Testimony of

THE PASSAIC COUNTY LEGAL AID SOCIETY

and the

NATIONAL CONSUMER LAW CENTER

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

regarding

H.R. 1362

FINANCIAL INSTITUTIONS REGULATORY RELIEF ACT OF 1995

May 24, 1995

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Mrs. Chairman and Members of the Committee, the Passaic County Legal Aid Society and the National Consumer Law Center thank the committee for inviting us to testify today regarding the devastating impact that passage of H.R. 1362 would have on our low-income clients.

The Passaic County Legal Aid Society provides free legal services to the low income residents of Passaic County. Our eleven lawyers and three paralegals provide assistance in civil matters ranging from housing foreclosures to domestic violence cases. We expend considerable efforts to maintain home ownership for the minority and elderly low income segment of the community. Over the years, the Society has handled dozens of cases in which the Truth in Lending Act was the primary tool used to stop the foreclosures of abusive home loans.

The National Consumer Law Center is a nonprofit organization specializing in consumer credit issues. We work with thousands of attorneys around the country, representing low-income and elderly homeowners, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have.[1] As a result of our daily contact with these practicing attorneys we have seen examples of predatory home equity loans from almost every state in the union.[2] **Without a doubt, passage of H.R. 1362 in its current form would allow that sector of the lending industry which engages in abusive and unconscionable practices to grow and thrive.** The positive

[1]The National Consumer Law Center, Inc. (NCLC) is a nonprofit Massachusetts corporation founded in 1969 at Boston College School of Law and dedicated to the interests of low-income consumers. NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government and private attorneys across the country. *Usury and Consumer Credit Regulation* (NCLC 1991) and *Unfair and Deceptive Acts and Practices* (NCLC 1991), two of eleven practice treatises published by NCLC, and our newsletter, *NCLC Reports Consumer Credit & Usury Ed.*, describe the law currently applicable to home equity loan transactions.

[2]Some examples of the types of outrageous practices we have seen may be found in NCLC publications, such as Hobbs, Keest, DeWaal, "Consumer Problems with Home Equity Scams, Second Mortgages, and Home Equity Lines of Credit," (AARP 1989); Keest, "Second Mortgage Lending: Abuses and Regulation," (NCLC, for Rockefeller Family Fund, 1991); "Nature Abhors a Vacuum: High-rate Lending in Redlined, Minority Neighborhoods in Boston," and "Principal Padding: The Prepaid Payment Pyramid," 9 NCLC Reports *Consumer Credit & Usury Ed.* (May/June 1991).

effects of the good work accomplished in the last Congress through passage of the Home Ownership and Equity Protection Act would be completely outweighed by the effects of the deregulation resulting from H.R. 1362.

This testimony has five parts:

•Part 1 deals generally with the most dangerous aspects of H.R. 1362 those cast as a response to the *Rodash* case (sections 106 through 114 of the bill).

•Part 2 is a section by section analysis of Subtitle A of H.R. 1362 (Sections 101 through 115) plus Section 241, which have the greatest impact on our clients by amending the Truth in Lending Act and the Real Estate Settlement Procedures Act.

•Part 3 provides a response to Subtitle E - amendments to the Consumer Leasing Act.

•Part 4 outlines a proposed solution to the lender requests for relief from *Rodash* type actions as well as lender complaints about regulatory burden. These solutions will not only reduce regulatory burden, streamline and ease regulatory compliance requirements in the home loan process, but also provide better disclosures for homeowners.

•Part 5 includes a number of true case histories from low-income homeowners which illustrate the importance of maintaining the minimal protections that are in current law.

Part 1

H.R. 1362 Goes Too Far - It Eviscerates The Truth in Lending Act

This bill, along with its companion bill in the Senate is more damaging to American consumers than virtually any other bill introduced in the U.S. Congress in a very long time. These bills essentially gut the Truth in Lending Act. Among a variety of amendments, six proposals stand out - *any one of which would reduce Truth in Lending to a meaningless law for homeowners:*

•The right of rescission for all loans secured by first liens[3] which refinance prior extensions of credit would be eliminated. This would leave homeowners without the opportunity to escape from misleading and unfair home loans. (Sec. 107 of H.R. 1362.)

