L.A. disclosure requirements met, or During an extended statutory period for T.I.L.A. disclosure violations such as:

Failure to give adequate notice of right to rescind,

Failure to give adequate T.I.L.A. credit term disclosures.

Rescission voids the security interest in the principal dwelling. Consumer must have ownership interest in dwelling that is encumbered by creditor's security interest.

Consumer need not be a signatory to the credit agreement. T.I.L.A. rescission rights do not apply to business credit transactions, even if secured by consumer's principal dwelling.

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### **WHAT IS THE RIGHT OF RESCISSION?**

The right of rescission is a consumer protection law found within the Truth in Lending Act.

#### **RIGHT OF RESCISSION:**

In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership is or will be subject to the security interest has the right to rescind the transaction.

Lenders are required to deliver two copies of the notice of the right to rescind and one copy of the disclosure statement to each consumer entitled to rescind.

The notice must be on a separate document that identifies the rescission period on the transaction and must clearly and conspicuously disclose the retention or acquisition of a security interest in the consumer's principal dwelling; the consumer's right to rescind the transaction; and how the consumer may exercise the right to rescind with a form for that purpose, designating the address of the lender's place of business.

In order to exercise the right to rescind, the consumer must notify the creditor of the rescission by mail, telegram or other means of communication.

Notice is considered given when mailed, filed for telegraphic transmission or sent by other means, when delivered to the lender's designated place of business.

The consumer may exercise the right to rescind until midnight of the third business day

1. following consummation of the transaction;
2. delivery of the notice of right to rescind;
3. or delivery of all material disclosures, whichever occurs last.

When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective for all consumers.

When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer will no longer be liable for any amount, including any finance charge.

Within 20 calendar days after receipt of a notice of rescission, the lender is required to return any money or property that was given to anyone in connection with the transaction and must take any action necessary to reflect the termination of the security interest.

If the lender has delivered any money or property, the consumer may retain possession until the lender has complied with the above.

The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency.

To modify or waive the right, the consumer must give the lender a dated written statement that describes the emergency, specifically modifies or waives the right to rescind and bears the signature of all of the consumers entitled to rescind. Printed forms for this purpose are prohibited.

### **WHO IS ABLE TO RESCIND A LOAN?**

The right of rescission doesn't apply just to borrowers. All consumers who have an ownership interest in the property have the right to rescind.

While other parts of Regulation Z typically focus on the borrowers, this is one area where it affects those beyond the

applicants, in other words all owners of the home being pledged on the transaction.

### **WHAT DOES THE RIGHT OF RESCISSION REQUIRE OF LENDERS?**

The right of rescission requires lenders to provide certain "material disclosures" and multiple copies of the right of rescission notice to EACH owner of the property.

Following proper disclosures, lenders must wait at least three business days before disbursing loan proceeds.

### **WHEN DOES THE THREE-DAY RESCISSION TIME CLOCK BEGIN TO TICK?**

The three-day right of rescission period begins once the material disclosures and notice have been given, and lasts three full business days. Business days are defined by Reg Z to include all calendar days except Sundays and federal holidays. Saturday IS considered a business day for rescission purposes, regardless of whether your offices are open.

In order to properly complete the Notice of Right to Rescind form, you need to know how to calculate the rescission period. Consider the following example.

Assume a closing is set for Thursday, November 15th, 2001, and that all material disclosures and notices are provided to the parties at that time. The rescission period would run:

Friday, November 16, 2001;

Saturday, November 17, 2001, and

Monday, November 19, 2001.

Sunday is not counted since it is not considered a business day. The rescission period would end at midnight on November 19, 2001.

### **WHEN MAY A BORROWER WAIVE THE RIGHT OF RESCISSION?**

Reg Z allows borrowers to waive their rescission rights, but this exception only applies in very limited circumstances. The law is protective of the right of rescission, and you should be too.

Borrowers may waive their rescission rights and receive their loan proceeds immediately only if they have what is called a "bona fide personal financial emergency." This means a financial emergency of the magnitude that waiting an additional three days will be personally or financially devastating to the borrower. It might include situations involving natural disasters such as flooding, or a medical emergency that requires immediate funds. When this type of situation does arise, the borrower must provide a written explanation of his or her circumstances to the financial

institution. This is not a document that you should draft for the borrower.

Waiving the right of rescission is not a common practice, mostly because doing it wrong can backfire and create a rescindable loan, causing all kinds of problems down the road.

### **WHAT HAPPENS ONCE THE RESCISSION PERIOD IS OVER?**

After the right-of-rescission period has expired, the Lender must feel reasonably certain that the consumer has not rescinded before the loan proceeds are disbursed.

There are some risks to the Bank in disbursing after the third day.

The law allows consumers to exercise their rescission rights by mail, and a rescission is effective when mailed.

Thus, a rescission mailed on the third day after closing is effective even though the lender may not receive it until the fourth or fifth day after the closing.

To avoid further delay of the loan proceeds, the bank may want to obtain a confirmation statement from all the owners stating that they have not exercised their rescission rights.

Consumers should not sign this confirmation until after the three day period is over. Otherwise, it may look like they have improperly waived their rescission rights.

### **WHAT ARE THE CONSEQUENCES OF NONCOMPLIANCE?**

There are serious consequences for failing to follow the right-of-rescission rules. First, until a lender provides the material disclosures and the proper Notice of Right to Rescind, the three-business day rescission period does not start to run, and the transaction remains rescindable for up to three years.

And once a consumer rescinds a transaction, the security interest in the property becomes void and you must reimburse the consumer for all of the finance charges collected over the life of the loan.

Most rescission errors are alleged in response to collection actions or other litigation initiated by the lender.

### **WAIVER OF THE RIGHT TO RESCIND**

Consumers may modify or waive right to rescind credit transaction if extension of credit is needed to meet bona fide personal financial emergency before end of rescission period. Consumer must provide creditor with dated written statement describing emergency,

- Specifically modifying or waiving right, and
- Signed by all consumers entitled to rescind.

Borrower's who want to waiver because foreclosure is imminent is ineffective because under terms of mortgage, foreclosure could not occur before two months at time of waiver and thus, there was no bona fide emergency.

Borrowers may not falsely claim an emergency.

### **Delay of Performance.**

Unless the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party,

Disburse advances to the consumer,  
Begin performing services for the consumer, or  
Deliver materials to the consumer.

### **DURING THE DELAY PERIOD, A CREDITOR MAY**

Prepare cash advance check (or loan check in the case of open-end credit),  
Perfect the security interest and/or  
Accrue finance charges,  
In the case of open-end credit, prepare to discount or assign the contract to a third party.

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### **DELAY BEYOND RESCISSION PERIOD.**

Creditor must wait until he/she is reasonably satisfied consumer has not rescinded.

May do this by Waiting reasonable time after expiration of period to allow for mail delivery, or

Obtaining written statement from all eligible consumers that right not exercised.

### **RESCISSION PROCESS**

When consumer rescinds, the security interest becomes void and consumer is not liable for any amount, including finance charges.

Within 20 calendar days after receiving notice of rescission, creditor must return any property or money given to anyone in connection with the transaction, and take whatever steps necessary to reflect termination for the security interest.

When creditor meets its obligations, consumer must tender the money or property to creditor, or if tender not practicable, its reasonable value.

If creditor fails to take possession of tendered money or property within 20 days, consumer may keep it without further obligation.

Court has power to exercise equitable discretion and condition rescission of a loan upon the return of the loan proceeds.

## **PARTICULAR TYPES OF TRANSACTIONS**

### **Refinancing and Consolidation.**

Rescission rights do not apply to refinancing or consolidation by same creditor of an extension of credit already secured by consumer's principal dwelling.

Rescission rights do apply to extent new amount exceeds unpaid balance, any earned unpaid finance charges on existing debt, and amounts attributed solely to costs of refinancing or consolidation.

Open-end line of credit secured by home used to pay off loan not originally secured by home requires complete rescission rights.

### **Door-to-door sales.**

When home solicitation sale is financed with second mortgage loan, consumer may be entitled to two separate rights to cancel when the transactions are independent.

When consumer offers to obtain his/her own financing independent of assistance or referral from seller, sale and financing are separate transactions.

When there are separate transactions,  
FTC Rule (Cooling Off Period for Door-to-Door Sales) -  
Requires sellers to give buyers three days in which to cancel a home solicitation sale, and notice of this cancellation right.  
T.I.L.A. requires a three-day rescission period (unless extended for T.I.L.A. violation).

Seller bound by consumer's timely cancellation regardless of which party receives notice of cancellation.

For single transactions (seller arranged financing), look to state home solicitation law to determine whether transaction still covered by state's home solicitations statute three-day cooling off period.

When seller finances or arranges financing with second mortgage, this is considered a single transaction.

When there is a single transaction, T.I.L.A. rescission rights apply, but not FTC Rule three-day cooling off period.

FTC Rule does not apply to transactions in which there is a T.I.L.A. right to rescind (i.e., second home mortgage transactions).

Therefore, consumer has only T.I.L.A. right to rescind and not the additional three-day cooling off period rights under FTC Rule.

But, state cooling off periods may apply even when T.I.L.A. rescission rights are available.

State home solicitation law may not have exemption like FTC Rule does.

**Three-day right to cancel begins on date contract is signed (when validity of contract is dependent of obtaining independent, acceptable financing) and consumer is given T.I.L.A. disclosures which includes rescission rights notice.**

Seller must give notice of the transaction date, and, of the deadline for exercising right to cancel.

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## **VIOLATIONS OF TRUTH IN LENDING ACT**

Creditors are liable for violation of the disclosure requirements, regardless of whether the consumer was harmed by the nondisclosure, UNLESS:

The creditor corrects the error within 60 days of discovery and prior to written suit or written notice from the consumer, or

The error is the result of bona fide error. The creditor bears the burden of proving by a preponderance of the evidence that:

The violation was unintentional.

The error occurred notwithstanding compliance with procedures reasonably adapted to avoid such error. (Error of legal judgment with respect to creditor's T.I.L.A. obligations not a bona fide error.)

## **CIVIL REMEDIES FOR FAILURE TO COMPLY WITH T.I.L.A. REQUIREMENTS:**

Action may be brought in any U.S. district court or in any other competent court within one year from the date on which the violation occurred. This limitation does not apply when T.I.L.A. violations are asserted as a defense, set-off, or counterclaim, except as otherwise provided by state law. Private remedies - applicable to violations of provisions regarding credit transactions, credit billing, and consumer leases.

## **ACTUAL DAMAGES IN ALL CASES:**

Attorneys' fees and court costs for successful enforcement and rescission actions

### **Statutory damages:**

1. For individual actions, double the correctly calculated finance charge but not less than \$100 or more than \$1,000 for individual actions.
2. For class actions, an amount allowed by the court with no required minimum recovery per class member to a maximum of \$500,000 or 1% of the creditor's net worth, whichever is less.
3. Can be imposed on creditors who fail to comply with specified T.I.L.A. disclosure requirements, with the right of rescission, with the provisions concerning credit cards, or with the fair credit billing requirements.

## **ENFORCEMENT BY ADMINISTRATIVE AGENCIES**

The enforcement scheme for banks includes the Federal Reserve System, the Federal Deposit Insurance Corporation, and other agencies. The enforcement agency responsible for creditors not subject to the authority of any specific enforcement agency is the Federal Trade Commission.

Nine separate agencies currently have enforcement responsibilities.

### **Enforcement agencies can:**

Issue cease and desist orders or hold hearings pursuant to which creditors are required to adjust debtors' accounts to ensure that the debtor is not required to pay a finance charge in excess of the finance charge actually disclosed or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower.

If the FTC determines in a cease and desist proceeding against a particular individual or firm that a given practice is "unfair or deceptive," it may proceed against any other individual or firm for knowingly engaging in the forbidden practice, even if that entity was not involved in the previous proceeding.

**Criminal penalties** - Willful and knowing violations of T.I.L.A. permit imposition of a fine of \$5,000, imprisonment for up to one year, or both.

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## **FIRST COUNTY NATIONAL BANK AUDIT**

A review of the First County National Bank's consumer compliance program was conducted October 2, 1995, and included the period between July 1994 (the date of the most recent regulatory compliance examination) and October 2, 1995. An assessment of the bank's compliance with the following laws and their respective implementing of these regulations was performed:

- Community Reinvestment Act (CRA)
- Equal Credit Opportunity Act (ECOA)
- Fair Credit Reporting Act (FCRA)
- Fair Housing Act (FHA)
- Truth-in-Lending Act (T.I.L.A.)
- Real Estate Settlement Procedures Act (RESPA)
- Flood Disaster Protection Act (FDPA)
- Truth-in-Savings Act (TISA)
- Expedited Funds Availability Act (EFAA)
- Electronic Fund Transfers Act (EFTA)
- Bank Secrecy Act (BSA)
- Bank Protection Act (BPA)
- Right to Financial Privacy Act (RFPA)
- Fair Debt Collection Practices Act (FDCPA)
- Credit Practices Rule

### **The audit was performed by Kirschler Peterson**

Kirschler Peterson is a Certified Regulatory Compliance Manager Kirschler Peterson & Associates provides a full range of financial institution consulting services. (see resources page for web address of Kirschler Peterson)

## **SCOPE OF COMPLIANCE PROGRAM AUDIT**

### **COMPLIANCE MANAGEMENT**

To determine the bank's approach to managing its compliance program, the most recent compliance examination report, board of directors meeting minutes, policies, and procedures were reviewed and the Compliance Officer interviewed.

The examination report stated that the bank's level of compliance with consumer laws and regulations was less than satisfactory. The examination report noted many violations of the RESPA, TISA, and BSA. Since the examination, management has taken steps to ensure corrective action. This review revealed that such actions have been effective in correcting noted violations.

As stated in the examination report, the review was limited to approximately half of the applicable consumer laws and regulations. The scope of this initial review was more broad and included all applicable consumer laws and regulations.

As further described below, this review revealed substantive violations of Regulation Z as well as technical violations of the ECOA, RESPA, TISA, EFAA, and EFTA. To prevent future similar violations, it is recommended that additional staff training be conducted and that regular monitoring be implemented. It is also recommended that policy statements be adopted by the board and implemented by management that will provide staff with guidance regarding compliance with specific consumer laws and regulations.

It is further recommended that the bank establish a Compliance Committee to oversee daily operations. The Compliance Officer will chair periodic meetings to ensure that management receives timely information regarding regulatory changes as well as recommendations for implementing such changes. It is recommended that the committee be comprised of Executive Vice President/Lending, Executive Vice President/Operations, Senior Vice President/Security Officer, Assistant Vice President/Training Officer, Internal Auditor, and a CRA Officer (preferably the President or a member of senior management). The Compliance Committee will ensure that staff receive sufficient training and guidance and that the bank's compliance status is assessed at least annually.

The following describes the specific findings of, and recommendations resulting from, the review.

## **SPECIFIC FINDINGS**

### **Community Reinvestment Act (CRA)**

The bank's CRA Statement, CRA Notice, CRA Public File, and board of directors meeting minutes were reviewed to assess the bank's level of compliance with the CRA.

The CRA Statement, CRA Notice, and CRA Public File all contain the information required by regulation. In addition, the board of directors reviewed and approved the CRA Statement at its June 1995 meeting. The board also regularly discusses the bank's CRA-related activities.

It is recommended that subsequent to the end of 1995 a self-assessment be conducted that will detail the bank's compliance with CRA regulations. While not required, it is recommended that the results of the self-assessment be provided to the board of directors.

### **Fair Lending Laws and Regulations**

Equal Credit Opportunity Act (ECOA)

Fair Credit Reporting Act (FCRA)

Fair Housing Act (FHA)

To determine the bank's level of compliance with fair lending laws and regulations, the bank's loan policy, twenty-five (25) denied loan applications, and fifty (50) approved loans were reviewed. The bank does not currently operate under formal

policies or procedures concerning compliance with specific consumer laws or regulations.

The board has adopted and management has implemented nondiscriminatory lending standards. There are no recommendations in this regard.

Review of the denied loan applications revealed ten instances in which the documentation contained in the file did not support the reason for denial in violation of Section 202.9(b)(2) of Regulation B. It is recommended that lending staff be instructed to clearly document all reasons for denial. The denied loan application review also revealed that in twelve situations, the Adverse Action Notice was not provided within the time frame required by Section 202.9(a) of Regulation B. It is recommended that lending staff be instructed regarding the importance of adhering to these regulatory time frames.

### **SPECIFIC FINDINGS**

#### **Fair Lending Laws and Regulations (continued)**

Review of the approved loan applications revealed that in each instance the borrowers were not provided with the Appraisal Availability Notice required by Section 202.5a(a)(2)(i). To prevent future violations, it is recommended that management determine whether to automatically provide customers with a copy of an appraisal (independent or internal) or to provide customers with the notice advising them of their rights to obtain a copy of the appraisal used in connection with their loan application. It is recommended that this determination be described in formal procedures that will provide staff guidance.

While not required by regulation, it is recommended that the board of directors adopt a policy statement concerning compliance with fair lending laws and regulations that will assign responsibility and provide for periodic training and monitoring. In addition, it is recommended that management develop and implement procedures that will provide specific staff guidance.

A list of the denied and approved loan applications reviewed is contained in the Exhibit section of this report.

#### **Lending Laws and Regulations**

##### **Truth-in-Lending Act (T.I.L.A.)**

Fifteen (15) denied residential mortgage loan applications, thirty (30) approved residential mortgage loans, the bank's initial home equity line and credit card disclosures, two consecutive months of home equity lines statements for five customers and two consecutive months of credit card statements for five customers were tested to assess the bank's compliance with the T.I.L.A. and Regulation Z. The

bank does not currently operate under a formal policy or specific procedures.

***Review of the residential mortgage loans revealed three instances in which the rescission period was waived at the borrowers' request. As stated in Section 226.23(e) of Regulation Z, this is permissible only in financial emergencies. In one situation, the borrower was going out of town and had bills to pay; another customer perpetually waived her right to rescind based on unspecified financial emergencies; and one couple waived their right to rescind due to Christmas expenses. Management is reminded that permitting non-emergency rescission waivers is a substantive violation and may result in significant financial liability to the bank. In that regard, management is cautioned to only permit rescission waivers in extreme circumstances. To prevent these situations from occurring in the future, it is strongly recommended that specific procedures be immediately implemented and that all lending staff receive training concerning rescission provisions.***

#### **SPECIFIC FINDINGS**

##### **Truth-in-Lending Act (T.I.L.A.) (continued)**

***The approved residential mortgage loan review also revealed one instance in which it appears that the loan was funded during the rescission period in violation of Section 226.23(c). This is considered a substantive violation. To prevent future such violations, it is recommended that lending staff be provided training concerning rescission provisions.***

***In addition, there was one instance in which the finance charge was overstated by an amount that exceeded regulatory tolerance. Given that this is an isolated incident, there are no recommendations for improvement.***

Review of the denied applications revealed one instance in which the initial Regulation Z disclosure was not provided as required by Section 226.19(a). Continued monitoring is recommended to determine whether additional staff training is necessary.

***The bank's home equity line initial disclosure generally complies with regulatory requirements but does not disclose when fees are payable to third parties. It is recommended that this information be inserted or separately provided to customers. Review of the credit card application/disclosure revealed that it does not contain the statement that charges incurred are due when the periodic statement is received. It is recommended that this information be inserted or separately provided to customers.***

Review of the home equity line statements revealed that the statements contain the required information; however, payments do not appear to be credited on the date they are received. Specifically, payments listed as being received on a Friday are not credited until Monday and a payment submitted four days prior to the due date was not credited until the due date.

Of the statements reviewed, only one payment, that was submitted after the due date, was credited when received. Regulation Z specifically states that payments should be promptly credited unless the payment does not conform to the bank's requirements for payment (i.e., account number, payment stub, etc.). It is recommended that the accounts be researched to determine whether immediate credit should have been provided to these customers. If so, the bank may be required to re-credit the customers during the following billing cycle as the difference in crediting will affect the average daily balance that is used to calculate the finance charge. Following are the accounts requiring research:

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NAME	ACCOUNT NUMBER
Burton	82818
Grant	82825
Tracy	82883

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## **SPECIFIC FINDINGS**

### **Truth-in-Lending Act (T.I.L.A.) (continued)**

Review of the credit card statements revealed that the statements contain the information required by regulation and that the average daily balances and finance charges are accurately calculated. No adverse findings were noted.

While not required by regulation, it is recommended that the board of directors adopt a policy statement concerning T.I.L.A./Regulation Z compliance that will assign responsibility and provide for periodic training and monitoring. In addition, it is recommended that management develop and implement procedures that will provide specific staff guidance.

### **Real Estate Settlement Procedures Act (RESPA)**

To determine the bank's level of compliance with the RESPA and Regulation X, the OCC examination, five approved residential mortgage transactions, and five denied residential mortgage loan applications were reviewed. The bank does not currently operate under a formal policy or procedures.

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***The examination report stated that disclosures required by the RESPA, including the HUD-1 Settlement Statement, the Mortgage Servicing Transfer Disclosure, the Good Faith Estimate, and the Special Information Booklet, were not provided or copies, or evidence of receipt by the customer, were not maintained in the files.***

To prevent future violations of the RESPA, the Executive Vice President in charge of lending discussed RESPA requirements with lending staff. In addition, a form has been developed and implemented to verify that required RESPA disclosures were provided; customers will sign and date this form.

Review of the five approved residential mortgage transactions revealed that, with one exception, RESPA disclosures were provided as required. It is recommended that continued monitoring of RESPA transactions be conducted to ensure that corrective action initiated by management is sufficient.

***Review of the five denied residential mortgage loan applications revealed one instance in which the mortgage servicing transfer disclosure was not provided as required by Section 3500.21. It is again recommended that continued monitoring of RESPA transactions be conducted to ensure that corrective action initiated by management is sufficient.***

## **SPECIFIC FINDINGS**

### **Real Estate Settlement Procedures Act (RESPA) (continued)**

While not required by regulation, it is recommended that the board of directors adopt a policy statement concerning RESPA compliance that will assign responsibility and provide for periodic training and monitoring. In addition, it is recommended that management develop and implement procedures that will provide specific staff guidance.

### **Flood Disaster Protection Act (FDPA)**

The compliance examination and five residential mortgage loan files were reviewed to assess the bank's compliance with the FDPA. The bank does not currently operate under a formal policy or specific procedures.

The examiners noted no exceptions with regard to the bank's FDPA compliance. The file review also revealed no errors.

It is recommended; however, that the board of directors adopt a formal policy statement concerning FDPA compliance that assigns responsibility and provides for periodic training and monitoring. It is also recommended that management develop and implement formal procedures that will include

the Standard Flood Hazard Determination form the use of which is mandatory beginning January 2, 1996.

### **Credit Practices Rule**

***Three consumer loans having co-signers were reviewed to test the bank's compliance with the rule. The consumer contracts do not contain prohibited provisions and the appropriate co-signer notice is contained on the back of the combination note/T.I.L.A. disclosure.***

### **SPECIFIC FINDINGS**

#### **Savings Laws and Regulations**

##### **Truth-in-Savings Act (TISA)**

To assess the bank's compliance with the TISA and Regulation DD, the examination report, bank policy, and account brochures were reviewed. In addition, periodic statements for interest bearing accounts held by individuals were tested regarding the accuracy of the interest paid and the Annual Percentage Yield (APY) earned.

The bank's current TISA policy reflects general regulatory requirements but does not provide for periodic training and testing. In addition, implementing procedures have not been developed. It is; therefore, recommended that the policy be amended to provide for training and testing and that management develop and implement specific procedures that address Regulation DD compliance.

Review of the account brochure revealed that for the 18-month (both fixed and variable) and the 30-month IRA accounts, there are conflicting statements regarding the withdrawal of interest. Specifically, the brochure states "You can withdraw interest credited to your account in the term before maturity of that term without penalty"; then under transaction limitations, the brochure states "You cannot withdraw interest from your account before maturity". The brochure should be revised to correctly reflect whether interest withdrawals are permitted.

The bank's account brochure states that the bank requires a social security card and picture identification to open a checking account. While demand deposit accounts are not subject, per se, to fair lending rules and regulations, it is recommended that management consider alternative identification such as an alien identification card or cards issued to elderly persons for identification purposes.