[3]Other than those covered by the 1994 Home Ownership and Equity Protection Act, called "high cost mortgages" by many in the industry. It should be noted that this exemption would not protect the vast majority of loans made on the marketplace, including a substantial portion of abusive loans. However, where this section is combined with Sec. 241 effectively no loans would be excluded from coverage of Sec. 107.

•A "tolerance" in the finance charge disclosure, equal to thousands of dollars in some loans, would be allowed. The effect of this would be that the creditors could *deliberately* fail to include *thousands of dollars* of charges in the disclosure of finance charge, without violating TILA - when the essential purpose of TILA is to require the exact disclosure of the cost of credit. (Sec. 108 of H.R. 1362.)

•A change in the rules governing *assignee liability* which would make it virtually impossible to hold assignees liable for disclosure violations. As most home loans are assigned, this change would leave most homeowners without any remedy. Moreover, it removes all market incentives for ensuring compliance with the law. (Sec. 113 of H.R. 1362.)

•A total elimination of liability for damages or rescission for many mortgages loans already made. (Sec. 109 of H.R. 1362.)

•A prohibition on the equitable extension of the rescission period beyond three years, which courts have used as a method of last resort to provide relief as a defense to a foreclosure, in a very few situations. (Sec. 111 of H.R. 1362.)

•A change in the rules regarding *actual damages* which would make it virtually impossible for a borrower to ever recover actual damages in a TILA case. (Sec. 112 of H.R. 1362.)

<u>Background</u>

Much of Subtitle A of H.R. 1362 is a response to the decision in the recently decided case of *Rodash v. AIB Mortgage Co.*[4] In *Rodash*, after the consumer-plaintiff was forced into foreclosure because her loan required payments in excess of her income, she rescinded based on the lender's violations of Truth in Lending.[5] The appellate court upheld the rescission, saying:

> The burdens imposed on creditors are minimal, especially when compared to the harms that are avoided. The appellee's actions in this case disregarded that policy.[6]

The reaction of the mortgage banking industry to this decision was to implore Congress to *retroactively* change Truth in Lending, despite the fact that the law has been clear on these points all along.

<u>A Deal that is No Longer a Deal</u>

The mortgage banking industry first went to Congress requesting emergency relief from the effects of the *Rodash* decision in the fall of 1994. After extensive negotiations with representatives of consumers,

[4] 16 F.3d 1142 (11th Cir. 1994).

[5] Once a loan is rescinded under TILA, a homeowner still owes the amount borrowed; the lender only loses its profits.

[6] 16 F.3d at 1149.

an amendment was attached to the bill amending the Fair Credit Reporting Act. This amendment gave the industry the relief it sought - protection, even retroactively, from law suits alleging violations of TILA found to be illegal by the *Rodash* court. The amendment also changed the law *prospectively* to ensure that lenders would know how to make disclosures on these charges, without risking legal exposure in the future.

The amendment drafted in late 1994 failed to pass Congress because the bill to which it was attached hit a snag in the Senate. Yet, the mortgage industry lobbied forcefully for its passage - because the amendment addressed every one of the industry concerns raised by the *Rodash* case.

Unlike the 1994 amendments, H.R. 1362 does not just respond to lender concerns raised by Rodash - it goes much further.

Bankers Need A "Tolerance" For Adding Up Money?

Current regulations allow a $10 tolerance on the finance charge; in other words, a creditor can avoid liability for an inaccurate disclosure of the finance charge if the inaccuracy is no greater than $10. The proposal in Section 108 of H.R. 1362 would allow mortgage lenders to fail to include in the finance charge[7] - a crucial disclosure of the cost of credit under TILA - thousands of dollars of charges.[8] *Mistakes in arithmetic are already forgiven by TILA.*[9] ***H.R. 1362 would allow deliberately hidden charges****.*

TILA requires the disclosure of numbers which reveal the various components of the cost of credit, including the "amount financed" and the "finance charge." Each of these disclosures are determined by combining a sum of a series of independent numbers. It is the appropriate arithmetical amalgamation of these numbers that TILA requires. To say that one number is less important because it is only one number among many, misses the point of the strict rules of disclosure created by the Truth in Lending law. It is precisely the strict requirement that each number be specifically disclosed that makes the TILA required disclosures helpful at all to consumers. With the proposal in Section 108, lenders would be able to call their charges to consumers something they are not.