The bank's periodic statements contain the information required by Regulation DD. In addition, the interest paid and the APY earned are within regulatory tolerance. The periodic statements contain the "average balance for APY" which

does not appear to correspond to the interest paid or the APY earned. It is; therefore, recommended that this be deleted from the periodic statement if possible.

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### **SPECIFIC FINDINGS**

#### **Expedited Funds Availability Act (EFAA)**

The bank's policy, procedures, account brochure, and a sample of eight recently completed hold notices were reviewed to determine the bank's level of compliance with the EFAA and Regulation CC.

The bank's policy and procedures generally reflect regulatory requirements and bank practices; however, it conflicts with the account brochure regarding the availability of electronic deposits. The policy/procedures state that such deposits are available the next day following deposit while the brochure states that deposits are available the day they are received by the bank. It is recommended that the bank revise the policy/procedures to reflect that electronic deposits are immediately available.

The bank's general policy is to make funds available on the next business day following deposit; holds are imposed on a case-by-case basis. The bank's procedures specify how to complete a hold notice. For customer convenience, it is recommended that the actual date the funds will be available be reflected on the hold notice; it will be necessary to revise the bank's procedures to reflect this change.

Review of a sample of eight recently completed hold notices revealed that in one instance availability was not provided on the proper day in violation of the EFAA and Regulation CC. In addition, there were five instances in which the hold notice was not correctly completed. Specifically, the name or address was not completed or the reason for the hold was listed under the check description. It is recommended that staff responsible for EFAA/Regulation CC compliance receive additional training concerning hold notice completion. A list of the hold notices reviewed is contained in the Exhibit section of this report.

#### **Electronic Fund Transfers Act (EFTA)**

To assess the bank's compliance with the EFTA and Regulation E, its policy, procedures, account brochure, and periodic statements were reviewed.

The bank's policy and procedures generally reflect regulatory requirements and bank practices; however, it is recommended that the policy/procedures describe who, or what area of the bank, is responsible for resolving EFT errors

and for communicating with customers concerning the error resolution.

The bank's policy/procedures also do not discuss the types of transfers permitted or transfer limits. It is recommended that the policy/procedures refer to the bank's account brochures which reflect this information.

## **SPECIFIC FINDINGS**

### **Electronic Fund Transfers Act (EFTA) (continued)**

The bank's account brochure states that a customer will only be liable for the first \$50 if a lost or stolen ATM card is reported to the bank within four days. The disclosure also states that unauthorized or disputed transfers reflected on periodic statements must be reported to the bank within 90 days; the bank's policy/procedures states that unauthorized transfers must be reported within 60 days. The EFTA and Regulation E state that a lost or stolen ATM card must be reported within 2 days to limit the customer's liability to \$50 and that unauthorized transfers must be reported within 60 days of the first periodic statement. It is recommended that a label reflecting the proper time frames be developed and placed over the existing language so that customers are provided with proper information. It is also recommended that existing customers be provided a re-disclosure and that recently-reported errors be researched to determine whether customers were harmed by the incorrect disclosure.

Review of the bank's periodic statements revealed that they contain required information. No adverse findings were noted.

## **Operations Laws and Regulations**

### **Bank Secrecy Act (BSA)**

The bank's policy, procedures, most recent regulatory compliance examination, large cash transaction report, recent Currency Transaction Reports (CTRs), exemption list, and Monetary Instruments Log were reviewed to determine the bank's level of compliance with the BSA and implementing Treasury Regulations.

The bank's policy was approved by the board at its February 1995 meeting and provides for proper reporting, monitoring, and training. It also states that the bank's Compliance Officer also has the responsibility of BSA Officer; this is not appropriate.

As stated above in the Compliance Management section, it is recommended that the bank form a Compliance Committee that will oversee daily operations. The BSA Officer should be a member of this committee. To ensure adequate controls, it is recommended that Executive Vice President of Operations,

or a designee, be appointed the position of BSA Officer. The BSA Officer will ensure prompt and accurate reporting of cash transactions and will provide daily guidance to staff. Appointing the Executive Vice President of Operations as BSA Officer will provide the Compliance Officer and Internal Auditor with the independence necessary to properly review or audit the bank's BSA compliance program. Management is reminded that implementation of the above recommendations will necessitate revising the bank's current policy/procedures to reflect the separation of duties.

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### **SPECIFIC FINDINGS**

#### **Bank Secrecy Act (BSA) (continued)**

Review of CTRs filed since the compliance examination revealed that the section regarding the identity of the individual is now fully completed. The bank has attempted to obtain the revised CTR form that became effective October 1, 1995 but had not yet received a working copy as of the date of the review and will continue to file the previous form until receipt of the revised form. The IRS stated that it is permissible to use the previous form until the end of 1995; provided, the bank has made a good faith effort to obtain the new form.

The bank's exemption list contains the names, addresses, and tax identification numbers of all correspondent banks. None of the bank's customers are exempted from CTR reporting requirements. While the bank's current automated system easily reports these transactions, the IRS has stated that exemptions should be used so that the IRS system does not become overloaded with unnecessary information. As recommended by the OCC examiners, management should consider exempting some of its retail customers that regularly deposit, withdrawal, or exchange in excess of \$10,000.

Review of the monetary instruments log revealed that the bank continues to collect information that is no longer required by Treasury Regulations. It is; therefore, recommended that the Monetary Instruments Log contained in the Exhibit section of this report be utilized as it complies with current requirements.

#### **Bank Protection Act (BPA)**

To assess the bank's approach to compliance with the BPA, the board of director meeting minutes, security program, equipment testing, and training records were reviewed.

At its June 1995 meeting, the board of directors approved the bank's security program and appointed the bank's Security Officer. The security program describes opening and

closing procedures, security devices, and robbery procedures. The program provides for annual training for the Security Officer and periodic staff training. There are no recommendations for improvement.

Review of the equipment testing records revealed that security devices are generally tested monthly and information regarding the testing is forwarded to the Security Officer at the main office. It appears; however, that the First County office has not forwarded such information. It is recommended that the Security Officer ensure that all offices promptly report equipment testing and failures to ensure continued security.

### **SPECIFIC FINDINGS**

#### **Bank Protection Act (BPA) (continued)**

Training records indicate that, with the exception of the Second County office, the bank's entire staff received security training in June 1995. It is recommended that the Second County staff receive security training prior to year end.

#### **Right to Financial Privacy Act (RFPA)**

A recent subpoena from the SEC was reviewed and management interviewed to determine the bank's level of compliance with the RFPA. The bank does not currently operate under a formal policy or procedures.

Review of the SEC subpoena and supporting documentation revealed that the bank received proper authorization prior to complying with the SEC information request. Management is reminded that under the RFPA, the bank may recoup from the SEC its clerical, copying, and other costs associated with the information requested.

It is recommended that the board of directors adopt a formal policy concerning compliance with the RFPA and that management develop and implement procedures that will provide staff guidance.

#### **Fair Debt Collection Practices Act (FDCPA)**

The bank's loan and collection policy and procedures were reviewed to determine the bank's approach to compliance with the FDCPA.

Since the bank does not act as a "debt collector", the FDCPA does not apply. The bank has; however, adopted and implemented a "non-harassment" policy and procedures for handling bank collections. There are no recommendations for improvement.

**THESE ARE SOME OF THE T.I.L.A. VIOLATIONS THAT CAN BE FOUND ON MORTGAGE CONTRACTS.**

Over-escrowing.

Junk charges.

Examples:

- a. yield spread premiums
- b. service release fees

Upselling

Overages

Undisclosed referral fees to mortgage originators

Breach of Fiduciary Duty

(Please see Defining Breach of Fiduciary Duty at the end of this book)

Failure to disclose the circumstances under which private mortgage insurance ("PMI") may be terminated.

Unauthorized servicing charges

Example: The imposition of payoff and recording charges.

Improper ARM adjustments

Underdisclosure of the cost of credit.

Payment of compensation to mortgage brokers and originators by lenders.

For example: a lender who pays a mortgage broker secret compensation may face liability for inducing the broker to breach his fiduciary or contractual duties, fraud, or commercial bribery.

**13 STEPS TO BRING THE BANK TO THE BARGAINING TABLE**

**Truth In Lending Act Program Outline**

(Each Mortgage is based on its own merits; your case may have more steps)

1. Submit mortgage papers and closing documents to specially trained auditors
2. Auditors review documents to find T.I.L.A. violations
3. Paralegals write accusatory letter to Bank
4. Client sends letter number one to Bank

5. Wait 30 days for Bank to respond
6. Receive Bank's response
7. Client sends response to Paralegals
8. Paralegals write amendment to accusatory letter
9. Client sends letter number two to bank
10. Bank wants to come to bargaining table to make offer
11. Client wants to eliminate the Mortgage and collect fines
12. Bank agrees
13. Current Mortgage is discharged and Client gets  
\$40,000 in fines and Clear Title

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### **CURRENT TRENDS IN RESIDENTIAL MORTGAGE LITIGATION**

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(see resources page for website address for Edelman & Combs)

#### **HIGHLIGHT:**

Borrowers Have Successfully Sued Based on Allegations of Over-escrowing, Unauthorized Charges and Brokers' Fees, Improper Private Mortgage Insurance Procedures, and Incorrectly Adjusted ARMS. The Author Analyzes Such Lending Practices, and the Litigation They Have Spawned.

#### **BODY:**

This article surveys current trends in litigation brought on behalf of residential mortgage borrowers against mortgage originators and servicers.

The following types of litigation are discussed: (i) over-escrowing; (ii) junk charges; (iii) payment of compensation to mortgage brokers and originators by lenders; (iv) private mortgage insurance; (v) unauthorized servicing charges; and (vi) improper adjustments of interest on adjustable rate mortgages.

We have omitted discussion of abuses relating to high-interest and home improvement loans, a subject that would justify an article in itself.

**OVER-ESCROWING** In recent years, more than 100 class actions have been brought against mortgage companies complaining about excessive escrow deposit requirements.

Requirements that borrowers make periodic deposits to cover taxes and insurance first became widespread after the Depression. There were few complaints about them until the late 1960s, probably because until that time many lenders used the "capitalization" method to handle the borrowers' funds. Under this method, escrow disbursements were added to the principal balance of the loan and escrow deposits were credited in the same manner as principal payments. The effect of this "capitalization" method is to pay interest on escrow deposits at the note rate, a result that is fair to the borrower. When borrowers could readily find lenders that used this method, there was little ground for complaint.

The "capitalization" method was almost entirely replaced by the current system of escrow or impound accounts in the 1960s and 1970s. Under this system, lenders require borrowers to make monthly deposits on which no interest is paid. Lenders use the deposits as the equivalent of capital by placing them in non-interest-bearing accounts at related banks or at banks that give "fund credits" to the lender in return for custody of the funds. Often, surpluses greatly in excess of the amounts actually required to make tax and insurance payments as they came due are required. In effect, borrowers are required to make compulsory, interest-free loans to their mortgage companies.

One technique used to increase escrow surpluses is "individual item analysis." This term describes a wide variety of practices, all of which create a separate hypothetical escrow account for each item payable with escrow funds. If there are multiple items payable from the escrow account, the amount held for item A is ignored when determining whether there are sufficient funds to pay item B, and surpluses are required for each item. Thus, large surpluses can be built up. Individual item analysis is not per se illegal, but can readily lead to excessive balances.

During the 1970s, a number of lawsuits were filed alleging that banks had a duty to pay interest on escrow deposits or conspired to eliminate the "capitalization" method. Most courts held that, in the absence of a statute to the contrary, there was no obligation to pay interest on escrow deposits. The only exception was Washington. Following these decisions, some 14 states enacted statutes requiring the payment of interest, usually at a very low rate.

Recent attention has focused on excessive escrow deposits. In 1986, the U.S. District Court for the Northern District of

Illinois first suggested, in *Leff v. Olympic Fed. S & L Assn.* that the aggregate balance in the escrow account had to be examined in order to determine if the amount required to be deposited was excessive. The opinion was noted by a number of state attorneys general, who in April 1990 issued a report finding that many large mortgage servicers were requiring escrow deposits that were excessive by this standard. The present wave of over-escrowing cases followed.

Theories that have been upheld in actions challenging excessive escrow deposit requirements include breach of contract, state consumer fraud statutes, RICO, restitution, and violation of the Truth in Lending Act ("T.I.L.A."). Claims have also been alleged under section 10 of the Real Estate Settlement Procedures Act ("RESPA"), which provides that the maximum permissible surplus is "one-sixth of the estimated total amount of such taxes, insurance premiums and other charges to be paid on dates . . . during the ensuing twelve-month period." However, most courts have held that there is no private right of action under section 10 of RESPA. Most of the over-escrowing lawsuits have been settled. Refunds in these cases have totaled hundreds of millions of dollars.

On May 9, 1995, in response to the litigation and complaints concerning over-escrowing, HUD issued a regulation implementing section 10 of RESPA. The HUD regulation: 1. Provides for a maximum two-month cushion, computed on an aggregate basis (i.e., the mortgage servicer can require the borrower to put enough money in the escrow account so that at its lowest point it contains an amount equal to two months' worth of escrow deposits) Does not displace contracts if they provide for smaller amounts; and Provides for a phase-in period, so that mortgage servicers do not have to fully comply until October 27, 1997.

Meanwhile, beginning in 1990, the industry adopted new forms of notes and mortgages that allow mortgage servicers to require escrow surpluses equal to the maximum two-month surplus permitted by the new regulation. However, loans written on older forms of note and mortgage, providing for either no surplus or a one-month surplus, will remain in effect for many years to come. In recent years, many mortgage originators attempted to increase their profit margins by breaking out overhead expenses and passing them on to the borrower at the closing. Some of these "junk charges" were genuine but represented part of the expense of conducting a lending business, while others were completely fictional. By breaking out the charges separately and excluding them from the finance charge and annual percentage rate, lenders were able to quote competitive annual percentage rates while increasing their profits.

Most of these charges fit the standard definition of "finance charge" under T.I.L.A.. A number of pre-1994 judicial and administrative decisions held that various types of these

charges, such as tax service fees, fees for reviewing loan documents, fees relating to the assignment of notes and mortgages, fees for the transportation of documents and funds in connection with loan closings, fees for closing loans, fees relating to the filing and recordation of documents that were not actually paid over to public officials, and the intangible tax imposed on the business of lending money by the states of Florida and Georgia, had to be disclosed as part of the "finance charge" under T.I.L.A..

The mortgage industry nevertheless professed great surprise at the March 1994 decision of the U.S. Court of Appeals for the Eleventh Circuit in *Rodash v. AIB Mtge. Co.*, holding that a lender's pass-on of a \$ 204.00 Florida intangible tax and a \$22.00 Federal Express fee had to be included in the finance charge, and that Martha Rodash was entitled to rescind her mortgage as a result of the lender's failure to do so. The court found that "the plain language of T.I.L.A. evinces no explicit exclusion of an intangible tax from the finance charge," and that the intangible tax did not fall under any of the exclusions in **REGULATION Z** dealing with security interest charges. Claiming that numerous loans were subject to rescission under *Rodash*, the industry prevailed upon Congress and the Federal Reserve Board to change the law retroactively through a revision to the FRB Staff Commentary on **REGULATION Z** and the Truth in Lending Act Amendments of 1995, signed into law on September 30, 1995. The amendments:

1. Exclude from the finance charge fees imposed by settlement agents, attorneys, escrow companies, title companies, and other third party closing agents, if the creditor neither expressly requires the imposition of the charges nor retains the charges;
2. Exclude from the finance charge taxes on security instruments and loan documents if the payment of the tax is a condition to recording the instrument and the item is separately itemized and disclosed (i.e., intangible taxes);
3. Exclude from the finance charge fees for preparation of loan-related documents;
4. Exclude from the finance charge fees relating to pest and flood inspections conducted prior to closing;
5. Eliminate liability for overstatement of the annual percentage rate.
6. Increase the tolerance or margin of error;
7. Provide that mortgage servicers are not to be treated as assignees.

The constitutionality of the retroactive provisions of the Amendments is presently under consideration.

The FRB Staff Commentary amendments dealt primarily with the question of third-party charges, and provided that they were not finance charges unless the creditor required or retained the charges.

The 1995 Amendments substantially eliminated the utility of T.I.L.A. in challenging "junk charges" imposed by lenders. However, "junk charges" are also subject to challenge under RESPA, where they are used as devices to funnel kickbacks

or referral fees or excessive compensation to mortgage brokers or originators. This issue is discussed below.

"UPSELLING," "OVERAGES," AND REFERRAL FEES TO MORTGAGE ORIGINATORS A growing number of lawsuits have been brought challenging the payment of "upsells," "overages," "yield spread premiums," and other fees by lenders to mortgage brokers and originators.

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During the last decade it became fairly common for mortgage lenders to pay money to mortgage brokers retained by prospective borrowers. In some cases, the payments were expressly conditioned on altering the terms of the loan to the borrower's detriment by increasing the interest rate or "points." For example, a lender might offer brokers a payment of 50 basis points (0.5 percent of the principal amount of the loan) for every 25 basis points above the minimum amount ("par") at which the lender was willing to make the loan. Industry publications expressly acknowledged that these payments were intended to "compensate mortgage brokers for charging fees higher than what the borrower would normally pay." In other instances, brokers were compensated for convincing the prospective borrower to take an adjustable-rate mortgage instead of a fixed-rate mortgage or for inducing the purchase of credit insurance by the borrower.

In the case of some loans, the payments by the lender to the broker were totally undisclosed. In other cases, particularly in connection with loans made after the amendments to regulation X discussed below, there is an obscure reference to the payment on the loan documents, usually in terms incomprehensible to a lay borrower. For example, the HUD-1 form may contain a cryptic reference to a "yield spread premium" or "par plus pricing," often abbreviated like "YSP broker (POC) \$ 1,500."<sup>39</sup>

The burden of the increased interest rates and points resulting from these practices is believed to fall disproportionately on minorities and women. These practices are subject to legal challenge on a number of grounds.

**Breach of Fiduciary Duty** Most courts have held that a mortgage broker is a fiduciary. One who undertakes to find and arrange financing or similar products for another becomes the latter's agent for that purpose, and owes statutory, contractual, and fiduciary duties to act in the interest of the principal and make full disclosure of all material facts. "A person who undertakes to manage some affair for another, on the authority and for the account of the latter, is an agent."

Courts have described a mortgage loan broker as an agent hired by the borrower to obtain a loan. As such, a mortgage

broker owes a fiduciary duty of the "highest good faith toward his principal," the prospective borrower. Most fundamentally, a mortgage broker, like any other agent who undertakes to procure a service, has a duty to contact a variety of providers and attempt to obtain the best possible terms.

Additionally, a mortgage broker "is 'charged with the duty of fullest disclosure of all material facts concerning the transaction that might affect the principal's decision.'" The duty to disclose extends to the agent's compensation. Thus, a broker may not accept secret compensation from adverse parties.

Furthermore, the duty to disclose is not satisfied by the insertion of cryptic "disclosures" on documents. The obligation is to "make a full, fair and understandable explanation" of why the fiduciary is not acting in the interests of the beneficiary and of the reasons that the beneficiary might not want to agree to the fiduciary's actions.

The industry has itself recognized these principles. The National Association of Mortgage Brokers has adopted a Code of Ethics which requires, among other things, that the broker's duty to the client be paramount. Paragraph 3 of the Code of Ethics states:

In accepting employment as an agent, the mortgage broker pledges himself to protect and promote the interest of the client. The obligation of absolute fidelity to the client's interest is primary.

Thus, a lender who pays a mortgage broker secret compensation may face liability for inducing the broker to breach his fiduciary or contractual duties, fraud, or commercial bribery.

**Mail/Fraud/ Wire Fraud/ RICO** The payment of compensation by a lender to a mortgage broker without full disclosure is also likely to result in liability under the federal mail and wire fraud statutes and RICO. It is well established that a scheme to corrupt a fiduciary or agent violates the mail or wire fraud statute if the mails or interstate wires are used in furtherance of the scheme.

**Real Estate Settlement Procedures Act** Irrespective of whether the broker or other originator of a mortgage is a fiduciary, lender payments to such a person may result in liability under section 8 of RESPA, which prohibits payments or fee splitting for business referrals, if the payments are either not fully disclosed or exceed reasonable compensation for the services actually performed by the originator.

Prior to 1992, the significance of section 8 of RESPA was minimized by restrictive interpretations. The Sixth Circuit

Court of Appeals held that the origination of a mortgage was not a "settlement service" subject to section 8.51 In addition; cases construing the pre-1992 version of implementing HUD regulation X required a splitting of fees paid to a single person. Finally, the payment of compensation in secondary market transactions was excluded from RESPA, and there was no distinction made between genuine secondary market transactions and "table funded" transactions, where a mortgage company originates a loan in its own name, but using funds supplied by a lender, and promptly thereafter assigns the loan to the lender.

In 1992, RESPA and regulation X were amended to close each of these loopholes. The amendments did not have practical effect until August 9, 1994, the effective date of the new regulation X.

First, RESPA was amended to provide expressly that the origination of a loan was a "settlement service." P.L. 102-550 altered the definition of "settlement service" in Section 2602(3) to include "the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans)." This change and a corresponding change in regulation X were expressly intended to disapprove the Sixth Circuit's decision in *United States v. Graham Mtge. Corp.*

Second, regulation X was amended to exclude table funded transactions from the definition of "secondary market transactions." Regulation X addresses "table funding" in sections 3500.2 and 3500.7. Section 3500.2 provides that "table funding means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds. A table-funded transaction is not a secondary market transaction (see Section 3500.5(b) (7))." Section 3500.5(b) (7) exempts from regulation by RESPA fees and charges paid in connection with legitimate "secondary market transactions," but excludes table funded transactions from the scope of legitimate secondary market transactions. Under the current regulation X, RESPA clearly applies to table funded transactions. Amounts paid by the first assignee of a loan to a "table funding" broker for "rights" to the loan -- i.e., for the transfer of the loan by the broker to the lender -- are now subject to examination under RESPA.

Third, any sort of payment to a broker or originator that does not represent reasonable compensation for services actually provided is prohibited.

Whatever the payment to the originator or broker is called, it must be reasonable. Another mortgage industry publication states: Any amounts paid under these headings [servicing release premiums or yield spread premiums] must be lumped together with any other origination fees paid to the

broker and be subjected to the referral fee/ market value test in Section 8 of RESPA and Section 3500.14 of Regulation X. If the total of this compensation exceeds the market value of the services performed by the broker (excluding the value of the referral), then the compensation does not pass the test, and both the broker and the lender could be subject to the civil and criminal penalties contained in RESPA.

Normal compensation for a mortgage broker is about one percent of the principal amount of the loan. Where the broker "table funds" the loan and originates it in its name, an extra .5 percent or one percent may be appropriate. This level of reasonableness is recognized by agency regulations. For example, on February 28, 1996, in response to allegations of gouging by brokers on refinancing VA loans, the VA promulgated new regulations prohibiting mortgage lenders from charging more than two points in refinanced transactions.

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The amended regulation makes clear that a payment to a broker for influencing the borrower in any manner is illegal. "Referral" is defined in Section 3500.14(f) (1) to include "any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business. . . ." The amended regulation also cannot be evaded by having the borrower pay the originator. An August 14, 1992 letter from Frank Keating, HUD's General Counsel, states unequivocally: "We read 'imposed upon borrowers' to include all charges which the borrower is directly or indirectly funding as a condition of obtaining the mortgage loan. We find no distinction between whether the payment is paid directly or indirectly by the borrower, at closing or outside the closing. . . . I hereby restate my opinion that RESPA requires the disclosures of mortgage broker fees, however denominated, whether paid for directly or indirectly by the borrower or by the lender."

Thus, **"yield spread premiums," "service release fees,"** and similar payments for the referral of business are no longer permitted. The new regulation was specifically intended to outlaw the payment of compensation for the referral of business by mortgage brokers, either directly or through the imposition of "junk charges." Thus, it provides that payments may not be made **"for the referral of settlement service business"** (Section 3500.14(b)).