To put what this proposal seeks to do in perspective, consider whether bankers have *tolerances* of thousands of dollars when disclosing profits and losses to the IRS? Or to their stockholders? Or to their correspondent banks? Consider whether borrowers have a *tolerance* in the forgiveness of the debt equal to the *tolerance* allowed the creditor in disclosing the costs of the debt?

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[7]The exact amount of the "tolerance" would be determined by the annual percentage rate. The effect of this tie would be to that the more expensive the loan, the larger the allowed tolerance would be.

[8]For example, a $100,000 loan at 15% for 30 years would have a "tolerance" of $1799!

[9]§130(c) of TILA already exempts creditors from liability for errors resulting from clerical, calculation, computer malfunction and programming, and printing errors.

The purpose of TILA is to require the disclosure of the cost of credit. Tolerances in these disclosures beyond a few dollars vitiate the whole purpose of the Act. If this provision were allowed to pass the TILA *would no longer provide meaningful disclosures of the cost of credit to many homeowners*.

The Right of Rescission - The Last Line of Defense For Homeowners

In 1968, just as in 1995, Congress had been alerted to the significant risk of losing the family home due to ill-considered or overreaching home equity lending.[10] The stories in 1968 were the same as the stories in 1995, which is why Congress enacted a cooling off period to allow consumers to think about the risk of borrowing on their home, in the quiet of their living room, away from the sales pressure, and with full and accurate information about the cost of the step they were about to take. The right to rescind is extended beyond three days only if the lender does not give full and accurate information about one or more of the 6 pieces of information Congress deemed the most critical.[11] Even then, that right is cut off at three years.[12] When a consumer exercises that right, the security interest is canceled, the lender cannot keep finance charges or costs, and the borrower must tender the loan's real proceeds back to the lender.

Compliance is Enforced Through Deterrence. The right to rescind the loan is necessary to deter non-compliance with the crucial requirements of the TILA law.[13] It is also TILA that keeps competitive forces at work, as the most efficient lenders can disclose the lowest cost, and attract more consumers. It is those honest, efficient lenders who will lose when higher cost, inefficient lenders can wrongly disclose lower costs without fear of any significant consequences.

The Deterrence Provided by the Possibility of Rescission Works. There is no doubt that the vast majority of lenders who make home loans in the United States have *never* been subject to a TILA rescission. This is because on most loans, made by most home lenders, there are no TILA violations. This shows that TILA is working. Lenders are properly disclosing all of the costs of credit in almost all cases. Most lenders are sufficiently concerned with the threat of rescission that they ensure that their loans are not subject to it, they properly make TILA disclosures. If the remedy of rescission is removed, so is the impetus for compliance with TILA.

The Right of Rescission Provides Some Balance in the Deregulated Marketplace. It has been recognized since biblical times that borrowers need some protection from overreaching lenders. Borrowers are often desperate to obtain what only the lender can provide - immediate money. For centuries, this vast

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[10]Not all home-secured loans are rescindable. Only non-purchase money loans secured by the borrower's principal dwelling are.

[11]Finance charge, amount financed, APR, total of payments, payment schedule, and notice of right of cancellation.

[12]Common law recoupment allows defendants in civil actions to raise claims they have against a plaintiff as a defense, even if the statute of limitations has run on that statute. However, Sec. 111 would eliminate due right of recoupment.

[13]Banks understand the logic of deterrence. They justify charging $25 for late payments or bounced checks that cost them only $1 to 2 dollars in order to deter consumers from making late payments or bouncing checks.

difference in bargaining power has been the reason for the close regulation of consumer credit. However, in 1980, Congress *prohibited* states from imposing caps or ceilings on loans secured by *first liens on homes.* In 1982, Congress extended this prohibition of consumer protections by outlawing the limitation on terms and conditions of these loans secured by first liens on homes.[14] *The justification for this deregulation was the strict requirement of disclosure of all the costs and terms of the credit.* The rationale was that as long as full and fair disclosure is required, the market will police itself. Thus, deregulation of home lending was premised on the strict enforcement of the disclosure rules in TILA.

H.R. 1362 Would Leave Homeowners Obtaining Already *Deregulated* Loans With No Protections. Sec. 107 of H.R. 1362 proposes to exempt the same loans which are already deregulated as to rates and terms from the only remaining protections borrowers have - the right to full and accurate information about loan terms, and rescission if these disclosures are not made.