The mortgage industry has recognized that types of fees that were once viewed as permissible in the past are now "prohibited and illegal." The legal counsel for the National Second Mortgage Association acknowledged: "Even where

the amount of the fee is reasonable, the more persuasive conclusion is that RESPA does not permit service release fees." "Also, if . . . the lender is 'table funding' the loan, he is violating RESPA's Section 8 anti-kickback provisions."

In the first case decided under the new regulation, *Briggs v. Countrywide Funding Corp.*, the U. S. District Court for the Middle District of Alabama denied a motion to dismiss a complaint alleging the payment of a "yield spread premium" by a lender to a broker in connection with a table funded transaction. Plaintiffs alleged that the payment violated RESPA as well as several state law doctrines. The court acknowledged that RESPA applied to the table funded transactions and noted that whether or not disclosed, the fees could be considered illegal.

**Truth in Lending Act Implications** Many of the pending cases challenging the payment of "yield spread premiums" and "**upselling**" allege that the payment of compensation to an agent of the lender is a T.I.L.A. "finance charge." The basis of the T.I.L.A. claims is that the commission a borrower pays to his "broker" is a finance charge because the "broker" is really functioning as the agent of the lender. The claim is not that the "upsell" payment made by the lender to the borrower's broker is a finance charge.

Decisions under usury statutes uniformly hold that a fee charged to the borrower by the lender's agent is interest or points. 64 The concept of the "finance charge" under T.I.L.A. is broader than, but inclusive of, the concept of "interest" and "points" at common law and under usury statutes. **REGULATION Z** specifically provides that the "finance charge" includes any "interest" and "points" charged in connection with a transaction. 65 Therefore, if the intermediary is in fact acting on behalf of the lender, as is the case where the intermediary accepts secret compensation from the lender or acts in the lender's interest to increase the amount paid by the borrower, all compensation received by the intermediary, including broker's fees charged to the borrower, are finance charges.

**Unfair and Deceptive Acts and Practices** The pending "upselling" cases also generally allege that the payment of compensation to the mortgage broker violates the general prohibitions of most state "unfair and deceptive acts and practices" ("UDAP") statutes. The violations of public policy codified by the federal consumer protection laws create corresponding state consumer protection law claims.

**Civil Rights and Fair Housing Laws** The Department of Justice brought two cases in late 1995 alleging that the disproportionate impact of "overages" and "upselling" on minorities violated the Fair Housing Act and Equal Credit Opportunity Act. Both cases alleged disparate pricing of loans according to the borrower's race and were promptly settled. Other investigations are reported to be pending. The

principal focus of enforcement agencies appears to be on the civil rights implications of overages.

It is likely that such a practice would also violate 42 U.S.C. Section 1981. While Section 1981 requires intentional discrimination, a lender that decides to take advantage of the fact that other lenders discriminate by making loans to minorities at higher rates is also engaging in intentional discrimination. In *Clark v. Universal Builders*, the Seventh Circuit held that one who exploits and preys on the discriminatory hardship of minorities does not occupy a more protected status than the one who created the hardship in the first instance; that is, a defendant cannot escape liability under the Civil Rights Act by asserting it merely "exploited a situation created by socioeconomic forces tainted by racial discrimination."

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**PRIVATE MORTGAGE INSURANCE LITIGATION** Another group of pending lawsuits is based on claims of misrepresentation of or failure to disclose the circumstances under which private mortgage insurance ("PMI") may be terminated. PMI insures the lender against the borrower's default -- the borrower derives no benefit from PMI. It is generally required under a conventional mortgage if the loan to value ratio exceeds about 80 percent. Approximately 17.4 percent of all mortgages have PMI.

Standard form conventional mortgages provide that if PMI is required it may be terminated as provided by agreement. Most servicers and investors have policies for terminating PMI. However, the borrower is often not told what the policy is, either at the inception of the mortgage or at any later time. As a result, people pay PMI premiums unnecessarily. Since there is about \$ 460 billion in PMI in force, this is a substantial problem. The failure accurately and clearly to disclose the circumstances under which PMI may be terminated has been challenged under RICO and state consumer fraud statutes.

**UNAUTHORIZED SERVICING CHARGES** Another fertile ground of litigation concerns the imposition of charges that are not authorized by law or the instruments being serviced. The collection of modest charges is a key component of servicing income. For example, many mortgage servicers impose charges in connection with the payoff or satisfaction of mortgages when the instruments either do not authorize the charge or affirmatively prohibit it.

The imposition of payoff and recording charges has been challenged as a breach of contract, as a deceptive trade practice, as a violation of RICO, and as a violation of the Fair Debt Collection Practices Act ("FDCPA"). In *Sandlin v. State Street Bank*, the U. S. District Court for the Middle District of Florida held that the imposition of a payoff statement fee is a

violation of the standard form "uniform instrument" issued by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, and when imposed by someone who qualifies as a "debt collector" under the FDCPA, violates that statute as well. However, attempts to challenge such charges under RESPA have been unsuccessful, with courts holding that a charge imposed subsequent to the closing is not covered by RESPA.

## **THE FAIR DEBT COLLECTION PRACTICES ACT**

**Adjustable rate mortgages** Adjustable rate mortgages ("ARMs") were first proposed by the Federal Home Loan Bank Board in the 1970s. They first became widespread in the early 1980s. At the present time, about 25 to 30 percent of all residential mortgages are adjustable rate mortgages ("ARMs").

The ARM adjustment practices of the mortgage banking industry have been severely criticized because of widespread errors. Published reports beginning in 1990 indicate that 25 to 50 percent of all ARMs may have been adjusted incorrectly at least once. The pattern of misadjustments is not random: approximately two-thirds of the inaccuracies favor the mortgage company.

Grounds for legal challenges to improper ARM adjustments include breach of contract, T.I.L.A., the Uniform Consumer Credit Code, RICO, state unfair and deceptive practices statutes, failure to properly respond to a "qualified written request" under section 6(e) of RESPA, and usury.

Substantial settlements of ARM claims have been made by Citicorp Mortgage, First Nationwide Bank, and Banc One. On the other hand, several cases have rejected borrower claims that particular ARM adjustment actions violated the terms of the instruments. For example, a Connecticut case held that a mortgage that provided for an interest rate tied to the bank's current "market rate" was not violated when the bank failed to take into account the rate that could be obtained through the payment of a "buydown." A Pennsylvania case held that the substitution of one index for another that had been discontinued was consistent with the terms of the note and mortgage.

A major issue in ARM litigation is whether what the industry erroneously terms "undercharges" -- the failure of the servicer to charge the maximum amount permitted under the terms of the instrument -- can be "netted" or offset against overcharges -- the collection of interest in excess of that permitted under the terms of the instrument. Fannie Mae has taken the position that "netting" is appropriate.

The validity of this conclusion is questionable. First, nothing requires a financial institution to adjust interest rates upward to the maximum permitted, and there are in fact often sound

business reasons for not doing so. On the other hand, the borrower has an absolute right not to pay more than the instrument authorizes. Thus, what the industry terms an "undercharge" is simply not the same thing as an "overcharge."

Second, the upward adjustment of interest rates must be done in compliance with T.I.L.A.. An Ohio court held that failure to comply made the adjustment unenforceable. "Where a bank violates the Truth-in-Lending Act by insufficient disclosure of a variable interest rate, the court may grant actual damages. . . . If the actual damage is the excess interest charge over the original contract term, the court may order the mortgage to be recalculated at its original terms, and refuse to enforce the variable interest rate provisions."

Third, if the borrower is behind in his payments, "netting" may violate state law requiring the lender to proceed against the collateral before undertaking other collection efforts. A decision of the California intermediate appellate court concluded that the state's "one-action rule" had been violated when a lender obtained an offset of interest overcharges against amounts owed by the borrower under an ARM.

1. E.g., G. Marsh, *Lender Liability for Consumer Fraud Practices of Retail*

*Dealers and Home Improvement Contractors*, 45 Ala. L. Rev. 1 (1993); D. Edelman, *Second Mortgage Frauds*, Nat'l Consumer Rights Litigation Conference 67 (Oct. 19-20, 1992).

2. The lender would deposit the escrow funds in a non-interest-bearing account at a bank which made loans to the lender. The lender would receive a "funds credit" against the interest payable on its borrowings based on the value of the escrow funds deposited at the bank.

3. *Aitken v. Fleet Mtge. Corp.*, 1991 U.S. Dist.

- LEXIS 10420 (ND Ill., July 30, 1991), and 1992 U.S. Dist. LEXIS 1687 (ND Ill., Feb. 12, 1992);
- *Attorney General v. Michigan Nat'l Bank*, 414 Mich. 948, 325 N.W.2d 777 (1982);
- *Burkhardt v. City Nat'l Bank*, 57 Mich. App. 649, 226 N.W.2d 678 (1975).

4. See generally, *Class Actions Under Anti-Trust Laws on Account of Escrow and Similar Practices*, 11 Real Prop., Probate & Trust Journal 352 (Summer 1976).

5. *Buchanan v. Century Fed. S. & L. Ass'n*, 306 Pa. Super. 253, 452 A.2d 540 (1982), later opinion, 374 Pa. Super. 1, 542 A.2d 117 (1986);

Carpenter v. Suffolk Franklin Savings. Bank, 370 Mass. 314, 346 N.E.2d 892 (1976);

Brooks v. Valley Nat'l Bank, 113 Ariz. 169, 548 P.2d 1166 (1976);

Petherbridge v. Prudential S. & L. Ass'n, 79 Cal.App.3d 509, 145 Cal.Rptr. 87 (1978);

Marsh v. Home Fed. S. & L. Ass'n, 66 Cal.App.3d 674, 136 Cal.Rptr. 180 (1977);

LaThrop v. Bell Fed. S. & L. Ass'n, 68 Ill.2d 375, 370 N.E.2d 188 (1977);

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Sears v. First Fed. S. & L. Ass'n, 1 Ill.App.3d 621, 275 N.E.2d 300 (1st Dist. 1973); Durkee v. Franklin Savings Ass'n, 17 Ill.App.3d 978, 309 N.E.2d 118 (2d Dist. 1974); Zelickman v. Bell Fed. S. & L. Ass'n, 13 Ill.App.3d 578, 301 N.E.2d 47 (1st Dist. 1973); Yudkin v. Avery Fed. S. & L. Ass'n, 507 S.W.2d 689 (Ky. 1974); First Fed. S. & L. Ass'n of Lincoln v. Board of Equalization of Lancaster County, 182 Neb. 25, 152 N.W.2d 8 (1967); Kronisch v. Howard Savings Institution, 161 N.J.Super. 592, 392 A.2d 178 (1978); Surrey Strathmore Corp. v. Dollar Savings Bank of New York, 36 N.Y.2d 173, 366 N.Y.S.2d 107, 325 N.E.2d 527 (1975); Tierney v. Whitestone S. & L. Ass'n, 83 Misc.2d 855, 373 N.Y.S.2d 724 (1975); Cale v. American Nat'l Bank, 37 Ohio Misc. 56, 66 Ohio Ops.2d 122 (1973); Richman v. Security S. & L. Ass'n, 57 Wis.2d 358, 204 N.W.2d 511 (1973); In re Mortgage Escrow Deposit Litigation, 1995 U.S.Dist. LEXIS 1555 (ND Ill. Feb. 8, 1995).

6. National Mortgage News, Nov. 11, 1991, p. 2.

7. Leff v. Olympic Fed. S & L Ass'n, 1986 WL 10636 (ND Ill 1986).

**8. Overcharging on Mortgages:** Violations of Escrow Account Limits by the Mortgage Lending Industry: Report by the Attorneys General of California, Florida, Iowa, Massachusetts, Minnesota, New York & Texas (24 Apr 1990).

9. Leff v. Olympic Fed. S. & L. Ass'n, n. 7 supra; Aitken v. Fleet Mtge.Corp., 1992 U.S.Dist. LEXIS 1687 (ND Ill., Feb. 12, 1992); Weinberger v. Bell Federal, 262 Ill.App.3d 1047, 635 N.E.2d 647 (1st Dist. 1994); Poindexter v. National Mtge. Corp., 1995 U.S.Dist. LEXIS 5396 (ND Ill., April, 24, 1995); Markowitz v. Ryland Mtge. Co., 1995 U.S.Dist. LEXIS 11323 (ND Ill. Aug. 8, 1995); Sanders v. Lincoln Service Corp., 1993 U.S.Dist. LEXIS 4454 (ND Ill. Apr. 9, 1993); Cairns v. Ohio Sav. Bank, 1996 Ohio App. LEXIS 637 (Feb. 22, 1996). See generally, GMAC Mtge. Corp. v. Stapleton,

236 Ill.App.3d 486, 603 N.E.2d 767 (1st Dist. 1992), leave to appeal denied, 248 Ill.2d 641, 610 N.E.2d 1262 (1993).

10. Leff v. Olympic Fed. S. & L. Ass'n, n. 7 supra; Aitken v. Fleet Mtge. Corp., n.9 supra; Poindexter v. National Mtge. Corp., n.9 supra; Sanders v. Lincoln Service Corp., n. 9 supra.

11. Leff v. Olympic Fed. S. & L. Ass'n, Aitken v. Fleet Mtge. Corp., n.9 supra; Robinson v. Empire of America Realty Credit Corp., 1991 U.S. Dist. LEXIS 2084 (ND Ill., Feb. 20, 1991); Poindexter v. National Mtge. Corp., n. 9 supra.

12. Poindexter v. National Mtge. Corp., n. 9 supra.

13. Martinez v. Weyerhaeuser Mtge. Co., 1995 U.S. Dist. LEXIS 11367 (ND Ill. Aug. 8, 1995). The theory is that the excessive portion of the escrow deposit is a finance charge.

14. 12 U.S.C. Section 2609.

15. State of Louisiana v. Litton Mtge. Co., 50 F.3d 1298 (5th Cir. 1995); Allison v. Liberty Savings, 695 F.2d 1086, 1091 (7th Cir. 1982); Herrman v. Meridian Mtge. Corp., 901 F.Supp. 915 (ED Pa. 1995); Campbell v. Machias Savings Bank, 865 F.Supp. 26, 31 (D.Me. 1994); Michels v. Resolution Trust Corp., 1994 U.S. Dist. LEXIS 6563 (D.Minn. Apr. 13, 1994); Bergkamp v. New York Guardian Mortgagee Corp., 667 F.Supp. 719, 723 (D.Mont. 1987). Contra, Vega v. First Fed. S. & L. Ass'n, 622 F.2d 918, 925 (6th Cir. 1980).

16. 24 C.F.R. 3400.

17, issued at 60 FR 24734.17. The pre-1990 "uniform instrument" issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation did not provide for any surplus. The pre-1990 FHA form and the VA form provided for a one-month surplus.

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18. The finance charge includes "any charge, payable directly or indirectly by the consumer, imposed directly or indirectly by the creditor, as an incident to or a condition of the extension of credit." **REGULATION Z**, 12 C.F.R. 226.4(a). The definition is all-inclusive: any charge that meets this definition is a finance charge unless it is specifically excluded by T.I.L.A. or **REGULATION Z**. R. Rohner, *The Law of Truth in Lending*, section 3.02 (1984). There are exclusions from the finance charge which apply only in mortgage transactions. 12 C.F.R. 226.4(c)(7). However, the exclusions require that the charges be bona fide and reasonable in amount, *id.*, and the exclusions are narrowly construed to protect consumers from

**Underdisclosure** of the cost of credit. Equity Plus Consumer Fin. & Mtge. Co. v. Howes, 861 P.2d 214, 217 (NM 1993). See also In re Celona, 90 B.R. 104 (Bankr.ED Pa. 1988), aff'd 98 B.R. 705 (Bankr. ED Pa. 1989). "Only those charges specifically exempted from inclusion in the 'finance charge' by statute or regulation may be excluded from it." Buford v. American Fin. Co., 333 F.Supp. 1243, 1247 (ND Ga. 1971).

19. In re Souders, 1992 U.S.Comp.Gen. LEXIS 1075 (Sept. 29, 1992); In re Barry, 1981 U.S.Comp.Gen. LEXIS 1262 (April 16, 1981); In re Bayer, 1977 U.S.Comp.Gen. LEXIS 2116 (Sept. 19, 1977); In re Wahl, 1974 U.S.Comp.Gen. LEXIS 1610 (Oct. 1, 1974); In re Ray, 1973 U.S.Comp.Gen. LEXIS 1960 (March 13, 1973). A tax service fee represents the purported cost of having someone check the real estate records annually to make sure that the taxes on the property securing the loan are shown as having been paid.

20. In re Celona, 90 B.R. 104, 110-12 (Bankr. E.D.Pa. 1988), aff'd, 98 B.R. 705 (ED Pa. 1989) (lender violated T.I.L.A. by passing on \$200.00 fee charged by attorney to review certain documents without including fee in "finance charge"); Abel v. Knickerbocker Realty Co., 846 F.Supp. 445 (D.Md. 1994) (lender violated T.I.L.A. because "origination fee" of \$290.00 excluded from "finance charge"); Brodo v. Bankers Trust Co., 847 F.Supp. 353 (ED Pa. 1994) (lender violated T.I.L.A. by imposing charge for preparing T.I.L.A. disclosure documents without including them in the "finance charge").

21. Cheshire Mtge. Service, Inc. v. Montes, 223 Conn. 80, 612 A.2d 1130 (1992) (lender violated T.I.L.A. by imposing fee for assigning the mortgage when it was sold on the secondary market without including it in the "finance charge"); In re Brown, 106 B.R. 852 (Bankr. E.D.Pa. 1989) (same); Mayo v. Key Fin. Serv., Inc., 92-6441-D (Mass.Super.Ct., June 22, 1994) (same).

22. In re Anibal L. Tobaos, 1985 U.S.Comp.Gen. LEXIS 854 (July 19, 1985) ("The relevant part of **REGULATION Z** expressly categorizes service charges and loan fees as part of the finance charge when they are imposed directly or indirectly on the consumer incident to or as a condition of the extension of credit. The finance charge, therefore, is not limited to interest expenses but includes charges which are imposed to defray a lender's administrative costs. A messenger service charge paid to the mortgage lender may not be reimbursed because it is part of the lender's overhead, a charge for which is considered part of the finance charge under **REGULATION Z**."); In re Schwartz, 1989 U.S. Comp. Gen. LEXIS 55 (Jan. 19, 1989) ("a messenger service charge or fee is part of the lender's overhead, a charge which is deemed to be a finance charge and not reimbursable").

23. Decision of the Comptroller General No. B-181037, 1974 U.S.Comp.Gen. LEXIS 1847 (July 16, 1974) (loan closing fee was part of the finance charge under T.I.L.A.); Decision of the Comptroller General, No. B-189295 1977, U.S. Comp.Gen. LEXIS 2230 (Aug. 16, 1977) (same); In the Matter of Real Estate Expenses -- Finance Charges, No. B-179659, 54 Comp. Gen. 827, 1975 U.S.Comp.Gen. LEXIS 180 (April 4, 1975) (same).
24. *Abbey v. Columbus Dodge*, 607 F.2d 85 (5th Cir. 1979) (purported \$ 37.50 "filing fee" that creditor pocketed was a finance charge); *Therrien v. Resource Finan. Group. Inc.*, 704 F.Supp. 322, 327 (DNH 1989) (double-charging for recording and discharge fee and title insurance premium constituted undisclosed finance charges).
25. Decision of the Comptroller General, B-174030, 1971 U.S. Comp. Gen. LEXIS 1963 (Nov. 11, 1971).
26. 16 F.3d 1142 (11th Cir. 1994).
27. *Id.* at 1149.
28. 60 FR 16771, April 3, 1995.
29. See Jean M. Shioji, Truth in Lending Act Reform Amendments of 1995, Rev. of Bank. and Finan. Serv., Dec. 13, 1995, Vol. 11, No. 21; at 235.
30. P.L. 104-29, sections 2(a), (c), (d), and (e), to be codified at 15 U.S.C. 1605(a), (c), (d) and (e).
31. P.L. 104-29, section 2(b), to be codified at 15 U.S.C. 1605(a)(6).
32. The amendment broadened the language in 15 U.S.C. 1605(e)(2), which previously excluded "fees for preparation of a deed, settlement statement, or other documents."
33. P.L. 104-29, sections 2(a), (c), (d), and (e), to be codified at 15 U.S.C. 1605(a), (c), (d) and (e).
34. P.L. 104-29, section 3(a), to be codified at 15 U.S.C. 1605(f)(2); P.L. 104-29, section 4(a), to be codified at 15 U.S.C. 1649(a)(3); P.L. 104-29, section 8, to be codified at 15 U.S.C. 1635(i)(2); 15 U.S.C. 1606(c).
35. P.L. 104-29, section 7(b), to be codified at 15 U.S.C. 1641(f). The apparent purpose of this provision was to alter the result in *Myers v. Citicorp Mortgage*, 1995 U.S. Dist. LEXIS 3356 (MD Ala., March 14, 1995).
36. The amendments were applied to existing transactions in *Hickey v. Great W. Mtge. Corp.*, 158 F.R.D. 603 (ND Ill. 1994), later opinion, 1995 U.S. Dist. LEXIS 405 (ND Ill., Jan.

3, 1995), later opinion, 1995 U.S. Dist. LEXIS 3357 (ND Ill., Mar. 15, 1995), later opinion, 1995 U.S. Dist. LEXIS 4495 (ND Ill., Apr. 4, 1995), later opinion, 1995 U.S. Dist. LEXIS 6989 (ND Ill., May 1, 1995); and *Cowen v. Bank United*, 1995 U.S. Dist. LEXIS 4495, 1995 WL 38978 (ND Ill., Jan. 25, 1995), *aff'd*, 70 F.3d 937 (7th Cir. 1995).

37. Jonathan S. Hornbliss, *Fleet Unit Discontinues Overages on Loans to the Credit-Impaired*, *American Banker*, June 9, 1995, p. 8. See also, Kenneth R. Harney, *Loan Firm to Refund \$ 2 Million in 'Overage' Fees*, *Los Angeles Times*, Nov. 6, 1994, part K, p. 4, col. 1 ("Yield spread premiums" or "overages" are paid "to brokers when borrowers lock in or sign contracts at rates or terms that exceed what the lender would otherwise be willing to deliver"); Ruth Hepner, *Risk-based loan rates may rate a look*, *Washington Times*, Nov. 4, 1994, p. F1 (such fees are paid to mortgage brokers "to bring in borrowers at higher-than-market rates and fees"); Jonathan S. Hornbliss, *Focus on Overages Putting Home Lenders in Legal Hot Seat*, *American Banker*, May 24, 1995, p. 10 (giving examples of how the fees affect the borrower).

38. The extra fees -- known in the trade as overages or yield-spread premiums -- typically are paid to local mortgage brokers by large lenders who purchase their home loans. The concept is straightforward: If a mortgage company can deliver a loan at higher than the going rate, or with higher fees, the loan is worth more to the large lender who buys it. For every rate notch above "par" -- the lender's standard rate -- the lender will pay a local originator a bonus. Kenneth R. Harney, *Suit Targets Extra Fees Paid When Mortgage Rate Inflated*, *Sacramento Bee*, Aug. 13, 1995, p. J1.

39. Prior to 1993, according to industry experts, back-end compensation of this type rarely was disclosed to consumers. More recently, however, some brokers and lenders have sharply limited the size of the fees and disclosed them. They often appear as one or more line items on the standard HUD-1 settlement sheets used for closings nationwide. *Id.*

40. Jonathan S. Hornbliss, *Focus on Overages Putting Home Lenders In Legal Hot Seat*, *American Banker*, May 24, 1995, p. 10; K. Harney, *U. S. Probes Higher Fees for Women, Minorities*, *Los Angeles Times*, Sept. 24, 1995, p. K4.

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41. *In re Estate of Morys*, 17 Ill.App.3d 6, 9, 307 N.E.2d 669 (1st Dist. 1973).