As was recognized by the 103rd Congress with the passage of the Home Ownership and Equity Protection Act, many older Americans and many minority Americans have been the victims of an industry that has developed in the vacuum created by the lack of regulation of home loans. The ***complete absence of caps on the interest rates and fees*** that lenders can charge on many of these loans, as well as the dramatic increases in home values over the last decade, has led to the development of an entire industry which targets less sophisticated homeowners and engages them in high priced and unfair loan practices. High interest rates and other abusive loan terms are typical. Consumers are often coaxed into signing loans for which there is no reasonable probability that they will be able to repay.

In many elderly, minority, or low-income neighborhoods, the number of houses sold at foreclosure have skyrocketed due to these abusive loans. With the significant exception of TILA rescission, most state and federal laws are generally inapplicable to these loans. Despite the rampant unfairness of many of these loans, there is often only one way to save the home from foreclosure - rescind for a TILA disclosure violation.[15]

The right of rescission is the only tool left under state or federal laws generally available to save homes from foreclosure due to abusive loan terms. Cutting back on its use will leave homeowners generally with no protection whatsoever from overreaching lenders, and with no way to save their homes.

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[14] Congress' contribution to this problem can be traced to the passage of 1) the Depository Institutions Deregulation and Monetary Control Act of 1980, §501 (often referred to as "DIDMCA"), codified at 12 U.S.C. §1735f-7a, which *preempted* state usury ceilings on mortgage lending secured by first liens (whether purchase money or not); and 2) the passage of the Alternative Mortgage Transaction Parity Act of 1982 (often referred to as "AMTPA"), 12 U.S.C. §3800, *et seq.*, which preempted state limitations on risky "creative financing" options, such as negative amortization loans, or balloon notes.

[15] It was widely recognized during the congressional discussions of the Home Ownership and Protection Act of 1994 that this Act alone will not address all of the abusive home lending.

Part 2

Section by Section analysis of H.R. 1362 as it Affects Low-Income Consumers

Sec. 101.**Transfer of Authority**

This section proposes to transfer the authority of the Real Estate Settlement Procedures Act from the Department of Housing and Urban Development to the Federal Reserve Board, as well as eliminates some regulations. In addition to making clarifying changes to RESPA regarding the change in regulatory authority from HUD to the Board, this section sets out the specifications which the Board is instructed to use regarding these disclosure requirements. Conspicuously absent from the specifications is any language requiring the regulations to *ensure or facilitate helpful and timely disclosures to be made to consumers.*

This section further deals with enforcement of compliance. The addition of the language in section (d) giving the Federal Trade Commission enforcement authority is good, however, there would still be no private right of action for the failure to make required RESPA disclosures.

Sec. 102.**Truth in Lending and RESPA Comparability**

Generally, there is no problem with requiring that these two laws be coordinated, however there are a number of problems with the specific provisions of this section. First, there is no requirement that disclosures be made in the most informative and helpful manner for consumers. Second, there is a specific prohibition against new disclosures, so that the only way the Federal Reserve Board would be permitted to "coordinate" the two laws would be to eliminate some of the existing disclosure requirements. Instead, more appropriately, there should be an instruction for new, consistent and coordinated disclosures to be made under both laws. [In fact, our proposal outlined in Part 4 of this testimony, does just that - sets out amendments to the Truth in Lending Act and RESPA which will eliminate much of the duplication between the two laws, simplifies the lenders' requirements, and improves the quality of the information provided to the consumer.]

The major change implemented by this and the previous section would be to shift regulatory authority of RESPA from HUD to the Federal Reserve Board. This probably goes too far. RESPA has both disclosure requirements and substantive requirements (regarding escrow accounts and unfair acts during settlement). It makes much more sense to shift the regulatory authority over *disclosures* to the Federal Reserve Board, while leaving the substantive regulations within HUD's bailiwick.

Sec. 103.**General Exemption Authority for Loans**

This section requires the Board to exempt some transactions from TILA coverage altogether. The section is unnecessary, and clearly not written for the benefit of consumers. The Board already has authority to exempt classes of transactions which "in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." (Section 105 of TILA.)

Conspicuously absent from the list of factors the Board is instructed to use to determine which classes of transactions to exempt are any that relate to the protection of the borrowing public, or the importance of maintaining and strengthening home ownership. Further, the factors that are listed are unclear in the intent and their effect. For example, the first factor mentions small loans. Does this imply that on small loans TILA disclosures and protections would not be necessary? Yet those are exactly the types of loans which low-income borrowers are most likely to obtain, and which are already rife with abuses. Should the Georgia citizens who borrowed $600 and $581 not be told theirs were 57.64% and 58.11% loans, respectively? Should the Utah customers at a local finance company not be told the company charges anywhere from 280% to 420% for loans of $100 to $200? Should South Carolina borrowers not be told that loans of less than $150 can cost more than 100%?[16]

Sec. 104.**Reductions in Real Estate Settlement Procedures Act Regulatory Burdens**

Among the changes that would be made in this section is the repeal of the RESPA coverage of loans secured by subordinate liens. There are two issues with this proposal. The most serious problem is that the prohibition against kickbacks to loan brokers would be repealed for junior lien loans. There is no justification for such a repeal. This anti-kickback provision is one of the few federal substantive consumer laws that provide real protection to consumers. Repealing this protection would encourage the growth of reverse incentives in the mortgage broker industry. Without a prohibition against kickbacks by a lender to a broker, market forces reward the brokers who refer borrowers to the most *expensive* lenders, rather than the cheapest.

Secondly, assuming the disclosures required by RESPA provide valuable information to borrowers who are providing their homes as security for a loan, there is no justification for not providing the same disclosures for junior lien loans. [See our proposal in Part 4 below regarding a method of making RESPA disclosures and TILA disclosures more streamlined and more helpful to consumers.]

Sec. 105.**Alternative Disclosures for Adjustable Rate Mortgages**

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[16]These rates are not fictional; they are real life examples from NCLC files, and the files of the attorneys who work directly with these borrowers. See also Paul Tosto, "Alternative banks often profit from the poor," The State, p. 1A (Dec. 26, 1993).

This section provides the lender with an alternative to the current disclosures required for adjustable rate mortgages in both the open end and closed end credit sections of TILA. The alternative disclosure is simply a sentence that says the monthly payment may increase or decrease. This alternative information is of minimal use to the consumer. Of far more benefit to the consumer would be the requirement that the lender disclose the ***maximum possible payment*** under the loan. Assuming the borrower draws the maximum allowed from the credit line, and the interest rates goes to highest level, information about the resulting payment would be of far more value to the consumer than either the current disclosures or the new sentence proposed by H.R. 1362.

Sec. 106.**Treatment of Certain Charges**

This is the first of the "*Rodash* fixes." This section would ensure the exclusion of three types of charges from the finance charge: charges imposed by third parties (including closing agents), intangible tax fees, and loan document preparation fees. We only have a comment on the first proposal.

It is interesting that the language of this section is different from its counterpart in the Senate bill. The house bill proposes to exclude from the finance charge: "fees and amounts imposed by third parties not affiliated with the creditor . . . if the creditor does not expressly require the imposition of the charges and does not retain the charges." Significantly, the equivalent section in S. 650 adds the words *"closing agents"* after the words "third party." The omission of the closing agent limitation opens up a huge area for serious problems for consumers. For example, the House bill language would allow brokers fees of thousands of dollars to be *excluded* from the finance charge, so long as the creditor had not *expressly* required the use of the broker, and thus the imposition of the broker's fees.

Yet, a creditor may *implicitly* require the use of the broker, or the other fees. The Truth in Lending Act would then allow a creditor to *exclude* from the definition of the finance charge a fee of thousands of dollars which is undoubtedly associated with the procurement of that credit.

As between the two proposals, that in H.R. 1362 and that in S. 650, the proposed language in S. 650 would do much less harm to the integrity of TILA. This Senate proposal would exclude from the finance charge fees imposed by third party closing agents if the creditor does not expressly require the imposition of the charge and does not retain the charge and has not required the use of the third party imposing the charge.[17] We would recommend adding the requirements that the creditor:

[17]For example, it is the lender who chooses to require that third-party closing agents be used -- inserting another layer of middlemen into the loan origination process. While they may offer the borrowers a choice from among an approved list, the creditor <u>requires</u> that a third party be used. Moreover, it selects who goes on the list from which the borrower may "choose." Thus it is the creditor who has the choice to compete on costs by eliminating the middleman entirely. Or, if it chooses to insert the middlemen, at least it would have an incentive to monitor those middlemen to ensure that the ones who do the job efficiently and cheaply are the ones who make the list. Without such a requirement, once again, reverse competition can prevail, for the more expensive the middleman, the more the lender can learn in interest on an increased loan balance.