42. *Wyatt v Union Mtge. Co.*, 24 Cal.3d 773, 782, 157 Cal.Rptr. 392, 397, 598 P.2d 45 (1979); accord: *Pierce v. Hom*, 178 Cal. Rptr. 553, 558 (Ct. App. 1981) (mortgage broker has duty to use his expertise in real estate financing for the benefit of the borrower); *Allabastro v. Cummins*, 90

Ill.App.3d 394, 413 N.E.2d 86, 82 (1st Dist. 1980); *Armstrong v. Republic Rlty. Mgt. Corp.*, 631 F.2d 1344 (8th Cir. 1980); *In re Dukes*, 24 B.R. 404, 411-12 (Bankr. ED Mich. 1982) ("the fiduciary, Salem Mortgage Company, failed to provide the borrower-principal with any sort of estimate as to the ultimate charges until a matter of minutes before the borrower was to enter into the loan agreement"); *Community Fed. Savings v. Reynolds*, 1989 U.S. Dist. LEXIS 10115 (N.D.Ill., Aug. 18, 1989); *Langer v. Haber Mortgages, Ltd.*, *New York Law Journal*, August 2, 1995, p. 21 (N.Y. Sup.Ct.). See also, *Tomaszewski v. McKeon Ford, Inc.*, 240 N.J.Super. 404, 573 A.2d 101 (1990) *Browder v. Hanley Dawson Cadillac Co.*, 62 Ill.App.3d 623, 379 N.E.2d 1206 (1st Dist. 1978) *Fox v. Industrial Cas. Co.*, 98 Ill.App.3d 543, 424 N.E.2d 839 (1st Dist. 1981); *Hlavaty v. Kribs Ford Inc.*, 622 S.W.2d 28 (Mo.App. 1981), and *Spears v. Colonial Bank*, 514 So.2d 814 (Ala. 1987) (Jones, J., concurring), dealing with the duty of a seller of goods or services who undertakes to procure insurance for the purchaser. See generally 12 Am Jur 2d, Brokers, Section 84.

43. *Wyatt v. Union Mtge. Co.*, 24 Cal.3d 773, 782, 157 Cal.Rptr. 392, 397, 598 P.2d 45 (1979).

44. *Brink v. Da Lesio*, 496 F.Supp. 1350 (D.Md. 1980), modified, 667 F.2d 420 (4th Cir. 1981)

45. *Wyatt v Union Mtge. Co.*, 24 Cal.3d 773, 782, 157 Cal.Rptr. 392, 397, 598 P.2d 45 (1979).

46. *Martin v. Heinold Commodities, Inc.* 139 Ill.App.3d 1049, 487 N.E.2d 1098. 1102-03 (1st Dist. 1985), aff'd in part and rev'd in part, 117 Ill.2d 67, 510 N.E.2d 840 (1987), appeal after remand, 240 Ill.App.3d 536, 608 N.E.2d 449 (1st Dist. 1992), aff'd in part and rev'd in part, 163 Ill.2d 33, 643 N.E.2d 734 (1994).

47. An agreement between a seller and an agent for a purchaser whereby an increase in the purchase price was to go to the agent unbeknownst to the purchaser, constitutes fraud. *Kuntz v. Tonnele*, 80 N.J.Eq. 372, 84 A. 624, 626 (Ch. 1912). The buyer may sue both his agent and the seller. *Id.*

48. *Starr v. International Realty, Ltd.*, 271 Or. 296, 533 P.2d 165, 167-8 (1975).

49. *Bunker Ramo Corp. v. United Business Forms, Inc.*, 713 F.2d 1272 (7th Cir. 1983); *Hellenic Lines, Ltd. v. O'Hearn*, 523 F.Supp. 244 (SDNY 1981); *CNBC, Inc. v. Alvarado*, 1994 U.S. Dist. LEXIS 11505 (SDNY 1994). *Shushan v. United States*, 117 F.2d 110, 115 (5th Cir. 1941), *United States v. George*, 477 F.2d 508, 513 (7th Cir. 1973); *Formax, Inc. v. Hostert*, 841 F.2d 388, 390-91 (Fed. Cir. 1988); *United States v. Shamy*, 656 F.2d 951, 957 (4th Cir. 1981); *United States v. Bruno*, 809 F.2d 1097, 1104 (5th Cir. 1987); *United States v. Isaacs*, 493 F.2d 1124, 1150

(7th Cir. 1974); *United States v. Mandel*, 591 F.2d 1347, 1362 (4th Cir. 1979); *United States v. Keane*, 522 F.2d 534, 546 (7th Cir. 1975); *United States v. Barrett*, 505 F.2d 1091, 1104 (7th Cir. 1974); *GLM Corp. v. Klein*, 684 F.Supp. 1242, 1245 (SDNY 1988); *United States v. Procter & Gamble Co.*, 47 F.Supp. 676, 678-79 (D.Mass. 1942); *United States v. Aloï*, 449 F.Supp. 698, 718 (EDNY 1977); *United States v. Fineman*, 434 F.Supp. 189, 195 (EDPa. 1977).

50. U.S.C. Section 2607.

51. *United States v. Graham Mtge. Corp.*, 740 F.2d 414 (6th Cir. 1984).

52. *Durr v. Intercounty Title Co.*, 826 F.Supp. 259, 262 (ND Ill. 1993), *aff'd*, 14 F.3d 1183 (7th Cir. 1994); *Campbell v. Machias Savings Bank*, 865 F.Supp. 26, 31 n. 5 (D.Me. 1994); *Mercado v. Calumet Fed. S. & L. Ass'n*, 763 F.2d 269, 270 (7th Cir. 1985); *Family Fed. S. & L. Ass'n v. Davis*, 172 B.R. 437, 466 (Bankr. DDC 1994); *Adamson v. Alliance Mtge. Co.*, 677 F.Supp. 871 (ED Va. 1987), *aff'd*, 861 F.2d 63 (4th Cir. 1988); *Duggan v. Independent Mtge. Corp.*, 670 F.Supp. 652, 653 (ED Va. 1987).

53. The Alabama Supreme Court described the "table funding" relationship as:

Under this arrangement, the mortgage broker or correspondent lender performs all of the originating functions and closes the loan in the name of the mortgage broker with funds supplied by the mortgage lender. The mortgage broker depends upon "table funding," the simultaneous advance of the loan funds from the mortgage lender to the mortgage broker. Once the loan is closed, the mortgage broker immediately assigns the mortgage to the mortgage lender. The essence of the table funding relationship is that the mortgage broker identifies itself as the creditor on the loan documents even though the mortgage broker is not the source of the funds. (Emphasis added). *Smith v. First Family Financial Services Inc.*, 626 So.2d 1266, 1269 (Ala. 1993).

54. 57 FR 49607, Nov. 2, 1992; 57 FR 56857, Dec. 1, 1992; 59 FR 6515, Feb. 10, 1994.

55. N. 51 *supra*. In conjunction with amending regulation X, the Department of Housing and Urban Development made the following statement regarding the Sixth Circuit's interpretation of RESPA and regulation X: HUD has consistently taken the position that the prohibitions of Section 8 of RESPA (12 U.S.C. 2607) extended to loan referrals. Although the making of a loan is not delineated as a "settlement service" in Section 3(3) of RESPA (12 U.S.C. 2602(3)), it has always been HUD's position, based on the statutory language and the legislative history, that the section 3(3) list was not an inclusive list of all settlement

services and that the origination, processing and funding of a mortgage loan was a settlement service. In *U.S. v. Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984), the Sixth Circuit Court of Appeals stated that HUD's interpretation that the making of a mortgage loan was a part of the settlement business was unclear for purposes of criminal prosecution, and based on the rule of lenity, overturned a previous conviction. In response to the Graham case, HUD decided to amend its regulations to state clear and specifically that the making and processing of a mortgage loan was a settlement service. Accordingly, HUD restates its position unequivocally that the originating, processing, or funding of a mortgage loan is a settlement service in this rule. 57 F.R. 49600 (Nov. 2, 1992).

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56. Table Funding Rebuffed Again, *National Mortgage News*, Feb. 21, 1994, p. 6; HUD May Grant Home Equity Reprieve, *Thomson's International Bank Accountant*, Dec. 13, 1993, p. 4; HUD Wants Expansion of Mortgage Broker Fee Disclosure, *National Mortgage News*, p. 25 (Sept. 14, 1992).

57. Table Funding, Fee Rulings Near, *Banking Attorney*, Dec. 13, 1993, vol. 3, no. 47, p. 5; Table Funding to Be Disclosed, *International Bank Accountant*, Dec. 13, 1993, vol. 93, no. 47, p. 4.

58. The current version of regulation X, 24 C.F.R. Section 3500.14, provides, in part, as follows: Prohibition against kickbacks and unearned fees. (a) Section 8 violation. Any violation of this section is a violation of section 8 of RESPA (12 U.S.C. Section 2607) and is subject to enforcement as such under Section 3500.19(b). . . (b) No referral fees. No person shall give and no person shall accept any fee, kickback, or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a settlement service involving a federal-related mortgage loan shall be referred to any person. (c) No split of charges except for actual services performed. No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally-related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this Part be avoided by creating an arrangement wherein the purchaser of services splits the fee. (Emphasis added)

59. Robert P. Chamness, *Compliance Alert: What Changed the Face of the Mortgage Lending Industry Overnight?*, *ABA Bank Compliance*, Spring 1993, p. 23. Accord, Heather

Timmons, U.S. Said to Plan Crackdown on Referral Fees, *American Banker*, Dec. 20, 1995, p. 10. ("Section 8 [of RESPA] has prompted close scrutiny of back-end points, mortgage fees paid to a broker by the lender after closing. Federal attorneys are concerned that some lenders are improperly hiding referral fees in the rates charged to consumers . . . ."); HEL Lenders May Be Sued on Broker Referrals, *National Mortgage News*, April 3, 1995, p. 11 supra, ("there no longer is any possible justification for paying back-end points . . . [because] the very essence is that the compensation is paid for referral").

60. Mary Sit, *Mortgage Brokers Can Help Borrowers*. *Boston Globe*, Oct. 3, 1993, p. A13; Jeremiah S. Buckley and Joseph M. Kolar, *What RESPA has Wrought: Real Estate Settlement Procedures*, *Savings & Community Banker*, Feb. 1993, vol. 2, no. 2, p. 32.

61. 61 F.R. 7414 (February 28, 1996). See also Kenneth Harney, *Nation's Housing: VA Eyes Home-Loan Abuses*, *Newsday* p. D02 (Mar. 15, 1996). See also See Leonard A. Bernstein, *RESPA Invades Secondary Mortgage Financing*, *New Jersey Lawyer*, Aug. 1, 1994. HUD Stepping Up RESPA Inspections, *American Banker Washington Watch*, May 3, 1993.

62. HEL Lenders May Be Sued on Broker Referrals, *National Mortgage News*, April 3, 1995, p. 11.

63. 95-D-859-N (MD Ala., Mar. 8, 1996),

64. *Fowler v. Equitable Trust Co.*, 141 U.S. 384 (1891); *In re West Counties Construction Co.*, 182 F.2d 729, 731 (7th Cir. 1950) ("Calling the \$ 1,000 payment to Walker a commission did not change the fact that it was an additional charge for making the loan"); *Union Nat'l Bank v. Louisville, N. A & C. R. Co.*, 145 Ill. 208, 223, 34 N.E. 135 (1893) ("There can be no doubt that this payment, though attempted to be disguised under the name of 'commission, was in legal effect an agreement to pay a sum additional to the [lawful rate of interest], as the consideration or compensation for the use of the money borrowed, and is to be regarded as, to all intents and purposes, an agreement for the payment of additional interest"); *North Am. Investors v. Cape San Blas Joint Venture*, 378 So.2d 287 (Fla. 1978); *Feemster v. Schurkman*, 291 So.2d 622 (Fla.App. 1974); *Howes v. Curtis*, 104 Idaho 563, 661 P.2d 729 (1983); *Duckworth v. Bernstein*, 55 Md.App. 710, 466 A.2d 517 (1983); *Coner v Morris S. Berman, Unltd.*, 65 Md.App. 514, 501 A.2d 458 (1985) (violation of state secondary mortgage and finders' fees laws); *Julian v Burrus*, 600 S.W.2d 133 (Mo.App. 1980); *DeLee v. Hicks*, 96 Nev. 462, 611 P.2d 211(1980); *United Mtge. Co. v. Hilldreth*, 93 Nev. 79, 559 P.2d 1186 (1977); *O'Connor v Lamb*, 593 S.W.2d 385 (Tex.Civ.App. 1979) (purported broker was the actual lender); *Terry v. Teachworth*, 431 S.W.2d 918 (Tex.Civ.App.

1968); *Durias v. Boswell*, 58 Wash.App. 100, 791 P.2d 282 (1990) (broker's fee is interest where broker is agent of lender; factors relevant to determining agency include lender's reliance on broker for information concerning creditworthiness of borrower, preparation of documents necessary to close and adequately secure the loan, and performing recordkeeping functions; not relevant whether lender knew of broker's fee, as Washington law provides that where broker acts as agent for both borrower and lender, it is deemed lender's agent for purposes of usury statute); *Sparkman & McLean Income Fund v. Wald*, 10 Wash.App. 765, 520 P.2d 173 (1974); *Payne v Newcomb*, 100 Ill. 611, 616-17 (1881) (where intermediary was agent of lender, fees exacted by the intermediary on borrowers made loans usurious); *Meers v. Stevens*, 106 Ill. 549, 552 (1883) (borrower approaches A for loan, A directs borrower to B, a relative, who makes the loan in the name of A and charges a "commission" for procuring it; court held transaction was an "arrangement to charge usury, and cover it up under the claim of commissions"); *Farrell v. Lincoln Nat'l Bank*, 24 Ill.App.3d 142, 146, 320 N.E.2d 208 (1st Dist. 1974) ("if a fee is paid to a lender's agent for making the loan, with the lender's knowledge, the amount of the fee is treated as interest for the purposes of determining usury").

65. 12 C.F.R. Section 226.4(b)(1), (3).

66. *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244-45 (1972); *Cheshire Mtge. Service, Inc. v. Montes*, 223 Conn. 80, 107, 612 A.2d 1130 (1992) (court found a T.I.L.A. violation to violate the Connecticut Unfair Trade Practices Act because the violation of T.I.L.A. was contrary to its public policy of accurate loan disclosure).

67. 42 U.S.C. Section 3601 et seq.

68. 15 U.S.C. Section 1691 et seq.

69. Consent decree, *United States v. Security State Bank of Pecos*, WD Tex., filed Oct. 18, 1995; consent decree, *United States v. Huntington Mortgage Co.*, ND Ohio, filed Oct. 18, 1995.

70. *Bank Said to Face Justice Enforcement Action, Mortgage Marketplace*, Mar. 25, 1996, v. 6, no. 12, p. 5.

71. M. Hill, *Banks Revise Overage Lending Policies*, *Cleveland Plain Dealer*, July 14, 1994, p. 1C; Jonathan S. Hornblase, *Focus on Overages Putting Home Lenders in Legal Hot Seat*, *American Banker*, May 24, 1995, p. 10; John Schmeltzer, *Lending investigation expands; U.S. wants to know if minorities are paying higher fees*, *Chicago Tribune*, May 19, 1995, Business section, p. 1.

72. 501 F.2d 324, 330-31 (7th Cir. 1974).

73. See also *DuFlambeau v. Stop Treaty Abuse-Wisconsin, Inc.*, 41 F.3d 1190, 1194 (7th Cir. 1994). See *Mescall v. Burrus*, 603 F.2d 1266 (7th Cir. 1979); *Ortega v. Merit Insurance Co.*, 433 F.Supp. 135 (ND Ill. 1977) (plaintiff's allegations that a de facto system of discriminatory credit insurance pricing exists, and that defendant is exploiting this system is sufficient to withstand the defendant's motion to dismiss); *Stackhouse v. DeSitter*, 566 F.Supp. 856, 859 (N.D.Ill. 1983) ("Charging a black buyer an unreasonably high price for a home where a dual housing market exists due to racial segregation also violates this section . . .").

74. John D'Antona Jr., *Lenders requiring more mortgage insurance*, *Pittsburgh Post-Gazette*, Feb. 18, 1996, p. J1.

75. Duff & Phelps Credit Rating Co. report on the private mortgage insurance industry, Dec. 7, 1995. The figure is for 1994.

76. *No Bump in December MI Numbers*, *National Mortgage News*, Feb. 5, 1996, p. 2. The figure is as of the end of 1995.

77. *Charting the Two Paths to Profitability*, *American Banker*, September 13, 1994, p. 11; *Tallying Up Servicing Performance in 1993*, *Mortgage Banking*, June 1994, p. 12.

78. 15 U.S.C. Section 1692 et seq.

79. 1996 U.S. Dist. LEXIS 3430 (MD Fla., Feb. 23, 1996).

80. One who regularly acquires and attempts to enforce consumer obligations that are delinquent at the time of acquisition qualifies as an FDCPA "debt collector" with respect to such obligations. *Kimber v. Federal Fin. Corp.*, 668 F.Supp. 1480, 1485 (M.D. Ala. 1987); *Cirkot v. Diversified Systems*, 839 F.Supp. 941 (D.Conn. 1993); *Coppola v. Connecticut Student Loan Foundation*, 1989 U.S. Dist. LEXIS 3415 (D.Conn. 1989); *Commercial Service of Perry v. Fitzgerald*, 856 P.2d 58 (Colo.App. 1993).

81. The FDCPA defines as a "deceptive" practice -- (2) The false representation of -- (A) the character, amount, or legal status of any debt; or 15 U.S.C. Section 1692e. The FDCPA also prohibits as an "unfair" practice the collection or attempted collection of "any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law." 15 U.S.C. Section 1692f(1).

82. *Bloom v. Martin*, 865 F.Supp. 1377 (ND Cal. 1994), *aff'd*, 77 F.3d 318 (9th Cir., 1996). See also, *Siegel v. American S. & L. Ass'n*, 210 Cal.App.3d 953, 258 Cal.Rptr. 746 (1989); and *Goodman v. Advance Mtge. Corp.*, 34 Ill.App.3d 307, 339 N.E.2d 257 (1st Dist. 1981) (state statute construed to

permit charge for recording release, at least where mortgage is silent).

83. John Lee, John Mancuso and James Walter, Survey: Housing Finance: Major Developments in 1990," 46 Business Lawyer 1149 (May 1991).

84. Nelson and Whitman, Real Estate Finance Law, Section 11.4 at 816.

85. Thrifts Paying Big Bucks for ARM Errors, American Banker -- Bond Buyer, May 23, 1994, p. 8; J. Shiver, Adjustable-Rate Mortgage Mistakes Add Up, Los Angeles Times, Sept. 22, 1991, p. D3.

86. A Call To Arms on ARMs, Business Week, Sept. 6, 1993, p. 72.

87. Hubbard v. Fidelity Fed. Bank, 824 F.Supp. 909 (CD Cal. 1993).

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88. The UCCC has been enacted in Colorado, Idaho, Iowa, Kansas, Maine, Oklahoma, Utah and Wyoming. It imposes the same disclosure obligations as T.I.L.A., but does not cap classwide statutory damages at the lesser of 1 percent of the net worth of the creditor or \$ 500,000.

89. Michaels Building Co. v. Ameritrust Co., N.A., 848 F.2d 674 (6th Cir. 1988); Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384 (7th Cir. 1984); Morosani v. First Nat'l Bank of Atlanta, 703 F.2d 1220 (11th Cir. 1983).

90. Systematic overcharging of consumers in and of itself constitutes an unfair practice violative of state UDAP statutes. Leff v. Olympic Federal, n. 7 supra (overescrowing); People ex rel. Hartigan v. Stianos, 131 Ill.App.3d 575, 475 N.E.2d 1024 (1985) (retailer's practice of charging consumers sales tax in an amount greater than that authorized by law was UDAP violation); Orkin Exterminating Co., 108 F.T.C. 263 (1986), aff'd, 849 F.2d 1354 (11th Cir. 1988) (Orkin entered into form contracts with thousands of consumers to conduct annual pest inspections for a fixed fee and, without authority in the contracts, raised the fees an average of \$ 40).

91. The usury claim is that charging interest at a rate in excess of that agreed upon by the parties is usury. See Howes v. Donart, 104 Idaho 563, 661 P.2d 729 (1983); Garrison v. First Fed. S. & L. Ass'n of South Carolina, 241 Va. 335, 402 S.E.2d 25 (1991). Each of these decisions arose in a state which had "deregulated" interest rates with respect to some or all loans. There was no statutory limit on the rate of interest the parties could agree upon. However, in each case the court held that a lender that charged more

interest than the parties had agreed to violated the usury laws.

92. Barbara Ballman, Citibank mortgage customers due refunds on rate "maladjustments," Capital District Business Review, Apr. 5, 1993, p. 2 (\$ 3.27 million); Israel v. Citibank, N.A. and Citicorp Mortgage, Inc., No. 629470 (St. Louis County (Mo.) Circuit Court); Englard v. Citibank, N.A., Index No. 459/90 (N.Y.C.S.C. 1991).

93. Whitford v. First Nationwide Bank, 147 F.R.D. 135 (W.D.Ky. 1992).

94. "A call to arms on ARMs," Business Week, Sept. 6, 1993, p. 72.

95. Crowley v. Banking Center, 1994 Conn. Super. LEXIS 3026 (Nov. 29, 1994).

96. LeBourgeois v. Firstrust Savings Bank, 27 Phila. 42, 1994 Phila. Cty. Rptr. 15 (CP 1994).

97. Jacob C. Gaffey, Managing the risk of ARM errors, Mortgage Banking, Apr. 1995, p. 73.

98. Preston v. First Bank of Marietta, 16 Ohio App. 3d 4, 473 N.E.2d 1210, 1215 (1983).

99. Baxter v. First Bank of Marietta, 1992 Ohio App. LEXIS 5956 (Nov. 6, 1992).

100. Froland v. Northeast Savings, reported in Lender Liability News, Feb.20, 1996, and American Banker, Jan. 4, 1996, p. 11.

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### **CASE LAW**

#### **Cooper v. First Gov't Mortgage and Investors Corp.**

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#### **Lender's Assignee Who Failed to Show Due Diligence Under Home Ownership and Equity Protection Act Not Entitled to Summary Judgment**

**Cooper v. First Gov't Mortgage and Investors Corp.**, No. 00-0536 (RMU) (D. D.C. June 10, 2003)

The district court, denying a motion for summary judgment filed by defendant assignee of a home mortgage loan, ruled that, to prevail, defendant would have to demonstrate that it could not reasonably have determined that the Home Ownership and Equity Protection Act (HOEPA) governed the loan.

Plaintiff homeowners alleged predatory and fraudulent lending tactics in violation of the Truth in Lending Act (TILA) and HOEPA, as well as District of Columbia statutes. They

contended that, under HOEPA, defendant assignee was liable for all violations asserted against the original lender.

Moving for summary judgment, defendant argued that it was not liable unless “the HOEPA status of the loan [was] apparent on the face of the loan documents to a reasonable person exercising due diligence.” In denying the motion, the court noted defendant’s designee’s “poor understanding of HOEPA” and its failure to convince the court that it had conducted the type of search a reasonable person would undertake.

The court also rejected defendant’s motion for summary judgment on plaintiff’s claim for rescission under TILA. Defendant contended that plaintiff’s written acknowledgment was undisputed evidence that she received the required two copies of the Notice of Right to Cancel form and that, in any event, substantial compliance with TILA was sufficient.

The court said that plaintiff’s testimony was sufficient to meet the “low burden” that TILA plaintiffs faced in overcoming the presumption of delivery and that, since case law favored strict compliance with TILA, substantial compliance was insufficient.

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### **Whitley v. Rhodes**

In re EARLE K. WHITLEY, Debtor; EARLE K. WHITLEY, Plaintiff v. RHODES FINANCIAL SERVICES, INC., Defendant

Chapter 13, Case No. 93-19652-JNF, Adv. P. No. 94-1008

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MASSACHUSETTS

January 24, 1995, Decided  
January 24, 1995, Filed

Counsel: JOHN RODDY, ESQ. OF GRANT & RODDY, BOSTON, MA, for DEBTOR.

KEVIN J. SIMARD, ESQ., RIEMER & BRAUNSTEIN, BOSTON, MA, COUNSEL TO CHAPTER 7 TRUSTEE IN RHODES FINANCIAL SERVICES.

ERNEST L. SARASON, JR., ESQ., ASSISTANT ATTORNEY GENERAL - CONSUMER DIVISION, BOSTON, MA, for COMMONWEALTH OF MASSACHUSETTS.

Judges: Joan N. Feeney, United States Bankruptcy Judge

Author of opinion: Joan N. Feeney

## MEMORANDUM

### I. PROCEDURAL BACKGROUND

The matter before the Court is the Motion for Partial Summary Judgment filed by the Plaintiff, Chapter 13 Debtor Earle K. Whitley (the "Plaintiff" or the "Debtor"), in his

adversary proceeding against Rhodes Financial Services, Inc. (the "Defendant" or "Rhodes"), which adversary proceeding was filed on January 6, 1994. In addition to seeking damages and a determination that he validly rescinded the mortgage held by Rhodes, the Debtor sought a preliminary injunction against Rhodes to restrain it from refusing to honor his valid rescission. After notice and a hearing, this Court entered an order dated January 14, 1994, granting the Debtor's request for a preliminary injunction, ordering Rhodes to deliver a discharge of the mortgage it held on the Debtor's home, and requiring counsel to the Debtor and the Defendant to hold the sum of \$ 35,000.00 in a joint escrow account pending a decision on the merits of the adversary complaint.

In response to the Court's order, Rhodes filed a notice of appeal, a motion for leave to appeal and a motion for a stay pending appeal. Prior to a hearing on the motion for a stay pending appeal, the parties, on February 18, 1994, filed a stipulation in which Rhodes agreed to discharge its mortgage on the Debtor's property located at 23 Jacob Street, Dorchester, Massachusetts and to withdraw its motion for leave to appeal. The parties also agreed that the Debtor would execute and deliver to Rhodes a mortgage in the amount of \$ 45,000.00 for recordation and that they would establish an escrow account for net proceeds from the Debtor's refinancing with US Trust, which was anticipated at the time the stipulation was executed.

Rhodes failed to answer the Debtor's adversary complaint. It filed a voluntary petition under Chapter 7 on April 7, 1994, and Stephen Gray ("Gray") was appointed Chapter 7 Trustee. On July 20, 1994, the Debtor moved for relief from the automatic stay in the Rhodes case to continue the prosecution of his adversary proceeding. Rhodes' Chapter 7 Trustee assented to the motion. On August 11, 1994, Gray filed an answer to the Plaintiff's complaint.

On September 7, 1994, the Debtor moved for partial summary judgment against the Rhodes Chapter 7 estate under the federal Truth in Lending Act, *15 U.S.C.A. §§ 1601-1646* (West 1982 & Supp. 1994) ("TILA"), and the Massachusetts Consumer Credit Cost Disclosure Act, Mass. Gen. Laws Ann. Ch. 140D, § § 1-34 (West 1991 & Supp. 1994) ("CCCDA"), arguing that the following charges which Rhodes required the Debtor to pay were conditions of closing the loan and were undisclosed finance charges as defined by TILA and CCCDA:

1. a \$ 2,954.00 brokerage commission to The Money Tree, Inc., a mortgage broker that shared Rhodes' address and was managed by the brother of Rhodes' president and sole shareholder;
2. a \$ 25.00 fee to purchase an amortization schedule for a non-amortizing loan;
3. a \$ 10.00 fee to record an assignment of the mortgage to a third party;
4. a \$ 50.00 fee for updating the title even though Rhodes charged a \$ 250 fee for a full title examination;
5. a portion of the above \$ 50.00 fee to record documents even though Rhodes separately imposed itemized fees which fully covered its recording costs.

Gray, on behalf of the Rhodes estate, responded to the motion for partial summary judgment, disputing that the five charges outlined by the Debtor were undisclosed finance charges. The Trustee relied in part on the affidavit of Cheryl White, Rhodes's president and sole shareholder, which affidavit was filed in conjunction with Rhodes's opposition to the Debtor's request for a preliminary injunction.

On November 7, 1994, the Court heard the motion for partial summary judgment, as well as the Plaintiff's motion to strike certain portions of the affidavit of Cheryl White. During the course of the hearing, the Court granted the Plaintiff's motion to strike the portion of White's affidavit in which she stated that Rhodes never required the use of The Money Tree or any other broker in connection with making loans and that Rhodes did not require the Debtor to use The Money Tree as a broker. The Court found the following arguments made by the Debtor to be meritorious: 1) that the November 6, 1990 letter from Ms. White to Mr. Whitley, in which Ms. White outlined the "highlights" of the loan, including a broker's fee of approximately \$ 3,000.00, and legal fees of approximately \$ 1,500.00, constituted an offer that was accepted by the Debtor; 2) that the "highlights" set forth in the offer were in fact conditions for making the loan; and 3) that as a result of the parol evidence rule the affidavit could not be used to contradict the terms of the contract that resulted from the Debtor's acceptance of Rhodes's offer.

As a result of the Court's ruling, Gray's counsel conceded that a violation of TILA (and concomitantly CCCDA) had occurred, and the focus of the hearing shifted to the remedies available to the Debtor. At the conclusion of the hearing, the Court granted the Plaintiff leave to amend his complaint to detail actual damage claims and ordered the parties to file supplemental memoranda of law.

## II. FACTS

The following facts are undisputed. The Debtor has resided at 23 Jacob Street, Dorchester, Massachusetts with his family of six for the past 16 years. In the fall of 1990, he responded to an advertisement and applied to The Money Tree for a second mortgage on his home. The Money Tree submitted his application to Rhodes and, on November 6, 1990, Ms. White, on behalf of Rhodes, wrote to the Debtor, stating the following:

We have tentatively approved your loan; however, it is important you understand certain terms and conditions that will apply, and may influence your decision in accepting our loan....

The following are the highlights of your loan:

1. Gross amount of loan: \$ 32,000.00.
2. Term of loan: 2 years, interest only.
3. Interest rate: Initial rate 16% per annum, then adjustable periodically to prime rate plus 10% per annum, not less than 18% per annum.
4. Origination fee to Rhodes (1%): \$ 320.00.
5. Buydown (non-refundable): \$ 3,000.00.
6. Broker fee (to The Money Tree): \$ 3,000.00.
7. Legal fees (approximately): \$ 1,500.00.
8. Resulting A.P.R. (as prepared): 27%.

The Debtor did not sign any loan brokerage or commission agreement with The Money Tree at any time prior to the loan closing, which took place on November 29, 1990. On

that date, Rhodes, a creditor as defined in *15 U.S.C. § 1602(f)* and *M.G.L. c. 140D, § 1*, loaned the Debtor \$ 31,000.00, secured by a second mortgage on his Dorchester home.

At the closing, the Debtor signed documents entitled "Disclosure Statement" and "Loan Accounting and Disbursement Authorization." The Disclosure Statement set forth, among other things, an annual percentage rate of 26.25759%, a finance charge of \$ 15,710.69, an amount financed of \$ 27,543.77, and a total of payments of \$ 43,254.46. The Loan Accounting and Disbursement Authorization set forth the following:

RECEIPTS:

Rhodes Financial Services, Inc.	
-Initial Disbursement	\$ 31,000.00

PROJECTED APPLICATION AND DISBURSEMENT OF LOAN PROCEEDS:

LOAN ORIGINATION FEE	
TO: Rhodes Financial Services, Inc.	310.00
ODD DAYS INTEREST	
TO: Rhodes Financial Services, Inc.	165.23
ATTORNEY'S FEE	
TO: Stuart H. Sojcher, Esq.	1,040.00
FULL TITLE EXAMINATION	
TO: Alan H. Rosenbaum, Esq.	250.00
UPDATING OF TITLE; RECORDING OF DOCUMENTS	
TO: Alan H. Rosenbaum, Esq.	50.00
CONTRACT INTEREST RATE BUYDOWN (NON-REFUNDABLE)	
TO: Rhodes Financial Services, Inc.	2,981.00
DOCUMENT PREPARATION	
TO: Stuart H. Sojcher, Esq.	195.00
APPRAISAL FEE	
TO: (\$ 250.00 P.O.C.)	N/A
MUNICIPAL LIEN CERTIFICATE	25.00
RECORDING FEES	
-Mortgage	25.00
-Assignment of Mortgage	10.00
-Discharge of Mortgage and Liens	N/A
FINANCIAL CONSULTANT	
TO: The Money Tree, Inc.	2,954.00
TITLE INSURANCE (Lenders and Borrowers)	
TO: Lawyers Title Insurance Company	150.00
AMORTIZATION SCHEDULES	
TO: Stuart H. Sojcher, Esq.	25.00
COURIER/HANDLING FEES:	30.00
WATER/SEWER TAXES	
TO: City of Boston	3,813.16
REAL ESTATE TAXES	
TO:	N/A
HOMEOWNER'S INSURANCE	
TO: MacIntyre, Fay & Thayer	452.00
PAYOFF SECOND MORTGAGE	
TO: 1st American (FDIC)	7,000.00
PAYOFF	
TO: U.S.Trust (Windows)	4,599.29
PAYOFF	

TO: Boston Edison	981.29
PAYOFF	
TO: Boston Gas	564.18
CHECK(S) TO BORROWER(S)	
TO: Earl K. Whitley	5,379.85
TOTAL DISBURSEMENTS	\$
	31,000.00

On November 30, 1990, Rhodes recorded its mortgage on the Debtor's home. On December 27, 1990, Rhodes assigned its mortgage to Randal Mortgage Corp.

In mid-summer of 1992, with the two year balloon payment coming due, the Plaintiff approached Rhodes seeking to convert the short-term loan to a long-term loan. Rhodes informed the Debtor that it would not make such a loan even though he had regularly made all his payments.

On January 22, 1993, the Debtor, through his counsel, in a letter addressed to "Rhodes Financial, Inc." at the correct address in Natick, Massachusetts, informed Rhodes that he wished to rescind the loan. n1 On February 11, 1993, Rhodes replied to the letter, through counsel, stating "although we are substantively responding to your January 22, 1993 letter, we do not concede that it is proper notification under Massachusetts General laws, Chapter 140D.

n1Although the letter was addressed to Rhodes Financial, Inc., counsel in the first sentence of his letter, represented that he was representing "a Rhodes Financial Services, Inc. mortgagor."

In May of 1993, the Plaintiff was selected in a lottery held by US Trust as a prospective recipient of refinancing monies to be used to save his home. On August 12, 1993, US Trust issued a loan commitment to the Plaintiff for \$ 45,000.00, a sum sufficient to pay off the first mortgage and the principal amount of Rhodes's second mortgage. The loan closing was scheduled to take place on October 20, 1993. The closing did not take place, however, because Rhodes demanded \$ 41,965.91, as well as a release of the Plaintiff's claims against Rhodes. Thereafter, Rhodes took steps to foreclose its mortgage. The Debtor filed a voluntary petition under Chapter 13 of the Bankruptcy Code on October 27, 1993 to forestall a foreclosure sale.

### III. SUMMARY JUDGMENT STANDARDS

The Debtor is entitled to summary judgment if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." See Fed. R. Civ. P. 56(c), made applicable to this proceeding by Fed. R. Bankr. P. 7056.

### IV. STATUTORY PROVISIONS

Section 1635 of TILA provides in relevant part the following:

(a) Except as otherwise provided in this section, in the case of any consumer credit transaction ... in which a security interest ... is or will be retained or acquired in any property which is used as the principal dwelling of the person to whom credit is extended, the obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of the

information and rescission forms required under this section together with a statement containing the material disclosures required under this subchapter, whichever is later, by notifying the creditor, in accordance with regulations of the Board, of his intention to do so....

(b) When an obligor exercises his right to rescind under subsection (a) of this section, he is not liable for any finance or other charge, and any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such rescission. Within 20 days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, downpayment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value. Tender shall be made at the location of the property or at the residence of the obligor, at the option of the obligor. If the creditor does not take possession of the property within 20 days after tender by the obligor, ownership of the property vests in the obligor without obligation on his part to pay for it. The procedures prescribed by this subsection shall apply except when otherwise ordered by the court....

(f) An obligor's right of rescission shall expire three years after the date of consummation of the transaction or upon the sale of the property, whichever occurs first....

(g) In any action in which it is determined that a creditor has violated this section, in addition to rescission the court may award relief under section 1640 of this title for violations of this subchapter not relating to the right to rescind.

*15 U.S.C. § 1635.* Section 1640 provides in relevant part the following:

(a) Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this part, including any requirement under section 1635 of this title or part D or E of this subchapter with respect to any person is liable to such person in an amount equal to the sum of-

(1) any actual damage sustained by such person as a result of the failure;

(2)(A)(i) in the case of an individual action twice the amount of any finance charge in connection with the transaction, ... except that the liability under this subparagraph shall not be less than \$ 100 nor greater than \$ 1,000 ...; and

(3) in the case of any successful action to enforce the foregoing liability or in any action in which a person is determined to have a right of rescission under section 1635 of this title, the costs of the action, together with a reasonable attorney's fee as determined by the court.

(e) Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation....

*15 U.S.C. § 1640.* CCCDA provisions parallel those of TILA, and, accordingly, "should be construed in accordance with federal law." *Mayo v. Key Financial Services, Inc.*, No. 92-6441-D, slip op. at 6-7 (Superior Court June 22, 1994). Moreover, the regulations

promulgated under TILA and CCCDA are substantially similar as well. The only differences are with respect to the statutes of limitation for rescission and damage claims. Under the CCCDA, an obligor has four years to rescind and four years, rather than one year, to institute an action for damages. Compare M.G.L. c. 140D, § § 10, 32 with 15 U.S.C. § § 1635(f), 1640(e). As United States Bankruptcy Judge Hillman noted in *Myers v. Federal Home Loan Mortgage Co. (In re Myers)*, 175 Bankr. 122, 1876, 7, (Bankr. D. Massachusetts 1994), the Federal Reserve Board has determined that "credit transactions subject to the Massachusetts Truth in Lending Act are exempt from chapters 2 and 4 of the Federal act", except with respect to certain creditors that are federally chartered institutions. See 48 Fed. Reg. 14882, 14890 (April 6, 1983). Accordingly, for purposes of resolving the instant dispute, the only material difference between state and federal law is the limitation period for rescission and damages claims. Since the Debtor filed his adversary proceeding within four years of the November 29, 1990 loan closing, his rescission and damage claims are timely under Massachusetts law.

## V. DISCUSSION

### A. THE TILA AND CCCDA VIOLATIONS

The Debtor maintains that Rhodes required him to pay a brokerage commission to The Money Tree as a term and condition of the loan and Rhodes's failure to disclose this fee as a finance charge violated TILA and CCCDA. Regulation Z, a regulation issued by the Board of Governors of the Federal Reserve System to implement the Truth in Lending Act, defines the term finance charge as "... the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." 12 C.F.R. § 226.4(a). The Official Staff Commentary to Regulation Z promulgated by the Board further provides that "charges imposed on the consumer by someone other than the creditor for services not required by the creditor are not finance charges, as long as the creditor does not retain the charges." Regulation Z, Supplement I-Official Staff Interpretations, 12 C.F.R. § 226.4(a)(3) (1991). Moreover, charges which are bona fide and reasonable in amount may be excluded if they relate to any one of the following:

- (i) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes.
- (ii) Fees for preparing deeds, mortgages, and reconveyance, settlement, and similar documents.
- (iii) Notary, appraisal, and credit report fees.
- (iv) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

Regulation Z, 12 C.F.R. § 226.4(c)(7).

According to the Debtor, since brokers' fees are not contained in any of the exclusions of Regulation Z with respect to finance charges, they constitute a finance charge. The Trustee argues that Rhodes did not require the Debtor to use the services of The Money Tree, relying upon the affidavit of Ms. White. Since the Court determined on November 7, 1994 that Rhodes cannot rely upon that affidavit as a result of the parol evidence rule, see *Thomas V. Christensen*, 12 Mass. App. Ct. 169, 176, 422 N.E.2d 472 (1981); *Trustees of Tufts College v. Parlane Sportsware Co., Inc.*, 4 Mass. App. Ct. 783,

342 N.E.2d 727 (1976); see also *Baker v. Rapport*, 453 F.2d 1141 (1st Cir. 1972); *Wier v. Texas Co.*, 79 F. Supp. 299 (W.D. La. 1948), aff'd, 180 F.2d 465 (1950), the Court finds that Rhodes required the services of The Money Tree and \$ 2,954.00 should have been disclosed as part of the finance charge.

Rhodes also required the services of attorneys. Attorneys' fees for preparing deeds, mortgages, settlement sheets and similar documents are excluded from the finance charge. Likewise, fees for title examinations are excluded. However, these fees must be "bona fide and reasonable in amount." Regulation Z, 12 C.F.R. § 226.4(c)(7). The Court finds that the \$ 25.00 charge for the preparation of an amortization schedule for a non-amortizing loan was an unreasonable, indeed an egregious, fee that should have been included in the finance charge.

The \$ 10.00 recordation fee for Rhodes's assignment of the mortgage to Randal Mortgage Corporation is not a charge that can be excluded from the finance charge as it pertained to a separate transaction that did not involve the Debtor. Regulation Z provides in relevant part that "the finance charge includes ... charges imposed on a creditor by another person for purchasing or accepting a consumer's obligation, if the consumer is required to pay the charges in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation." See 12 C.F.R. § 226.4(b)(6). Pursuant to the plain language of the state and federal regulations, the future assignment fee was not excludable from the finance charge and resulted in the finance charge being understated. See *Mayo v. Key Financial Services, Inc.* No 92-6441-D, slip op. at 6-7 (Superior Court June 22, 1994), citing *In re Brown*, 106 Bankr. 852, 858-59 (Bankr. E.D. Pa. 1989); *Cheshire Mortgage Service, Inc. v. Montes*, 223 Conn. 80, 100-101, 612 A.2d 1130 (1992).

The Debtor objects to the \$ 50.00 lump sum charge for updating the title and recording documents, citing the Commentary to Regulation Z, which provides: "If a lump sum is charged for several services and includes a charge that is not excludable from the finance charge under Regulation Z, § 226.4(c)(7), a portion of the total should be allocated to that service and included in the finance charge." The Debtor maintains that a charge for updating the title is unreasonable because he was also charged \$ 250.00 for a "full" title examination and any portion of the same \$ 50.00 charge relating to recording documents cannot be excluded from the finance charge because Rhodes separately charged for all compensable recording fees.

The Trustee responds with the observation that the \$ 50.00 lump sum charge related to attorney's fees for a title update, which he maintains was prudent in view of the Debtor's financial history, and to time actually spent transporting documents to the Registry for recordation. From the existing record, the Court is unable to determine whether a portion of the \$ 50.00 was spent on actual recording fees, in which case that portion would be part of the finance charge, as only the second mortgage itself was recorded for a \$ 25.00 fee, or whether all of or only a portion of the charge was for attorney's fees. The Court also has no evidence as to what customary and reasonable attorney's fees were in 1990 with respect to full title examinations and whether there was anything unusual or complicated about the state of the Debtor's title that would warrant additional attorney time. Accordingly, based upon the existing record, the Court cannot find that this \$ 50.00 charge was an undisclosed finance charge and that a material misrepresentation of the finance charge occurred because of Rhodes's treatment of this charge.

In view of the foregoing discussion, the Court grants the Debtor's Motion for Partial Summary Judgment in so far as it seeks a determination that \$ 2,989.00 of the sums disbursed at the closing constituted undisclosed finance charges.

## B. RIGHT TO RESCIND AND DAMAGES

### 1. The Amended Complaint

In his Amended Complaint, the Debtor seeks the following forms of relief: 1) a declaration that the Plaintiff validly rescinded the transaction, that the Defendant's security interest is void and the Defendant's secured claim is disallowed; 2) a declaration that the Defendant's failure to honor the Plaintiff's valid rescission notice in accordance with the dictates of *15 U.S.C. § 1635* and M.G.L. c. 140D, § 10 vests in the Plaintiff the right to retain the net loan proceeds and that the Defendant has no allowable unsecured claim; 3) an order requiring the discharge of the second mortgage; 4) an order requiring the Defendant to refund to the Plaintiff all money paid to the Defendant in connection with the transaction; 5) an award of \$ 1,000.00 in statutory damages for the Defendant's failure to comply with *15 U.S.C. § 1638* and M.G.L. c. 140D, § 12, and an award of an additional \$ 1,000.00 in statutory damages for the Defendant's failure to comply with *15 U.S.C. § 1635(b)* and M.G.L. c. 140D, § 10(b); 6) actual damages; and 7) reasonable attorney's fees and costs.

### 2. Positions of the Parties

#### a. The Debtor

The Debtor relies upon the plain language of Regulation Z, which sets forth the effects of rescission as follows:

- (1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge.
- (2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.
- (3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value.... Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.
- (4) The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order.

Regulation z, 12 C.F.R. § 226.23(d)(1)-(4). See also *15 U.S.C. § 1635(b)* and M.G.L. c. 140D, § 10(b).

The Debtor, relying upon *Myers v. Federal Home Loan Mortgage Co. (In re Myers)*, 175 *Bankr. 122, 1876 (Bankr. D. Mass. 1994)*, and cases cited therein, argues that

Rhodes's security interest was void upon receipt of the rescission notice, and this effect of rescission cannot be conditioned or modified by the Court. Accordingly, the Debtor argues that, at best, Rhodes's Chapter 7 estate has an unsecured claim against the Debtor's estate. Additionally, he argues that pursuant to either section 1635(b) of TILA or section 10(b) of CCCDA and the applicable state and federal regulations, Rhodes forfeited its right to the return of any of the loan proceeds. In other words, the Debtor maintains 1) that he had no obligation to tender because Rhodes, after receipt of the notice of rescission, failed to return to him "any money or property given as earnest money or down payment;" and 2) that he did indeed "tender" \$ 31,000.00 to Rhodes, which tender was refused.

The Debtor also argues that this Court should use its modification powers to vest the loan proceeds in him, even if the Court were to rule that the proceeds of the Rhodes loan have not explicitly vested in him due to Rhodes' failure to accept tender (or, as this Court observes, because the Debtor did not actually tender the proceeds to Rhodes at its usual place of business in conformance with Regulation Z). The Debtor emphasizes Rhodes's predatory lending practices set forth in the amicus brief filed by the Commonwealth.

Finally, the Debtor seeks the full panoply of damages available to him under TILA and CCCDA. n2 In particular, the Debtor seeks actual damages consisting of an unspecified amount of interest that he was compelled to pay US Trust on the additional funds he was forced to borrow and place into escrow because of Rhodes' actions and undisclosed finance charges which this Court has determined to be \$ 2,989.00. He also seeks a second statutory damage award in the amount of \$ 1,000.00, citing *Aquino v. Public Finance Consumer Discount Co.*, 606 F. Supp. 504 (E.D. Pa. 1985), as well as unspecified costs and attorney's fees. See also *In re Michel*, 140 Bankr. 92, 101 (Bankr. E.D. Pa. 1992) (\$ 1,000.00 awarded to debtors for lender's refusal to honor valid rescission, plus reasonable attorney's fees pursuant to 15 U.S.C. § 1640(a)(3)).

n2 As the court recognized in Myers, slip op. at 8, unlike TILA, the CCCDA does not have a one year statute of limitations for damage claims.

#### b. Chapter 7 Trustee of the Rhodes Estate

The Trustee's position is succinctly stated in his memorandum as follows:

In this case, the equities clearly favor allowing the Trustee to maintain at least an unsecured claim against the Plaintiff's Estate. This is not a proper case to force compliance with TILA's requirements or provide an incentive for a creditor to comply with TILA. In this case, Rhodes has already filed bankruptcy, thus, any of the remedial and punitive policies of TILA will have no impact on Rhode's [sic]future lending policies. Rather, the harsh remedies will only harm other creditors of Rhodes. If this Court is to allow rescission, it should condition the rescission on the Plaintiff returning all proceeds he received from the loan to the Trustee or, alternatively, allowing the Trustee an unsecured claim against the Plaintiff's Estate.