1) has no control over the imposition of the charge;
2)has not required the service inducing the charge;
3)has no reasonable way of knowing the amount of charge at the time the disclosures are prepared;
4)has not required the use of the third party imposing the charge; and
5)is not related to or affiliated with the third party.

Adding the requirement that the creditor does not require the particular service for which the agent is charging the borrower tracks the recently published change to the Commentary regarding what should be excluded from the finance charge by the Board. (See 63 Federal Register 16777, April 3, 1995.) [Also see Part 4 of this testimony regarding our proposal to include all charges in the finance charge except those charges imposed by third party closing agents meeting the above criteria.]

Further, to ensure that only *de minimus* charges are excluded from the finance charge in this way, we propose that the total amount to be excluded from the finance charge because of third party imposed charges be limited to $50. Regardless of what else is done on this subject, lenders should be limited to excluding *bona fide* charges.

Sec. 107.**Exemptions from Rescission**

As stated above, this proposal would eliminate the right of rescission for all loans secured by first liens which refinance prior extensions of credit. This would leave homeowners without the opportunity to escape from misleading and unfair home loans.

This exemption purports to exclude those loans covered by the 1994 Home Ownership and Equity Protection Act, called "high cost mortgages" by many in the industry.[18] By no means would this exception from the proposed exemption protect homeowners from abusive loans. There are still tens of thousands of loans on the marketplace which are not caught within the high trigger requirements of the high costs mortgage law, for which homeowners should have the right of rescission. Indeed, the effect of this proposal would leave the vast majority of loans made on the marketplace, including a substantial portion of abusive loans without *virtually the only protections homeowners now have from deceptive home loans.*

As this proposal has gained notoriety, homeowners of all income levels have come forward with stories of necessary uses of the right of rescission - within the original three days - and afterwards. Homeowners need the right of rescission not only in the archetypal "abusive" home loan setting, but often also when dealing with a reputable lender. All too frequently,

[18]The exclusion from coverage of high cost loans from the proposed exemption from the right of rescission is misleading because another section of H.R. 1362 - Section 241 - would limit applicability of the entire high cost law to junior lien loans. See discussion below on the effect of Section 241.

homeowners have found when they get to closing that the terms or rates on the loans they are being asked to sign are different than those to which they had agreed. Often, because of the dozens of pieces of paper which are placed before them in rapid succession for their signature, they do not appreciate the full extent of the discrepancies between what they had agreed to in the application process and what they signed at closing.

The extra time to digest the ramifications of all the terms, the rates, and the fees, agreed to in a home loan, provided by the three day right of rescission is an essential protection to homeowners. It is especially important in light of the fact that *there are virtually no other limits on the rates and terms required in these loans.* (See full discussion of the importance of the right of rescission in Part 1 of this testimony.)

Sec. 108.**Tolerances; Basis for Disclosures**

Taking the second part of the proposed change in this section first - the basis for disclosure for per diem interest - we have no objection.

This is not the case with the first proposed change. This section would allow lenders can a tolerance in the finance charge equal to one sixteenth of the annual percentage rate. Consider the amount of money this would actually allow lenders to fail to disclose properly on some loans:

$10,000 loan at 15% APR for 5 years	would allow a "tolerance" of $19.69
$50,000 loan at 12% APR for 10 years	would allow a "tolerance" of $216.92
$100,000 loan at 10% APR for 30 years	would allow a "tolerance" of $1,663.93
$150,000 loan at 8% APR for 30 years	would allow a "tolerance" of $2,356.17.

It is important to remember throughout this discussion the ***name*** of the law being amended - the TRUTH IN LENDING ACT. If lenders are permitted to avoid properly disclosing some fees they receive, where is the *truth* in that disclosure? Further, why should lenders who charge much more in finance charges - and hence have far more profit from which to draw compliance incentives - be allowed to avoid disclosing so much more in those finance charges?

Rather than allow lenders a *tolerance* level for the assumed inability to comply with an overly technical law, it would make far more sense to simplify the law, clarify for both lenders and borrowers those charges which should be included in the finance charge, and demand full compliance. Our proposal, in Part 4 of this testimony, sets out a specific method by which lenders would be assured of no liability so long as they included in the finance charge all of the costs associated with the imposition of the credit. Lenders say they need clarity on what charges should be included in the finance charge, and that the penalties for making a mistake on a small charge is too great, and unfair to lenders.