Supplemental Memorandum in Support of Trustee's Opposition to Plaintiff's Motion for Partial Summary Judgment. The Trustee's position is not without support. See, e.g., *Williams v. Homestake Mortgage Co.*, 968 F.2d 1137 (11th Cir. 1992); *Brown v. Nat'l Permanent Fed. Sav. & Loan Ass'n*, 221 U.S. App. D.C. 125, 683 F.2d 444 (D.C. Cir. 1982); *Powers v. Sims and Levin*, 542 F.2d 1216 (4th Cir. 1976); *New Maine Nat'l Bank v. Gendron*, 780 F. Supp. 52 (D. Me. 1991); *In re Lynch*, 170 Bankr. 26 (Bankr. D. Me. 1994); *In re Cox*, 162 Bankr. 191 (Bankr. C.D. Ill. 1993); *In re Foster*, 105 Bankr. 67 (Bankr. N.D. Okla. 1989).

### C. ANALYSIS

In *Homestake*, a case relied upon by the Maine Bankruptcy Court in *Lynch*, the Court of Appeals for the Eleventh Circuit considered 15 U.S.C. § 1635 (b) and 12 C.F.R. § 226.23(d)(1)-(4), while recognizing that "the sequence of rescission and tender set forth in § 1635(b) is a reordering of common law rules governing rescission. It noted the following:

Under common law rescission, the rescinding party must first tender the property that he has received under the agreement before the contract may be considered void. Once the rescinding party has performed his obligations, the contract becomes void and the rescinding party may then bring an action in replevin or assumpsit to insure that the non-rescinding party will restore him to the position that he was in prior to entering into the agreement, i.e., return earnest money or monthly payments and void all security interests. Under § 1635(b), however, all that the consumer need do is notify the creditor of his intent to rescind. The agreement is then automatically rescinded and the creditor must, ordinarily, tender first. Thus, rescission under § 1635 'place[s] the consumer in a much stronger bargaining position than he enjoys under the traditional rules of rescission.' Furthermore, because rescission is such a painless remedy under the statute [placing all burdens on the creditor], it acts as an important enforcement tool, insuring creditor compliance with TILA's disclosure requirements.

Though one goal of the statutory rescission process is to place the consumer in a much stronger bargaining position, another goal of § 1635(b) is to return the parties most nearly to the position they held prior to entering into the transaction. The addition of the last sentence of § 1635(b), stating that 'the procedures prescribed by this subsection shall apply except when otherwise ordered by the court,' was added by the Truth in Lending Simplification and Reform Act ... and is a reflection of this equitable goal.

*Id.* The court, while citing *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565, 63 L. Ed. 2d 22, 100 S. Ct. 790 (1980), then considered and rejected the obligor's argument that the Federal Reserve Board Staff Interpretations construing TILA and Regulation Z should be dispositive. It stated the following:

[The obligor] reads this section of the regulations to mean that 'the court modification provision in subsection (d)(4) applies only to subsections (d)(2) and (d)(3) and does not apply to the first step of the rescission process, given in subsection (d)(1). ... Thus, according to Williams [the obligor], the voiding of the creditor's security interest, which Williams argues is guaranteed by the mandate of subsection (d)(1), may not be conditioned on the consumer's tender. Although this is technically correct, it is not a realistic recognition of the full scope of the statutory scheme....

Where 'the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.' In this instance, Congress, through its legislative history, has made it quite clear that 'the courts, at any time during the rescission process, may impose equitable conditions to insure that the consumer meets his obligations after the creditor has performed his obligations as required by the act.' Furthermore, the plain language of § 1635(b) leaves little room for narrowing the court's ability to modify the process of effecting rescission, as Congress' grant of authority covers all 'procedures prescribed by [the] subsection.' Thus, we hold that a court may impose conditions that run with the voiding of a creditor's security interest upon terms that would be equitable and just to the parties in view of all surrounding circumstances.

Id. at 1141-42 (citations omitted, footnote omitted). Thus, the Court of Appeals for the Eleventh Circuit concluded that TILA as amended gives courts the authority to restructure loans in ways that could range from ordering the immediate return of the full principal to leaving the creditor with its state law rights to requiring the execution of substitute security instruments based upon such considerations as the severity of the TILA violations and the creditor's ability to repay. Id. at 1142 n.9.

The legislative history of TILA indicates that "a court is authorized to modify this section's [section 1635(b)]procedures where appropriate", see S.Rep No. 96-368, 96th Cong., 1st Sess. 29 (1979), reprinted in 1980 U.S. Code Cong. & Ad. News 236, 264-65 (emphasis supplied). Regulation Z, which regulation the United States Supreme Court has determined to be dispositive unless "demonstrably irrational," *Milhollin*, 444 U.S. at 556, was effective in April of 1981 and amended in March of 1982, after the enactment of the Truth in Lending Simplification and Reform Act. It breaks down the provisions of section 1635(b) into four parts, only two of which are subject to the discretion of courts. Courts following the reasoning of *Homestake* reject the import of Regulation Z to the extent that it purports to limit the discretion courts have to condition or modify the effect of a customer's notice of rescission, namely the voiding of any security interest.

This Court need not decide whether it lacks the ability to condition rescission on a customer's tender because in this case the Court chooses not to condition rescission and to follow the position espoused by the court in *Myers*: "rescission by an obligor is not conditioned by tender or payment in the context of a bankruptcy case." *Myers*, slip op at 13. Cf. *In re Holland*, No.93-19496-JNF, 2133 (Bankr. D. Mass. December 21, 1994).

In *Myers*, Bankruptcy Judge Hillman adopted the reasoning advanced by the district court in *In re Celona*, 98 Bankr. 705, 707 (E.D. Pa. 1989), a case in which the court stated that "[j]udicial preconditioning of cancellation of the creditor's lien on the customer's tender is inappropriate in bankruptcy cases." This Court can conceive of circumstances where the statutory right to rescind might be conditioned upon an obligor's tender based upon equitable considerations, in which case a determination as to whether the effect of a rescission notice is a substantive right not subject to discretionary action or a procedural step subject to the last sentence of section 1635(b); however, this case is not one of them. n3 As the court stated in *Aquino v. Public Fin. Consumer Discount Co.*, 606 F. Supp. 504 (E.D. Pa. 1985), "courts in their effort to insure a just result should not forget that the TILA 'was passed primarily to aid the unsophisticated consumer'" and that it was "'intended to balance scales thought to be weighted in favor of lenders and ... to be liberally construed in favor of borrowers.'" *Id.* at 509, citing *Thomka v. A.Z. Chevrolet, Inc.*, 619 F.2d 246, 248 (3d Cir. 1980), and *Bizier v. Globe Financial Services, Inc.*, 654 F.2d 1, 3 (1st Cir. 1981).

n3 The Court notes and it is undisputed that the Commonwealth of Massachusetts, through the Attorney General, commenced an action against Rhodes, The Money Tree and Randolph Lee White, II, alleging that they engaged in unfair and deceptive lending and brokerage practices and preyed on unsophisticated Massachusetts consumers.

The Court finds that the Debtor's notice of rescission was valid (the omission of the words "Services" in the address preceding the salutation was harmless as Rhodes was correctly identified in the first sentence of the rescission letter). Accordingly, upon receipt of the notice, the mortgage was void, and Rhodes's claim became an unsecured claim. See Regulation Z, 12 C.F.R. § 226.23(d)(1). Since the rescission notice was transmitted to Rhodes approximately nine months prior to the bankruptcy filing, Rhodes had at best an unsecured claim on the petition date. The Court takes judicial notice that Rhodes was listed as a creditor on the Debtor's schedules and matrix and received notice

of the section 341 meeting of creditors, as well as the March 21, 1994 deadline for filing proofs of claim. Rhodes did not file a proof of claim. Accordingly, the Trustee's unsecured claim against the Debtor is disallowed pursuant to *11 U.S.C. § 502*. See also Fed. R. Bankr. P. 3002(c).

## VI. CONCLUSION

In accordance with the foregoing, the Court grants the Debtor's Motion for Partial Summary Judgment. The Court finds that the Debtor shall have an unsecured claim against the Rhodes estate comprised of the following: 1) statutory damages in the amount of \$ 2,000.00, see M.G.L. c. 140D, § 32(a)(2)(a) (\$ 1,000.00 for material nondisclosures and \$ 1,000.00 for failure to honor the valid rescission notice); and 2) actual damages in the amount of costs equal to the amount of interest paid on the sum borrowed from US Trust and costs and reasonable attorney's fees incurred in conjunction with the TILA and CCCDA violations, Id. § 32(a)(3). The Court also finds that the Debtor is entitled to an unsecured claim against the Rhodes's estate equal to the amount of money he paid during the two years the loan was in good standing, an amount he estimates at approximately \$ 18,000. n4

n4 Rhodes's Trustee would at most have an unsecured claim against the Debtor's estate in the amount of \$ 22,789.77, representing the proceeds which the Debtor had at his disposal following the closing (\$ 5,379.85) plus the total amount of proceeds used to procure insurance and to satisfy outstanding obligations owed by the Debtor at the time of the closing. Even assuming Rhodes's Trustee were to obtain an allowed claim against the Debtor's estate, its only effect would be to delimit the Debtor's unsecured claim against the Rhodes estate, since the Debtor's claim against the Rhodes estate likely will exceed any claim the Trustee would have against the Debtor as attorney's fees and costs are likely to exceed \$ 3,000.00.

The Court hereby orders the Debtor and his attorney to file the following within 20 days of the date of this order: 1) a statement indicating the precise amount of payments made by the Debtor to Rhodes prior to the filing of his Chapter 13 petition; 2) a statement as to the interest paid by the Debtor on account of monies borrowed from US Trust; and 3) a fee application in conformance with Local Rule 34.

By the Court,

Joan N. Feeney

United States Bankruptcy Judge

Dated: January 24, 1995

## ORDER

In accordance with the Memorandum dated January 24, 1995, the Court grants the Debtor's Motion for Partial Summary Judgment. The Court finds that the Debtor shall have an unsecured claim against the Chapter 7 estate of Rhodes Financial Services, Inc. comprised of the following: 1) statutory damages in the amount of \$ 2,000.00, see Mass. Gen. Laws Ann. Ch. 140D, § 32(a)(2)(a) (West 1991 & Supp 1994) (\$ 1,000.00 for material nondisclosures and \$ 1,000.00 for failure to honor the valid rescission notice); and 2) actual damages in the amount of costs equal to the amount of interest paid on the sum borrowed from US Trust and costs and reasonable attorney's fees incurred in conjunction with violations of the Massachusetts truth in lending law, Id. § 32(a)(3). The

Court also finds that the Debtor is entitled to an unsecured claim against the estate of Rhodes Financial Services, Inc. equal to the amount of money he paid during the two years the loan was in good standing, an amount he estimates at approximately \$ 18,000. The Court hereby orders the Debtor and his attorney to file the following within 20 days of the date of this order: 1) a statement indicating the precise amount of payments made by the Debtor to Rhodes Financial Services, Inc. prior to the filing of his Chapter 13 petition; 2) a statement as to the interest paid by the Debtor on account of monies borrowed from US Trust; and 3) a fee application itemizing legal services rendered in conformance with Local Rule 34.

By the Court,

Joan N. Feeney

United States Bankruptcy Judge

Dated: January 24, 1995

**BACK TO TOP**

**Maxwell v. Fairbanks**

**VICTORY IN PREDATORY LENDING CASE**

*...Nevertheless, Fairbanks in a shocking display of corporate irresponsibility repeatedly fabricated the amount of the debtor's obligation to it out of thin air. There is no other explanation for the wildly divergent figures it concocted in correspondence with the Debtor and her agents and in pleadings and documents filed with the bankruptcy court. Judge Joan Feeney from her memorandum supporting her order in favor of the debtor.<sup>1</sup>*

The Community Enterprise Project (“CEP”) of the Hale and Dorr Legal Services Center (“The Center”) regularly receives calls from low-income homeowners facing foreclosure. Tara Twomey, who came to the Center as a Skadden Fellow in 1999, responds to these calls, which are frequently referred by local community groups. Aware that many of these callers have been victims of unscrupulous lending practices, Ms. Twomey has developed a protocol for scrutinizing her client’s loans for violations of federal and state statutes that protect consumers against dishonest and illegal lending practices by mortgage brokers, lenders and their agents. Eighty-three year old Ms. Maxwell was one such client.

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<sup>1</sup> See in Re: Maxwell, Chapter 13 Case No. 00-14283-JNF; Adv.P No. 00-1568, July 16, 2002. (There is also a regular BR cite for this case)

In 1977, Ms. Maxwell purchased her Dorchester home for thirty thousand dollars. Her original mortgage was a 30-year fixed rate loan at 8.5% with monthly payments of \$207.63. In 1988, Ms. Maxwell was approached by a door-to-door salesman who suggested a variety of home repairs including the installation of new vinyl siding and windows. The salesman referred Ms. Maxwell and her granddaughter to ITT Financial Services (ITT), a subsidiary of Aetna Finance, to finance the repairs and consolidate other outstanding loans. In 1988, Ms. Maxwell received a 15-year fixed rate loan with an Annual Percentage Rate (“APR”) of 16.78% from ITT in the principal amount of \$137, 611.01. In 1991, ITT refinanced its 1988 loan and provided Ms. Maxwell and her granddaughter a new loan which ITT said would lower their monthly payments. However, the new five-year loan had a principal amount of \$149,150.00 with an APR of 16%. The 1991 loan was also negatively amortized, that is, the balloon payment due at the end of the five years was greater than the principle amount of the loan. The monthly payment of \$2005.71 constituted 98.5% of Ms. Maxwell and her granddaughter’s combined incomes.

Predictably, it was not long before Ms. Maxwell and her granddaughter realized that they could not make the monthly payments. Afraid of losing her home, Ms. Maxwell contacted ITT who agreed to lower the monthly payments to \$800, failing, however, to explain to Ms. Maxwell and her granddaughter that these reduced payment would result in further negative amortization and increase the amount of the balloon payment when it became due. In 2001, Fairbanks Capital Corporation, who claimed to be an assignee of the ITT loan, initiated foreclosure proceedings against Ms. Maxwell and her granddaughter. At the time, Fairbanks claimed that Ms. Maxwell owed approximately \$363,000.

Ms. Twomey’s involvement in this case began after Ms. Maxwell had filed her own Chapter 13 bankruptcy petition to prevent a scheduled foreclosure. She did not, however, file the required schedules or a Chapter 13 plan. In July 2000, facing the dismissal of her case and a motion from the bank to proceed with its foreclosure, Ms.

Maxwell came to the Legal Services Center. The initial assessment of the case was bleak, in part, due to the lack of documentation for the loan and Ms. Maxwell's vague memory. As the story unfolded, it became apparent, however, that Ms. Maxwell and her granddaughter had been victims of predatory lending practices.

Ms. Twomey first obtained an extension of time to submit Ms. Maxwell's remaining schedules and with the assistance of law students, Claire Connolly and David Dologite, from the Center's summer program, began researching potential defenses to Fairbanks' motion to proceed with the foreclosure. The strongest argument to emerge centered on Fairbanks' Lost Note Affidavit. Fairbanks, who did not have the original note, or even a copy, had proceeded against Maxwell on a Lost Note Affidavit. The initial review of the Lost Note Affidavit submitted to the court revealed technical deficiencies. Among other things, the affidavit was dated prior to the date that Fairbanks claimed to have acquired the note. This defense was sufficient to delay the hearing on the Fairbanks' motion and provided Ms. Twomey with more time to develop the case. In November 2000, Ms. Twomey filed an adversary complaint in bankruptcy court on Ms. Maxwell's behalf asserting nine causes of action, including violations of Truth-in-Lending (TILA) violations, Real Estate Settlement Procedures Act (RESPA), Fair Debt Collection Practices Act (FDCPA), Massachusetts Consumer Credit Cost Disclosure Act, (MCCDA) and Massachusetts Consumer Protection Act. On May 9, 2002, Judge Feeney heard arguments on the parties cross-motions for summary judgment on four of the nine counts, FDCPA, RESPA, MCCDA and unconscionability.

In an order and Memorandum dated July 16, 2002, Judge Feeney granted partial summary judgment in favor of Ms. Maxwell finding violations of the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, and the Massachusetts Consumer Credit Cost Disclosure act. In her stinging opinion, Judge Feeney also held that "The 1991 transaction was unconscionable and [took] notice that it and the 1988 transaction satisf[ied], in all material respects, the paradigm of predatory lending". In holding that the 1991 transaction was unconscionable and that ITT had

failed to provide Ms. Maxwell and her granddaughter the required disclosures under MCCDA, Judge Feeney stated that Ms. Maxwell would be entitled to rescind the loan by way of recoupment.<sup>2</sup>

Following this decision, the case was resolved favorably in an out-of-court settlement. Ms. Maxwell remains in her home, the mortgage was discharged, and she received an additional \$50,000 from Fairbanks. For its work, the Center was paid \$75,000 in attorney's fees.

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## **Merriman vs Beneficial**

Question: ORDER GRANTING SUMMARY JUDGMENTS

### **TRUTH IN LENDING ACT**

### **NOTICE REQUIREMENTS; COURT'S ABILITY TO MODIFY CONSEQUENCES OF RESCISSION UNDER TRUTH IN LENDING ACT**

#### **Facts:**

The Truth in Lending Act ("TILA") is applicable to both of these proceedings because both proceeding involve non-purchase money loans secured by the consumer-borrowers' homes (principal dwellings). TILA violations are measured by a strict liability standard so even minor or technical violations impose liability on a creditor and a borrower can prevail without showing damages.

#### **Case No. 01-42851-13; Adv. No. 01-7142**

Patricia Joan Merriman ("Merriman") filed a Chapter 13 petition in October 2001. One month later her attorney sent Beneficial Mortgage Co. of Kansas ("Beneficial") a notice that Merriman was exercising her right to rescind the contract. Beneficial did not consider Merriman's rescission to be effective since it was beyond the three-day rescission period.

Merriman maintained that the notice of rescission was adequate and timely. Merriman argued that due to Beneficial's failure to provide Merriman with the two copies of her right to rescind the transaction, the time frame for rescinding the transaction was extended from three-days to three years. *See holding #1.*

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<sup>2</sup> "Recoupment is the common law doctrine that resurrects countervailing claims, which otherwise could not have been raised. The reasoning is that if recoupment claims are barred by the relevant statute of limitations, lenders could avoid the legal consequences of their actions by simply waiting until the expiration of the relevant limitations period to sue on the borrower's default, thereby frustrating fundamental policies of debtor/creditor regulation. Allowing a creditor to profit from a violation of the law simply because the consumer's limitations period had passed, but the creditor's had not, would obstruct the purposes of the law.

Merriman also maintained that the notice of the rescission was ineffective because the notice was insufficient to inform her of her rescission rights. The form that Beneficial provided Merriman combined the two model forms produced by the Federal Reserve Board for New Loan Financing and Refinancing into one form. The information on the Fed forms was contained on Beneficial's form, but because Beneficial had combined the two forms, it had two boxes that related to the two types of financing. Beneficial's employee was required to check the appropriate box on the form indicating the type of financing the borrower had obtained. Beneficial checked neither box, and in Merriman's case she had a pre-existing loan with Beneficial, which made the form confusing. Merriman argued that because the form was confusing, Beneficial had not provided her with sufficient notice of her right to rescind and therefore the time frame to rescind should be extended from three-days to three years based on lack of notice. *See holding #2.*

***Case No. 01-42119-13; Adv. No. 01-7122***

Marcelino Emelio Ramirez and Toni Lee Ramirez ("Debtors") filed a joint Chapter 13 bankruptcy. Approximately one month after filing the petition Debtors sent a timely notice of rescission to Household Finance Corp. III ("Household").

Prior to their filing, in February 2000, Mr. Ramirez borrowed money from Household and signed a promissory note. Debtors then signed a mortgage on their principal dwelling to secure the note. Household only gave notice of the right to rescind to Mr. Ramirez, even though Household was required under the TILA to provide notice to both Mr. and Mrs. Ramirez. Despite the failure to provide notice as required by TILA, the Court held that the appropriate remedy was not to void the mortgage, but to off-set the amount owed by the closing costs and all amounts paid on the loan. *See holding #3.*

**Holdings:**

1. The fact that Beneficial had allegedly failed to provide two copies of the right to rescind form to Merriman did not extend the rescission period from three-days to three years. The second physical copy of the notice was not actually necessary to inform Merriman of her right to rescind so long as she had one copy. The Court reasoned that as long as the notice was otherwise sufficient the second physical copy, intended to be kept solely for the borrower's records, could have been easily reproduced by photocopying the notice.

2. Beneficial's failure to check the appropriate box indicating the type of financing transaction that Merriman could rescind made the form confusing and rendered the notice insufficient, and therefore the time period to rescind the transaction was extended from three-days to three years, under TILA.

3. The Court followed *Quenzer III* and ruled that the Court has the ability to alter the remedy for TILA violations based on the facts in front of the Court. The Court noted in its ruling the fact that a majority of courts have refused to enforce the automatic voiding of the creditor's mortgage thereby altering the remedy for violations. The Court refused to void the mortgage liens, and altered the amounts secured by the liens remaining in place by deducting the closing costs and payments made on the loan from the amount of the secured claims. The Court also noted that the parties had expressed their intentions to appeal any adverse ruling and therefore, a decision based on *Quenzer III* would allow for swifter access to the Circuit.

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## **HISTORY OF PREDATORY LENDING**

LegalAid GA is a project of Atlanta Legal Aid Society, Georgia Legal Services Program and the Pro Bono Project of the State Bar of Georgia. The project is funded by the Legal Services Corporation and the Georgia Access to Justice Project and produced in cooperation with Pro Bono Net, the Carl Vinson Institute of Government and legal service organizations and government agencies throughout Georgia and the United States.

by: Atlanta Legal Aid Society

## **PREDATORY LENDING: HISTORICAL PERSPECTIVE**

### **Atlanta Legal Aid Society**

**Last Reviewed: November 2003**

Atlanta Legal Aid's Bill Brennan, as one of the nation's experts on predatory lending, was asked by Senator Grassley to testify at the Senate Special Committee on Aging hearing on "Equity Predators: Stripping, Flipping, and Packing Their Way to Profits." Bill was warmly received and several Senators made statements at the hearing indicating the value they placed on legal service program involvement in this area. Bill's testimony (see text below) clearly outlines the problems of predatory lending and equity theft, how victims are targeted, and some historical perspective. An Exhibit (updated in September 2000) presented to the Committee details how these scams work.

Bill was quoted in the New York Times, December 13, 1997 in an article about lending practices. "We have financial apartheid in our country. We have low-income, often minority borrowers, who are charged unconscionably high interest rates, either directly or indirectly through the cover of added charges."

### **Testimony of William J. Brennan, Jr., Director, Home defense program of the Atlanta Legal Aid Society, Inc. before the committee on banking and financial services, United States house of representatives May 24, 2000**

Thank you for this opportunity to address the United States House Committee on Banking and Financial Services on the subject of predatory mortgage lending practices directed against elderly, minority, low and moderate income, and women homeowners. My name is William J. Brennan, Jr. For almost 32 years, I have been a staff attorney at the Atlanta Legal Aid Society, Inc. specializing in housing and consumer issues. For the past 12 years, I have served as the director of the Home Defense Program of the Atlanta Legal Aid Society.

Over the years, the Home Defense Program has provided referrals and legal representation to hundreds of low and moderate income homeowners and home buyers who have been victimized by home equity and home purchase scams, including predatory mortgage lending. The Program is funded by the Atlanta Legal Aid Society and the DeKalb County, Georgia, Department of Human and Community Development with HUD community development block grant funds. The Program consists of myself, a staff attorney, and a paralegal.

On a daily basis, we assist individual homeowners who have been targeted by local and national companies with abusive, predatory mortgage lending practices. We evaluate their cases to determine whether legal claims exist. We settle some cases without litigation and litigate others. Most often, because of our limited resources, we assist homeowners in obtaining private attorneys to represent them in cases where the homeowners may have legal claims. Where appropriate, we also refer homeowners to local nonprofit housing counseling and other agencies which assist them in obtaining refinancing of their high cost mortgage loans through low cost, conventional mortgage lenders or other special programs. We refer many senior citizen homeowners for reverse mortgages. We also participate on a regular basis in a range of community education efforts aimed at warning home buyers and homeowners against home equity theft scams, including abusive mortgage lending practices.