To provide that clarity to lenders we recommend that from henceforward *everything* that the consumer must pay due to the fact that a loan is being obtained must be included in the finance charge. The only exclusions should possibly be those small charges imposed by the third party closing agent over which the lender has no control, and from which the lender receives no benefit. Our proposal to deal with this problem, as well as the coordination of RESPA disclosures with TILA disclosures is set out in Part 4 of this testimony.

Sec. 109.**Certain Limitations on Liability**

These *retroactive* exclusions from liability would excuse lenders on virtually all outstanding loans. *In fact, these exclusions from liability far exceed even the prospective changes proposed by the bill.* This proposal essentially asks the United States Congress to insert itself into disputes currently waging in the courts on the appropriate penalties that lenders should pay for their continued and systematic violations of clear and unambiguous provisions of TILA. This is all proposed under the guise of the necessity to protect lenders from liability of the *Rodash* case progeny. Yet, the proposal goes far beyond anything determined by the *Rodash* court.

Not only would the lenders be excused from liability in class actions, but also for all individual actions filed. Specifically, the proposal in Sec. 109 would exempt from liability lenders who failed to disclose properly:

•The fee for the intangible tax which was disputed in the *Rodash* case. (Sec. 139(a)(1)(A).This retroactive exclusion does correspond to a prospective change in the law. It also corresponds to the Federal Reserve Board's treatment of these fees in its Commentary. (*See Commentary* §226.4(7)(D), 63 Federal Register 16777. April 3, 1995.)

•Fees for preparation of deeds, settlement statements, or other documents, or appraisals. (Sec.139(a)(1)(B).) This proposed exclusion is absurd. These fees are already specifically excluded from the finance charge in the Truth in Lending Act, and have been for many years. Lenders who have deliberately ignored the law are now trying to avoid liability for their behavior in flagrant violation of the law. They cannot claim that their actions were a mistake, or else they would not need this retroactive protection from liability. Lenders are already provided with protection from liability for bona fide or accidental errors. (TILA §130(c).)

•Fees for charges imposed by third parties. (Sec. 139(a)(1)(B).) This retroactive exclusion does correspond to a prospective change in the law. Yet, as explained above in the analysis of Sec.106, this would allow lenders to avoid liability for failing to disclose thousands of dollars of brokers fees, or other fees.

•Delivery charges imposed by a creditor. (Sec. 139(a)(1)(C). This proposed exemption is absurd. It seeks to exempt from liability lenders who failed to include in the finance charge fees which even H.R. 1362 would still include in the finance charge. There has never been any lack of clarity regarding how a creditor imposed delivery fee should be disclosed. The law, both in the past, and as proposed in H.R. 1362 and S. 650, always has required that these fees be included in the finance charge. There is no justification for allowing an avoidance of liability for previously improperly disclosed creditor delivery charges, because there was never any confusion on this point.

•Thousands of dollars in fees which were improperly excluded from the finance charge. (Sec.139(b)(1)(A).) This retroactive exclusion does correspond to a prospective change in the law. But the effect of this proposal would be to cut out virtually the only method that victims of abusive home loans have to save their homes from foreclosure.

•Fees which are greater than those required to be disclosed. (Sec. 139(b)(1)(B).)

Sec. 110. **Applicability**

Unlike other laws amending the Truth in Lending Act, which always require the implementation of regulations before making the law effective, this provision would make all changes effective immediately following ratification.

Sec. 111. **Limitation on Rescission Period**

This section would stop a practice in which the courts have used their equitable powers to extend the right of rescission beyond the statutorily permitted three years, when rescission is raised as a method of recoupment in a foreclosure.[19] The limited use by the courts of this equitable remedy has provided one of the few methods courts have to help balance the interests between lenders and homeowners who stand to lose their homes because of abusive loan terms. It is rarely used, but of crucial importance when it is used.

The reported cases in which this right has been exercised are few. However, one case from Colorado reveals why the change proposed in this section would work an injustice for homeowners.

[19]It has long been recognized in common law that there is a right to assert a claim defensively which would be barred if asserted affirmatively. Otherwise it would be manifestly unfair to allow one party to demand performance on a contract to which the other party has a valid defense. Without this common law protection to assert rights by way of defense, the parties to a contract would be unevenly protected by the laws which enforce the rights and obligations under the contract. *See, e.g. Bull v. U.S.*, 295 U.S. 247, 262 (1935).