When homeowners come to the Home Defense Program with sub prime mortgage loans, my job is to conduct an investigation and determine whether they have any legal claim. In a few cases, a strong legal claim exists that will result in a settlement that cancels the mortgage. In other cases, legal claims exist that will result in a settlement that may give the homeowner some cash and a restructured mortgage loan with a lower balance, lower interest rate, and lower monthly payments that the homeowner can afford. In too many cases, the loan is full of predatory and abusive lending terms, but I can find no legal claim. Homeowners who are not eligible for a reverse mortgage or low cost refinance are bound to those high cost, abusive mortgages with no legal recourse. When they cannot make the payments, they go into default and lose their homes and all their equity.

The financial services industry (including banks and thrifts, local and national, large and small mortgage lenders and finance companies) has evolved a system of financial apartheid in our country. Many people with A credit are provided with fairly low cost loan products with little or no abusive practices. On the other hand, people with B and especially C and D credit (and some of those with A credit) are often egregiously overcharged and subjected to abusive lending practices. Moreover, these high cost, abusive loan products are marketed disproportionately among our elderly, minority, and low and moderate income communities. The

rationale that risk justifies exploitation is bogus. As Philadelphia Community Legal Services attorney Irv Ackelsberg points out, it is as though society has dealt with the problem of inadequate access to productive credit by drowning low income households in destructive debt.

### **Devastating Impact on Individuals, Families and Communities**

The impact of predatory mortgage lending has been devastating on individuals, families and communities. Because these mortgages are grossly overpriced and contain abusive, predatory terms that further drive up the cost, many families are struggling to make their monthly mortgage payments. Too often they forego paying for other important necessities such as food, medicine, utilities, and property taxes in order to keep their homes. When they fall behind on the mortgage payments, they face foreclosure. Many inevitably lose their homes and are kicked out on the street.

### **Predatory Lending Practices**

Based on my 32 years at the Atlanta Legal Aid Society, 12 years as director of the Home Defense Program, and hundreds of sub prime lending cases that have come through my program, I have never seen a sub prime mortgage lender not engage in one or more of three distinct categories of predatory lending practices. Here is what they do.

#### **I. They overcharge on interest and points.**

Predatory mortgage lenders charge egregiously high annual interest and prepaid finance charges (points) which are not justified by the risk involved because these loans are collateralized by valuable real estate. Since these companies only lend at 70-80% loan-to-value ratios, they have a 20-30% cushion to protect them if they have to foreclose. They usually buy in at the foreclosure auction sale, evict the former homeowner, and sell the house for enough to pay off the loan and often generate additional profits. This assertion may be tested by ascertaining the net profits sub prime mortgage lenders earn. If the risk were great, losses would be high. High losses would be reflected in diminished profits. In spite of this, profits in fact are great.

These profits are reflected in the trading values of these lenders. For example, two years ago Ford Motor Company sold its sub prime finance company subsidiary, Associates Financial Services, to stockholders for \$25.8 billion. First Union purchased The Money Store for \$2.1 billion. The CEO of GreenTree Financial received \$102 million in total compensation for 1996 and \$65 million in the previous year. More recently, Bank of America offered NationsCredit, one of

its sub prime mortgage lending subsidiaries, for sale for \$1 billion. "BOA Is Asking \$1 Billion For NationsCredit Unit," National Mortgage News, May 15, 2000, p. 1. According to the article, NationsCredit currently brings in \$5 million per month. EquiCredit, the other sub prime mortgage lending subsidiary owned by Bank of America, makes \$30 million per month. In an article entitled "Loan Sharks, Inc.," Thomas Goetz reports that:

Sub prime companies say their interest rates are so high to compensate for the greater risk these borrowers bring. But a welcome side effect of high rates is the profits that traditional banks can't hope to match. According to Forbes, sub prime consumer finance companies can enjoy returns up to six times greater than those of the best-run banks. Corporate America hasn't failed to notice.

*Village Voice, July 15, 1997 at 33.*

## **II. They perpetrate other profitable abuses.**

Predatory mortgage lenders purposely engage in other abusive lending practices that effectively allow the lenders to collect hidden, indirect interest and thereby increase and enhance profits.

Examples are:

- Loan flipping;
- Packing the loan with overpriced single premium-financed credit life, disability and unemployment insurance;
- Balloon payments;
- High prepayment penalties;
- Using scam home improvement companies to generate originations;
- Paying kickbacks to mortgage brokers to generate originations; and
- Paying off low cost or forgivable mortgage loans.

It is crucial to understand that the profitability of the sub prime mortgage lending business is derived not just from overcharging on interest and points as set out in Category I, but also from engaging in the above listed abusive lending practices set out in Category II and Appendix A [of the report]. The profitability is inextricably intertwined with the perpetration of these abusive lending practices.

Moreover, in this instance the sub prime lenders cannot legitimately argue that risk justifies their practices. While the price of the loan product should be related to actual risk, the abusive practices listed in Category II and Appendix A have nothing to do with risk and cannot be justified on the basis that many sub prime borrowers have less than perfect credit ratings.

### **III. They target groups based on age, race, income, and sex.**

Predatory mortgage lenders purposely target vulnerable elderly, minority, low and moderate income, and women homeowners with high cost abusive mortgage loans.

Elderly homeowners, who tend to have substantial equity but live on fixed incomes (social security and retirement benefits), are perhaps the principal targets. Their homes may be in need of expensive repairs (often roofing work) or they may have fallen behind on their property taxes, incurred substantial medical bills not covered by Medicare, Medicaid or health insurance, or suffered a loss of income after the death of a spouse. The common characteristics of these victims are a need for money (either real or suggested by the lender) combined with a lack of financial sophistication, often exacerbated by diminished mental capacity as a result of Alzheimer's and other dementia-related diseases.

Minority groups are disproportionately targeted by predatory lenders because their access to legitimate sources of loans and other financial services is disproportionately denied. Some banks and other conventional mortgage lenders engage in redlining by designating entire communities as bad financial risks and refusing to make them prime rate loans. Redlining creates a credit vacuum filled by the predatory lenders (many of which are owned by the same banks which redline communities). These predators target these same communities with overpriced loan products, knowing that the residents are a captive market with no access to reasonably-priced credit. This is called reverse redlining.

In Atlanta, sub prime loans are almost five times more likely in black neighborhoods than in white neighborhoods. In addition, homeowners in moderate-income black neighborhoods are almost twice as likely as homeowners in low-income white neighborhoods to have sub prime loans. See HUD Report, "Unequal Burden in Atlanta: Income and Racial Disparities in Sub prime Lending," April 2000. See also Appendix B, map of Atlanta metropolitan area showing a high concentration of sub prime lenders' market share of refinancing loan originations in 1998 in minority census tracts, and very low concentration in non-minority areas. By comparison, see Appendix C, map of the Atlanta metropolitan area showing a high concentration of Fannie Mae and Freddie Mac support for the conventional (low cost, non-abusive) home mortgage loan market in non-minority neighborhoods, and a dearth of Fannie and Freddie support for conventional mortgage lending in minority neighborhoods. For similar findings of disparities in lending based on race in Chicago, see "Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development," Woodstock Institute, November 1999.

Low and moderate income homeowners are also targets when they have or appear to have less than perfect credit ratings. Conventional lenders tend to deny loans to these individuals and often steer them to predatory lenders. In Atlanta, sub prime loans are three times more likely in low-income neighborhoods than in upper-income neighborhoods. See HUD Report.

Finally, a disproportionate number of my clients are women. Most of these are elderly, African American, and widowed. I believe that in many instances women are targeted because they are deemed by lenders to be vulnerable.

### **Expansion of Predatory Lending**

Over the past 12 years, I have seen a dramatic increase in the number of predatory mortgage loans in the Atlanta area. The number of sub prime refinance loans originated in Atlanta increased by more than 500% from 1993 to 1998. See HUD Report, "Unequal Burden in Atlanta: Income and Racial Disparities in Sub prime Lending," April 2000. In addition, the Atlanta metropolitan area saw a 232% increase in the number of foreclosures by sub prime lenders, while there was a 15% decrease in the number of foreclosures by nonsub prime lenders. See HUD Report.

### **Examples of Cases**

Examples of cases which have come into our office over the last few years include the following. A 62-year old African American widow borrowed \$88,900 from a bank owned sub prime lender with a 13% annual percentage rate (APR). The \$88,900 borrowed included approximately \$10,000 in single premiums for credit life, disability and unemployment insurance coverage. The premiums were financed over the term of the 15 year loan at 13% APR. The life insurance provided coverage for only the first ten years of the loan term. The disability insurance covered only the first five years of the loan. Thus, the lender packed in \$10,000 in expensive credit insurance which dramatically increased the balance and was financed over the term of the loan, though actually covered less than the term of the loan.

Another client is a 71-year-old, retired African American long time homeowner and her elderly, ill husband. They were living in a paid for house when she answered a newspaper advertisement offering home repairs which they needed. The home improvement salesman arranged financing through a bank-owned sub prime mortgage lender for the \$13,780.00 price for the home improvement work. The loan was for \$21,612.59, and included payoffs of some other debts they owed. The APR was 10% and the term was 15 years. The home improvement company drew down a check for \$6,899.00, installed a hot water heater, and disappeared. An expert valued the work performed at about \$500.00. When the homeowner complained to the mortgage

lender that the work had not been completed, the lender mailed her a check for the remaining \$6,890.00 made out to her, her husband (who had since died), and the home improvement company (which was long gone). Although she cannot cash the check, she has continued to make the payments on the mortgage. In this case, a sub prime lender used a scam home improvement company to aid it in generating a high cost sub prime mortgage loan.

An African American couple in their 40s purchased a home with a \$121,366.90 mortgage loan from a large national sub prime lender (not bank owned). The prepaid finance charge was \$3,534.96. The APR was 14.39%. The loan had a balloon payment provision requiring that \$106,320.28 be paid as the last payment on the 15-year mortgage. Although the balloon feature was disclosed, the purchasers did not know about it until six months after the loan closing, when the lender called and told them about the balloon feature, and suggested they come back in to obtain a new loan without a balloon. Although they hesitated to do so at first, they finally agreed to the refinancing to rid themselves of the balloon payment requirement. The new loan was for \$133,583.37. The prepaid finance charge was \$9,850.63. The APR was 13.58%. The new loan was for a 30-year term. In this case, the lender employed the balloon feature to trigger a refinanced (or flipped) loan which included about \$10,000 in points.

I could provide dozens of other examples of high cost, abusive mortgage lending cases. I have omitted the names of the homeowners and lenders here because these cases have either been settled or are in settlement discussions.

### **History and Role of the Banks in Predatory Lending**

When I started at Atlanta Legal Aid Society almost 32 years ago, the few abusive mortgage lending cases we saw involved local individuals and companies. In the mid to late 1980s, national finance companies started getting into the sub prime mortgage lending business, and we saw an increase in the proliferation of abusive lending practices. In the early 1990s to the present, other large national corporations and national banks got involved in the sub prime market. Ford Motor Company acquired the Associates, a large sub prime mortgage lender. Chrysler Motor Company created Chrysler First, Inc., a consumer finance and second mortgage company.

Although most banks have played no role in the sub prime lending business, some banks have played a very significant role in the expansion of sub prime lending and the abusive practices that are so much a part of it. That role is played out in a number of different ways.

A few banks own sub prime mortgage companies. Banks now control five of the nation's top ten sub prime leaders.

Among the top 25 sub prime lenders in the third quarter of 1999, ten are owned by either a bank or thrift. A year ago, just three of the top 25 were owned by depository institutions. "Banks Take Over Sub prime," National Mortgage News, November 15, 1999, p.1.

The recent history of Bank of America is illustrative. NationsBank acquired C&S National Bank which owned C&S Family Credit. In November 1992, NationsBank Corporation purchased Chrysler First. NationsBank combined C&S Family Credit with Chrysler First and called the new company NationsCredit. Later NationsBank acquired Barnett Bank which owned a subsidiary, EquiCredit. NationsBank then merged with Bank of America and is now known as Bank of America. It engages in sub prime mortgage lending through NationsCredit and EquiCredit.

Several years ago, First Union Bank purchased The Money Store. Thus, First Union is now in the sub prime mortgage lending business through The Money Store. CitiBank merged with Travelers Insurance Company which owned Commercial Credit. CitiBank, now known as CitiGroup, engages in sub prime mortgage lending through CitiFinance (formerly Commercial Credit).

We have numerous cases involving these bank-owned sub prime entities. In these cases, we have seen countless examples of abusive lending practices, including high interest rate and points, loan flipping, home improvement scams, credit insurance packing, high prepayment penalties, etc.

Some banks make capital loans to support the operations of sub prime mortgage companies. For example, 22 banks led by First Union National Bank made an unsecured \$850 million line of credit loan to now-defunct sub prime lender United Companies Financial Corporation. Incidentally, those banks lost at least \$300 million on the deal. "Banks on United Cos. Line Taking \$300 Million Loss," National Mortgage News, April 5, 1999, p. 1. United is now in a Chapter 11 bankruptcy. (The irony here is that most banks will not make fully secured low cost mortgage loans to low and moderate income homeowners with less than perfect credit who need loans for legitimate purposes, such as to replace a roof, and can repay the loan in full. These would be profitable, fully secured loans. Apparently, the banks involved with United felt an unsecured \$850 million line of credit to this company was a safe investment.)

Other banks support sub prime mortgage lenders by purchasing mortgage loans originated by sub prime mortgage companies or by acting as trustees in the securitization process. For example, The New York Times reported the following about Bankers Trust and sub prime mortgage lender Delta Funding.

High-interest lending in poor neighborhoods has long produced high profits for lenders and, often, equally high burdens for homeowners. But the entry of big banks like Bankers Trust is part of a growing trend in such lending and has changed the equation.

Over the last several years, Delta has converted hundreds of millions of dollars' worth of its mortgages into securities much like bonds, which it sells to investors through Bankers Trust.

In turn, Bankers Trust has provide Delta with hundreds of millions of dollars from the investors, allowing it to make more and more loans and become a major player in high-interest lending in New York and in 21 other states.

But there is a problem: a high percentage of the homeowners can't afford Delta's mortgages. Many say they were duped into taking the loans and now may lose their homes as Delta and Bankers Trust try to reclaim the money for their investors.

*"Suit Says Unscrupulous Lending Is Taking Homes From the Poor," The New York Times, January 18, 1999, p. 1.4*

Banks face the same incentives as other lenders to take advantage of sub prime borrowers. As a result, some banks down stream potential customers to their sub prime mortgage subsidiaries where they are subjected to high cost, abusive mortgage lending practices. These include mortgage loan applicants with less than perfect credit, as well as minorities and others with good credit who are steered downstream based on their race or national origin.

In addition, some banks engage in redlining practices. As described above, redlining creates a credit vacuum which is then filled by predatory lenders (many of which are owned by the same banks).

The involvement of these banks has resulted in the expansion of capital into the sub prime mortgage business, which in turn has resulted in the expansion of sub prime markets for the sub prime entities. The ultimate result is that many more homeowners have been and continue to be subjected to predatory lending practices, which puts them in a position of struggling to make their mortgage payments, with many eventually losing their homes to foreclosure.

I was handling predatory mortgage lending cases when the banks first became involved in sub prime lending. I vividly recall that when NationsBank purchased Chrysler First in 1992, the bank went out of its way to assure local communities that alleged predatory mortgage lending practices engaged in by Chrysler First would cease. In fact, when asked about homeowner lawsuits that had been filed against Chrysler First, a bank spokesman said that if "there

had been problems with prior business practices, this acquisition may well be the most effective way to fix them.” “Complaints Arise Over Finance Firm: Chrysler First Faces Lawsuits, The Charlotte Observer, January 10, 1993, page 1A. See Appendix D for a copy of this news article.

Before these acquisitions, we had clients who had mortgages with Chrysler First and EquiCredit where we saw abusive practices. Since NationsBank (now Bank of America) took over Chrysler First and EquiCredit, in my opinion the problems have gotten worse. We have more clients and more abusive practices in connection with these loans.

In sum, the involvement of these banks with sub prime lending has been a devastating development in terms of the expansion of abusive, predatory mortgage lending practices in low and moderate income and minority communities.

I know why these banks got involved: profitability. Remember that profitability is inextricably intertwined with the Category II and Appendix A abusive lending practices described above. I would argue that these banks use the profits from the sub prime mortgage lending business to keep the costs of their prime mortgage lending business at the lowest possible levels. These banks target their low cost mortgage loan products primarily into middle income and wealthy, white homeowner communities and target their sub prime, abusive mortgage loan products into low and moderate income, minority homeowner communities. The result is a shifting of home equity wealth out of the low and moderate, minority neighborhoods into middle class and wealthy, white neighborhoods.

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### **The Entry of Fannie Mae and Freddie Mac into the Sub prime Mortgage Lending Business**

I have been greatly disappointed that the entry of many prominent national banks into the sub prime mortgage lending business has resulted not in reform, but in the expansion of the abusive practices. The fact that these banks are federally regulated has made little difference. So far, the bank regulators have done little to stop the overcharging on cost and the other abusive practices.

Now, to my dismay, Fannie Mae and Freddie Mac have announced they are getting into the sub prime mortgage lending business. This is their response to HUD's mandate that they expand their affordable housing goals into low and moderate income, minority neighborhoods and rural communities. Like the banks before them, Fannie and Freddie claim that their involvement will effectuate positive change and reform in the sub prime market. I beg to differ. Freddie recently revealed that it has purchased 70 HOEPA loans which are by definition very high cost mortgage loans.

"Freddie Makes Sub prime Moves," National Mortgage News, February 22, 2000.

If Fannie and Freddie get involved in the sub prime mortgage lending business, I cannot see how the results would be any different from the results of the banks' involvement. The results most likely will be the same. In fact, the results likely will be even worse because even more capital will be infused into the sub prime business by Fannie and Freddie than has been the case with the banks. As a result, predatory mortgage lenders' penetration into minority communities with their poisonous, abusive, high cost mortgage loan products will likewise greatly increase. I would argue that Fannie and Freddie will use the profits from the sub prime mortgage lending business to keep the costs of their prime mortgage lending business at the lowest possible levels, just as the banks have done. Again, in my opinion, the result will be a shifting of home equity wealth out of the low and moderate income, minority neighborhoods into middle class and wealthy, white neighborhoods.

Some argue that Fannie and Freddie's involvement in sub prime lending will tend to eliminate the abusive lending practices. Proponents cite their huge capital base and uniform underwriting standards for the loans they purchase. In theory, the potential for reform is great. However, the promise of reform seems empty given recent developments.

In response to recent expressions of concern about Fannie and Freddie getting into the sub prime mortgage lending business, Fannie announced that it will not buy HOEPA loans, mortgage loans where single premium credit life insurance has been sold in connection with the loan, or mortgage loans where the points and fees exceed 5% of the amount borrowed. Fannie will only allow prepayment penalties under certain circumstances. Freddie has announced that it will not buy HOEPA loans or mortgage loans with single premium credit insurance policies. Freddie also announced it will not buy mortgage loans from companies that refuse to report to the credit bureaus timely payments by borrowers.

Our concern is this: what about all the other abuses set out and described in Category II and Appendix A? What about loan flipping? Home improvement scams? Paying off low cost and forgivable loans? I am certain that many if not most of the companies would simply expand into these other abuses because they are so closely tied to profitability, even as they might stop the few practices prohibited by Fannie and Freddie.

Why have Fannie and Freddie not undertaken policies to stop all the abuses? Profitability. Fannie and Freddie are beholden to their stockholders. Like other corporations, they need to report increases in profits. Lately, the overall volume of mortgages purchased by Fannie and Freddie has been down. Getting into the sub prime lending business

would increase profits substantially, but prohibiting the abusive practices would cause a substantial decrease in profits. Thus, there would be tremendous pressure on Fannie and Freddie not to prohibit the abuses.

There are other good reasons why Fannie and Freddie should not enter the sub prime market. If Fannie and Freddie enter the sub prime mortgage lending business, any downturn in the economy would result in a massive increase in foreclosures because one of the hallmarks of abusive lending is setting the payments at amounts the borrowers can barely afford. Fannie and Freddie, as government sponsored enterprises, might very well turn to Congress for a financial bailout, similar to the bailout of the savings and loan industry in the 1980s which cost taxpayers billions of dollars.

Finally, entering into the sub prime mortgage lending business may subject Fannie and Freddie to civil liability for predatory mortgage lending practices. Just a few weeks ago, homeowners filed a class action case against Lehman Brothers for its involvement in alleged predatory lending practices of First Alliance Mortgage Company. Fannie and Freddie's involvement in the sub prime mortgage lending business with the inherent abuses similarly may result in extensive litigation against both of them.

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### **Non-Legislative Solutions**

There is a non-regulatory, non-legislative solution to the problem of predatory mortgage lending. The financial services industry could easily agree to tear down the artificial wall that has been erected between the A borrowers and the B, C, and D borrowers. Lenders could make fairly priced, profitable loans based on accurate analysis of risk. They could also stop the abusive practices.

Models for this are emerging around the country. For example, the Boston based Neighborhood Assistance Corporation of America (NACA) has entered into a series of innovative agreements with major national banks to provide no cost, below market rate home purchase and refinance mortgage loans (currently less than 8% fixed) to persons who have less than perfect credit but have demonstrated an ability to make current payments on their mortgages. The program is a major success. Here the artificial wall was torn down. The result has been that thousands of people who formerly would have been denied access to low cost credit are now enjoying the benefits of home ownership, and the banks can take credit for positive community reinvestment. This movement has culminated in NACA's agreement with Bank of America to provide \$3 billion in home purchase and refinance funds to low and moderate income persons with less than perfect credit in 21 cities across America. Unfortunately, despite the success of its program with NACA,

Bank of America continues to engage in sub prime, abusive mortgage lending practices through its subsidiaries, NationsCredit and EquiCredit. "The Two Sides of Lending: Does NationsBank Play Good Cop and Bad Cop With Borrowers?" U.S. News and World Report, December 9, 1996, p. 74.

Here is a suggestion. Banks and large private mortgage companies could and should undertake a leadership role and follow this example. They could expand their fairly priced, non-abusive mortgage lending practices into the same communities now suffering under the burden of predatory mortgage lending. Banks with subsidiaries engaging in predatory lending practices should cease those practices. This expansion of conventional credit will lead to competition, and result in lower costs and the elimination of abuses, which would drive many of the predators out.

### **Regulatory and Legislative Solutions**

Unfortunately, self-reform does not seem to be occurring. Sub prime, predatory mortgage lending is expanding. Bank of America, First Union, CitiGroup and others still operate sub prime mortgage entities with the attendant overpricing and abusive practices. Accordingly, legislative and regulatory responses are desperately needed.

The trend toward prohibiting some but not all of the abusive mortgage lending practices as a solution is grossly insufficient. Lenders might very well refrain from the few prohibited practices, but would simply expand into the permissible abuses because they are so closely tied to profitability. All the abuses must be stopped. It is simply bad public policy to prohibit some egregious abuses but to allow the others to flourish.

Therefore, I propose that the Home Ownership and Equity Protection Act (HOEPA) should be amended in the following ways. First, the interest rate and points and fees triggers should be substantially lowered. Setting the triggers too high allows lenders to set their rates just under the triggers so they can engage in the prohibited practices. Second, all of the abuses set out in Category II and Appendix A should be prohibited.

In addition, HUD and/or Congress should require that Fannie Mae and Freddie Mac expand their support for conventional mortgage lending in minority and low and moderate income communities, and prohibit them from entering into the business of sub prime mortgage lending. Allowing Fannie and Freddie to get into sub prime lending would enable another explosion of predatory lending practices, which will result in millions of homeowners struggling to make their mortgage payments with many inevitably losing their homes to foreclosure. Any assurance that their involvement will lead to a decrease in predatory practices rings hollow. We

should learn from the history of the banks' entry into sub prime mortgage lending and the resulting damage inflicted on our communities. As a matter of public policy, Fannie and Freddie should not get into this pernicious, predatory business.

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### **PREDATORY MORTGAGE LENDING ABUSES**

**This document describes the different ways that mortgage lenders can trick homeowners into giving up their homes.**

#### **I. ORIGINATION OF THE LOAN**

**Solicitations.** Predatory mortgage lenders target low and moderate income and minority neighborhoods for extensive marketing. They advertise through direct mail, telephone and door to door solicitations, flyers stuffed in mailboxes, and highly visible signs in these neighborhoods. They advertise on radio stations with a large minority audience and employ television commercials that feature celebrity athletes. Many companies deceptively tailor their solicitations to resemble Social Security or other government checks to prompt homeowners to open the envelopes and otherwise deceive them about the transaction.

**Home Improvement Scams.** Predatory mortgage lenders use local home improvement companies essentially as mortgage brokers to solicit loan business. These companies target homeowners and solicit them to execute home improvement contracts. The company may originate a mortgage loan to finance the home improvements and sell the mortgage to a predatory mortgage lender, or steer the homeowner directly to the predatory lender for financing of the home improvements. There are many scams involving home improvements.

With FHA Title 1 home improvement loans, sometimes the contractor falsely claims that HUD will guarantee that the work will be done properly and/or that HUD will pay for the home improvements. In reality, HUD only guarantees to the holder of the mortgage that HUD will pay the mortgage if the homeowner defaults. HUD then pursues the homeowner for payment.

The homeowners are often grossly overcharged for the work, which the contractors often perform shoddily and fail to complete as agreed. They sometimes damage the homeowner's personal property in the process. In other cases, the contractor fails to obtain required city or county permits, thereby making sure that local code officials do not inspect the work for compliance with local codes and do not require that the shoddy work be corrected.

Some predatory mortgage lenders issue payments to the home improvement contractor without ensuring that the work has been properly completed according to the terms of the contract. Some predatory mortgage lenders issue checks payable solely to the contractor, thereby bypassing the homeowner.

Some home improvement companies solicit home improvement contracts with the intent to have the work financed and immediately begin the work prior to the expiration of the homeowner's three-day right to cancel the transaction.

Some home improvement contractors have the homeowner sign a cash home improvement contract for an amount the homeowner cannot afford in a lump sum. When the contractor arranges financing with the predatory mortgage lender and the homeowner objects to the terms of the predatory loan, the contractor threatens to place a lien on the property and sue the homeowner unless the homeowner goes through with the financing.

Predatory mortgage lenders deny responsibility for the overpriced, shoddy and incomplete work, even though they previously arranged for these home improvement companies to solicit loan business for them, and sometimes referred the homeowner directly to the unscrupulous contractor.

**Mortgage Broker's Fees and Kickbacks.** Predatory mortgage lenders also originate loans through local mortgage lenders who act as "bird dogs", or finders for the lenders. These brokers represent to the homeowners that they are working for them to help them obtain the best available loan, and the homeowners usually pay a broker's fee. In fact, the brokers are working for predatory lenders, who pay brokers kickbacks to refer borrowers to them. Mortgage brokers steer borrowers to the lender who will pay him or her the highest fee, not to the lender who will give the borrower the lowest interest rate and fees. Without the borrower's knowledge, the lender charges an interest rate higher than that for which the borrower would otherwise qualify in order to pass on to the borrower the cost of the kickback. On loan closing documents, the industry uses euphemisms or their abbreviations for these kickbacks: yield spread premiums (YSP) and service release fees (SRF). The industry also calls this bonus upselling or par-plus premium pricing; we call it paying unlawful kickbacks.

**Steering to High Rate Lenders.** Banks and mortgage companies steer customers with less than perfect credit to high rate lenders, often a subsidiary or affiliate of the bank or mortgage company. Some banks and mortgage companies steer customers - especially minorities - who may have good credit and would be eligible for a conventional loan to high cost lenders. Sometimes the customer is steered away even before completing a loan application.

Kickbacks or referral fees are paid as an incentive to steer the customer to a higher rate loan. This practice of steering these applicants to high rate lenders is called downstreaming. On the other hand, when people with good credit go to predatory mortgage lenders, the lender does not upstream the applicant to a bank or conventional mortgage company for a low cost mortgage loan.

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**Making Unaffordable Loans.** Some predatory mortgage lenders purposely structure loans with monthly payments that they know the borrower cannot afford so that when the homeowner is led inevitably to the point of default, she will return to the lender to refinance the loan, and the lender can impose additional points and fees. Other predatory mortgage lenders, called hard lenders, intentionally structure the loans with payments the homeowner cannot afford in order to lead to foreclosure so that they may acquire the house and the valuable equity in the house at a foreclosure sale.

**Falsified or Fraudulent Applications.** Some predatory mortgage lenders knowingly make loans to unsophisticated homeowners who do not have sufficient income to repay the loan. Often such lenders plan to sell the loan on the secondary market, especially through a process of securitization. This process generally involves oversight and due diligence by the purchaser to ensure that each borrower appears to have sufficient income to repay the loan. Knowing that these loan files may be reviewed at a later date by subsequent purchasers, such lenders have the borrowers sign a blank application form and then insert false information on the form, claiming that the borrower has employment income that she does not, so it appears that she can make the payments.

**Adding Inappropriate Cosigners.** This is done to create the false impression that the borrower can afford the monthly payments, even though the lender is well aware that the cosigner has no intention of contributing to the payments. Often, the lender requires the homeowner to transfer half ownership of the house to the cosigner. The homeowner thereby loses half the ownership of the home and is saddled with a loan she cannot afford to repay.

**Incapacitated Homeowners.** Some predatory lenders make loans to homeowners who are clearly mentally incapacitated. They take advantage of the fact that the homeowner does not understand the nature of the transaction or the papers that she signs. Because of her incapacity, the homeowner does not understand that she has a mortgage loan, does not make the payments, and is subject to foreclosure and subsequent eviction.

**Forgeries.** Some predatory lenders forge loan documents. In an ABC Prime Time Live news segment that aired April 23,

1997, a former employee of a high cost mortgage lender reported that each of the lender's branch offices had a "designated forger" whose job it was to forge documents. Forgeries are used to refinance a customer into another high cost mortgage with the same lender, to show apparent approval for payouts to home improvement contractors when the work is shoddy and/or incomplete, and to show apparent approval for such charges as credit insurance premiums.

**High Annual Interest Rates.** Because the purpose of engaging in predatory lending is to reap the benefit of high profits, these lenders always charge extremely high interest rates. This drastically increases the cost of borrowing for homeowners, even though the lenders' risk is minimal or nonexistent. Predatory lenders may charge rates of 10% and more, substantially higher than the rates of 7% to 8% on conventional mortgages.

**High Points.** Legitimate lenders charge discount points to borrowers who wish to buy down the interest rate on the loan. Predatory lenders charge high points, but offer no corresponding reduction in the interest rate. These points are imposed through prepaid finance charges (or points or origination fees), which are usually 3% to 10%, but may be as much as 20%, of the loan. The borrower does not pay these points with cash at closing. Rather, the points are always financed as part of the loan. This increases the amount borrowed, which generates more actual interest to the lender.

**Balloon Payments.** Predatory lenders frequently structure loans so that the borrower's payments are applied primarily to interest, and at the end of the loan period the borrower still owes most or the entire principal amount borrowed. The last payment balloons to an amount often equal to 85% or so of the original principal amount of the loan. The homeowner cannot afford to pay the balloon payment, and either loses the home through foreclosure or is forced to refinance with the same or another lender for an additional term and additional points, fees, and closing costs.

**Negative Amortization.** This involves structuring the loan so that interest is not amortized over the term. Instead, the monthly payment is insufficient to pay off accrued interest and the outstanding loan balance therefore increases each month. At the end of the loan term, the borrower may owe more than the amount originally borrowed. With negative amortization, there will almost always be a balloon payment at the end of the loan.

**Credit Insurance - Insurance Packing.** Predatory mortgage lenders market and sell credit insurance as part of their loans, often without the knowledge or consent of the borrower. Typical insurance products sold in connection with loans include credit life, credit disability, credit property, and

involuntary unemployment insurance, and debt cancellation and suspension agreements. Lenders frequently charge exorbitant premiums, which are not justified based on the extremely low actual loss payouts. Frequently, credit insurance is sold by an insurance company which is either a subsidiary of the lender or which pays the lender substantial commissions. They over-insure borrowers by providing insurance for the total indebtedness, including principal and interest, rather than merely the principal amount of the loan. They also under-insure borrowers by providing insurance for less than the outstanding principal balance and less than the full term of the loan. In short, credit insurance becomes a profit center for the lender and provides little or no benefit to the borrower.

**Padding Closing Costs.** In this scheme, certain costs are increased above their market value as a way of charging higher interest rates. Examples include charging document preparation fees of \$350 or credit report fees of \$300, which are many times the actual cost.

**Inflated Appraisal Costs.** In most mortgage loan transactions, the lender requires an appraisal. Most appraisals include a detailed report of the condition of the house, both interior and exterior, and prices of comparable homes in the area. Others are "drive-by" appraisals, done by someone simply looking at the outside of the house. The former naturally costs more than the latter. However, in some cases, borrowers are charged for a detailed appraisal, when only a drive-by appraisal was done.

**Inflated Appraisals.** In order to make large loans, predatory mortgage lenders arrange for appraisals that inflate the true value of the house. The homeowner is then stuck with the new mortgage, unable to sell the house or refinance in the future because the mortgage balance exceeds the true value of the home.

**Padded Recording Fees.** Mortgage transactions usually require that documents be recorded at the local courthouse, and state or local laws set the fees for recording the documents. Predatory mortgage lenders often charge the borrowers a recording fee in excess of the actual amount established by law.

**Increased interest rate after default.** Some predatory mortgage lenders make loans that allow the interest rate to increase if the borrower defaults on the loan, which makes it even more difficult for the homeowner to catch up the payments when they recover from a temporary financial loss.

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**Advance Payments from Loan Proceeds.** Some predatory mortgage lenders make loans in which more than

two monthly payments are consolidated and paid in advance from the loan proceeds. The payments can be used to mask a loan that is being made to a borrower who has no reasonable prospect of paying the loan. By creating this initial reserve of advance payments, the lender can use this reserve to keep the loan current for a period and make the loan appear justified. In addition, the lender's deducting these payments from the loan proceeds gives the lender free use of the borrower's money that the borrower is paying interest on.

**Bogus Mortgage Broker Fees.** In some cases, predatory lenders finance mortgage broker fees when the borrower never met or knew of the broker. This is another way such lenders increase the cost of the loan for their own benefit.

**Unbundling.** This is another way of padding costs by breaking out and itemizing charges that are duplicative or should be included under other charges. An example is charging a loan origination fee (which should cover all costs of initiating the loan) and then imposing separate, additional charges for underwriting and loan preparation.

**Prepayment Penalties and Fees.** Predatory lenders often impose exorbitant prepayment penalties. This is done in an effort to lock the borrower into the predatory loan for as long as possible by making it difficult for her to refinance the mortgage or sell the home. For example, a homeowner has a high cost mortgage loan with a balance of \$132,000 which she is unable to refinance at a lower rate because there is a \$6,200 prepayment penalty due at the end of her fifth year paying this mortgage. Predatory mortgage lenders often charge a fee for informing the borrower or a lender of the balance due to pay off the existing mortgage loan. The loan documents almost never authorize such a fee. These practices provide back end interest for the lender if the borrower does prepay the loan.

**Mandatory Arbitration Clauses.** Pre-dispute, mandatory, binding arbitration clauses limit the rights of borrowers to seek relief through the judicial process for any and all claims and defenses the borrower may have against the mortgage lender, mortgage broker, or other party involved in the loan transaction. By inserting these clauses in the loan documents, some lenders attempt to obtain an unfair advantage by relegating their borrowers to a forum perceived to be more favorable to the lender. This perception exists because discovery is not a matter of right, but is within the discretion of the arbitrator; the proceedings are private; arbitrators need not give reasons for their decisions or follow the law; a decision in any one case will have no precedential value; judicial review is extremely limited; and injunctive relief and punitive damages are not available. Furthermore, the lender is not required to arbitrate claims it may have against the borrower. If the borrower defaults on the loan, the lender proceeds directly to foreclosure.

**Flipping.** Loan flipping happens when mortgage lenders and mortgage brokers aggressively try to persuade homeowners to refinance repeatedly when the new loan does not have a reasonable, tangible net benefit to the borrower considering all the circumstances, including the terms of both the new and refinanced loan, the cost of the new loan, and the borrower's circumstances. Reduction of monthly payments alone is not a tangible benefit to the borrower. Predatory mortgage lenders and brokers hook the borrower into refinancing by offering lower monthly payments and lower interest, refinancing out from under a balloon payment or variable rate mortgage, or by offering additional cash. Each time the borrower refinances, the amount of the loan increases to include additional origination fees, points, and closing costs. Also, the term of the loan is extended. If the loan amount is increased and the term is extended, the borrower will pay much more interest than if the borrower had kept the original loan. If the borrower actually needs more money, it would be better if the lender made a second, separate loan for the additional amount needed. A powerful example of the exorbitant costs of flipping is the case of Bennett Roberts, who had eleven loans from a high cost mortgage lender within a period of four years. See Wall Street Journal, April 23, 1997. Mr. Roberts was charged in excess of \$29,000 in fees and charges, including 10 points on every financing, plus interest, to borrow less than \$26,000. The purpose of flipping is to keep the borrower in a constant state of indebtedness. To paraphrase from the famous Eagles' song, "Welcome to the Hotel California, you can check in but you can never check out."

**Recommending Default in connection with a Refinance.** Predatory mortgage lenders and brokers often recommend or encourage the borrower to stop making payments on their existing mortgage loan and other loans or debts because they will refinance "soon." However, the closing on the refinance is delayed and sometimes never happens. If the refinancing occurs, the borrower feels compelled to go through with the closing despite the high interest rate, points, and fees and other abusive features of the loan because the other creditors are demanding payment on their loans, possibly threatening foreclosure or other legal action. Also, the new lender charges an interest rate higher than originally promised, and justifies the higher rate by telling the borrower that their credit records now show no or slow payments on their bills.

**Modification or Deferral Fees.** Some predatory mortgage lenders charge borrowers a fee or other charge to modify, renew, extend or amend a mortgage loan or to defer any payment due under the terms of the mortgage loan, even though the contract does not authorize such a fee.

**Spurious Open End Mortgages.** In order to avoid making required disclosures to borrowers under the Truth in Lending Act, many lenders are making "open-end" mortgage loans. Although the loans are called "open-end" loans, in fact they

are not. Instead of creating a line of credit from which the borrower may withdraw cash when needed, the lender advances the full amount of the loan to the borrower at the outset. The loans are non-amortizing, meaning that the payments are interest only, so that the balance is never reduced.

**Paying Off Low Interest Mortgages.** A predatory lender usually insists that its mortgage loan pay off the borrower's existing low cost, purchase money mortgage. Instead of lending the borrower only the amount he actually needs in a second, separate loan, the lender makes a new loan paying off the current mortgage. The homeowner loses the benefit of the lower interest rate and ends up with a higher interest rate and a principal amount that is much higher than necessary.

**Paying Off Forgivable Loans and No-interest Loans.**

Many low income homebuyers obtain down payment assistance grants from state and local agencies. These grants are made in the form of second mortgages that are forgiven as long as the homebuyer remains in the home for five or ten years. Other government programs allow low income and elderly homeowners to obtain grants for necessary home improvement work to bring homes up to code standards. These grants are also made in the form of mortgage loans that are forgiven as long as the homeowner remains in possession of the home for five or ten years. When many predatory mortgage lenders make loans to these homeowners, they insist that these forgivable loans be paid off (to increase the amount borrowed) even though these loans would be forgiven in a matter of a few short years. Habitat for Humanity provides home purchase mortgage loans on which no interest is charged to low income homebuyers. Predatory mortgage lenders have targeted Habitat for Humanity homebuyers in Georgia and North Carolina for high cost mortgage loans, offering "cash out" loans to entice them and then requiring them to paying off their no interest Habitat mortgage loans.

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**Shifting Unsecured Debt Into Mortgage.** Mortgage lenders badger homeowners with advertisements and solicitations that tout the "benefits" of consolidating bills into a mortgage loan. The lender fails to inform the borrower that consolidating unsecured debt such as credit cards and medical bills into a mortgage loan secured by the home is a bad idea. If a person defaults on an unsecured debt, they do not lose their home. If a homeowner rolls their unsecured debt into their mortgage loan and default on their mortgage payments, they can lose their home. Furthermore, since unsecured debt generally is paid off between three and five years, shifting unsecured debt into a mortgage loan extends the payoff period to 15 to 30 years. Paying off unsecured debt with a mortgage loan also necessarily increases closing costs because they are often calculated on a percentage

basis, thereby increasing the loan balance. Whereas the old total monthly household debt payments may in some cases be less than the monthly payments on the new mortgage loan, the monthly mortgage payments are often more than the previous mortgage payments, thus exacerbating the risk that the homeowner will lose the home to foreclosure.

**Making Loans in Excess of 100% Loan to Value (LTV).**

Some lenders are making loans to homeowners in amounts that exceed the fair market value of the home. This makes it very difficult for the homeowner to refinance the mortgage or to sell the house to pay off the loan, thereby locking the homeowner into a high cost loan. Normally, if a homeowner goes into default and the lender forecloses on a loan, the foreclosure sale generates enough money to pay off the mortgage loan and the borrower is not subject to a deficiency claim. However, where the loan is 125% LTV, a foreclosure sale may not generate enough to pay off the loan, and the lender may pursue the borrower for the deficiency.

## **II. SERVICING OF THE LOAN**

**Force Placed Insurance.** Lenders require homeowners to carry homeowner's insurance, with the lender named as a loss payee. Mortgage loan documents allow the lender to force place insurance when the homeowner fails to maintain the insurance, and to add the premium to the loan balance. Some predatory lenders force place insurance even when the homeowner has insurance and has provided proof of insurance to the lender. The premiums for the force placed insurance are frequently exorbitant. Often the insurance carrier is a company affiliated with the lender, and the force placed insurance is padded because it covers the lender for risks or losses in excess of what the lender may require under the terms of the loan.

**Daily Interest When Payments Are Made After Due Date.** Most mortgage loans have grace periods, during which a borrower may make the monthly payment after the due date without incurring a late charge. The late charge often is assessed as a percentage of the late payment. However, many lenders also charge daily interest based on the outstanding principal balance. While it may be proper for a lender to charge daily interest when the loan so provides, it is deceptive for a lender to charge a late fee as well as daily interest when a borrower pays before the grace period expires.

**Late fees.** Some predatory mortgage lenders charge excessive late fees, such as 10% of the payment due. Sometimes they charge this fee more than once for only one late payment.

## **III. COLLECTION OF THE LOAN**

**Abusive Collection Practices.** In order to maximize profits, predatory lenders either set the monthly payments at a level the borrower can barely sustain or structure the loan to trigger a default and a subsequent refinancing. Adding insult to injury, the lenders use aggressive collection tactics to ensure that the stream of income flows uninterrupted. The collection departments call homeowners at all hours of the day and night, including Saturday and Sunday, send late payment notices (in some cases, even when the lender has received timely payment or even before the grace period expires), send telegrams, and even send agents to hound homeowners, who are often elderly widows, into making payments. These abusive collection tactics often involve threats to evict the homeowners immediately, even though lenders know they must first foreclose and follow eviction procedures. The resulting impact on homeowners, especially elderly homeowners, can be devastating.

**High Prepayment Penalties.** See description above. When a borrower is in default and must pay the full balance due, predatory lenders will often include the prepayment penalty in the calculation of the balance due.

**Flipping.** See description above. When a borrower is in default, predatory mortgage lenders often use this as an opportunity to flip the homeowner into a new loan, thereby incurring additional high costs and fees.

**Call provision.** Some predatory mortgage lenders make loans with call provisions, which permit the holder of the mortgage, in its sole discretion, to accelerate the indebtedness, regardless of whether the borrower's payments are current and the homeowner is otherwise in compliance with the terms of the loan.

**Foreclosure Abuses.** These include persuading borrowers to sign deeds in lieu of foreclosure, giving up all rights to protections afforded under the foreclosure statute, sales of the home at below market value, sales without the opportunity to cure the default, and inadequate notice which is either not sent or backdated. We have even seen cases of "whispered foreclosures", in which persons conducting foreclosure sales on courthouse steps have ducked around the corner to avoid bidders so that the lender was assured he would not be out-bid. Finally, foreclosure deeds have been filed in courthouse deed records without a public foreclosure sale.

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**PORTIONS OF THIS REPORT WERE OBTAINED FROM  
THE FOLLOWING WEB PAGES**

**TRUTH IN LENDING ACT (T.I.L.A.),**  
<http://www4.law.cornell.edu/uscode/15/ch41sch1.html>

**THE RIGHT OF RESCISSION**  
[http://www.complianceheadquarters.com/Res\\_\\_Real\\_Estate/RRE\\_Articles/right\\_of\\_rescission.html](http://www.complianceheadquarters.com/Res__Real_Estate/RRE_Articles/right_of_rescission.html)

**CURRENT TRENDS IN RESIDENTIAL MORTGAGE  
LITIGATION**  
<http://www.edcombs.com/>

**HISTORY OF PREDATORY LENDING AND PREDATORY  
LENDING ABUSES**  
<http://www.LegalAid-GA.org>

**OTHER RESOURCES:**

**FEDERAL RESERVE BOARD REGULATION Z (12 C.F.R.  
PART 226)**  
<http://www.federalreserve.gov/boarddocs/press/bcreg/2003/20030819/attachment.pdf>

**KIRSCHLER PETERSON**  
<http://www.kirschlerpeterson.com/>

**EDELMAN & COMBS, OF CHICAGO, ILLINOIS**  
<http://www.edcombs.com/>

**LEGALAID-GA.ORG**

LegalAid-GA.org provides information relating to the law and legal resources in Georgia. Other states have different laws. Therefore the information on LegalAid-GA.org may not apply to your situation if you are from another state. To find information and resources for other states, you may go to <http://www.lawhelp.org/>

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**DEFINING BREACH OF FIDUCIARY DUTY**

Understanding the importance of breach of fiduciary duty in a negligence case will help you understand whether the complaint will be successful.

Breach of duty is part of a negligence lawsuit and the most important aspect in proving such an issue. If no duty was ever breached then no negligent damages are owed.

In a negligence lawsuit there are four elements to consider: duty, breach of duty, causation and damages. For breach of duty, it must be decided whether or not the defendant, the one being accused of negligence, behaved in a way that a reasonable person would have under similar circumstances. If no duty is owed then there is no negligence lawsuit.

To determine breach of duty's existence, a determination is made as to the standard of care and an evaluation of the defendant's conduct in reflection of that determined standard. If duty of care by the defendant can be proven, using the reasonable care standard, then negligence can be an issue. The defendant needs to have recognized the risks created by her or his actions and to understand what could happen from those risks taken. The general standard of care is then applied to the specific circumstances of the situation and the jury must establish whether the defendant's conduct was negligent.

When the courts decide if duty was owed they consider the objective or subjective standard. Objective standard considers the defendant's actions against a hypothetical reasonable person. With the subjective standard, the court considers whether the tortfeasor, the person who is allegedly negligent, believes her or his actions were reasonable. For example, if someone attempts to rob an elderly woman in a parking lot and she happens to have a gun and shoots her attacker, the objective standard would ask if a reasonable person would have acted the same way. In the subjective standard the courts would ask the elderly woman if she thought she was acting in a reasonable fashion.

Professionals are held to a higher standard of care than an ordinary reasonable person would be. Police officers, for example, must behave as a reasonable officer would do so rather than a reasonable person. The perspective of an officer would be different than an ordinary person and that difference matters in the court.

Occasionally, statutes, or laws, will decide the reasonable standard of care rather than the courts interpreting the behavior. When statutes determine the standard of care owed, violations would be called negligence per se.

If a plaintiff, the person alleging negligence, is unable to prove the defendant's negligence because pertinent information is inaccessible, then the plaintiff can rely on *res ipsa loquitur*. What this means is that the act speaks for itself and needs no other information to determine negligence. But, in order to use this, the plaintiff must prove two things: the event which injured themselves only happens when negligence has occurred; the item or instrument which caused the injury was under exclusive control of the defendant and the plaintiff's injuries were not due to their own actions.

The key factor to remember in considering negligence is whether the duty of care was ever owed to the plaintiff, by the defendant, and whether or not that duty was breached.

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*There are many other things a freedom awakened person can do to truly be free. For more information, please call or email us.*

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