In *Dawes v. Merchants Mortgage and Trust Corp.*,[20] the borrowers, Mr. and Mrs. Dawes, did not receive a proper notice of their right to rescind their transaction, something agreed upon by all parties. They also stopped making payments after nearly a year when it became obvious that improvements promised by the creditor would not be completed. But then nothing happened for more than four years, when suit was filed on the note by Merchants, a bank which had obtained the note by assignment. Two years later, the Dawes notified the plaintiff of their intention to rescind in the nature of recoupment.

The Colorado Supreme Court permitted the rescission by recoupment after that claim had been denied as a matter of law by the lower courts. It held that if the rescission claims were barred by reason of the statute of limitations the lenders could avoid the penalties intended by the Truth in Lending Act and profit from its violations simply by waiting three years before bringing suit. For the same reasons, this proposal should not pass.

Sec. 112. **Calculation of Actual Damages**

The effect of this section would be to make it impossible to recover actual damages under TILA. To recover actual damages under this proposal a consumer would have to show the rate they *would* have received from another lender, to whom they did not submit an application, because they were deceived by the lender from whom they did receive credit. Even the most careful and cautious borrower would not be able to prove, months or years after the event, the rate for which another lender would have provided credit to them.

No other consumer credit protection statute has such a heavy, and impossible to meet, burden to obtain actual damages. In essence this provision would establish a fraud like *detrimental reliance* standard for TILA actual damages. Knowing the difficulty of prevailing with a standard such as this, unscrupulous lenders would be free to abuse the act with impunity. The terrible consequence is that the credit system in the United States would go from one which places the burden on lenders to provide true and valuable information about the real costs of credit, to one in which lenders would be free from market incentives to disclose truly their costs and fees.

Sec. 113. **Assignee Liability**

Changing the statute by omitting just a few words, this provision would virtually eliminate all assignee liability for TILA violations. As almost all home loans (as well as car loans) are assigned, the effect of the elimination of assignee liability would be to make it impossible to challenge improper disclosures, or even raise those violations of this disclosure law as a defense to a foreclosure or other action to collect on a debt. It should be noted that this section affects all consumer credit, not just credit secured by the home.

[20] 683 P.2d 796 (Colo.1984).

There should be no misunderstanding regarding the impact of this proposal. Its passage would dispatch the Truth in Lending Act to the wayside in terms of consumer protection laws. As it would no longer be enforceable in the majority of consumer loans, it would doubtfully be complied with in many instances.

This section also would clarify that the servicer of a loan would not be treated as an assignee. There is no problem with this concept, *so long as the servicer were required to provide the consumer with the name and address of the assignee or owner of the loan.*

Sec. 114. **Recovery of Fees**

This section would amend the law of rescission to allow a creditor to keep the costs of an appraisal report or a credit report after a borrower had rescinded the loan. To allow this is inconsistent with the basic concept of rescission, which is to place the parties in the same position after rescission, as they would have been had the loan never been made.

Sec. 115. **Homeownership Debt Counseling Notification**

This section would eliminate the HUD counseling provided to some borrowers prior to foreclosure. This would be unfortunate. People who are facing foreclosure have no where else to turn. They have no money to hire attorneys, and they too often do not have access to free legal services.

Sec. 241. **Second Mortgages**

This little proposal, at the end of Title II of H.R. 1362, would demolish the high cost mortgage law passed by the 103rd Congress by exempting from its coverage all loans secured by first liens. As first lien loans are currently deregulated, and are thus exempt from interest rate or term limitations, they are almost always the vehicle which the abusive lenders use to take advantage of consumers. There is no point in the 1994 Home Ownership and Equity Protection Act remaining on the books if this section becomes law.

Part 3

Consumer Leasing Act Amendments
Subtitle E - Consumer Leasing Act Amendments

Section 154 - Segregated Leasing Disclosures. This section would require that lessors provide consumers with an additional, simpler, more tabular layer of disclosure, without limiting existing disclosure requirements. The additional disclosures could prove helpful to consumers ***as long as existing disclosures are not restricted.***

The additional disclosures provide information that is already provided under the law:

- the total amount due at lease inception,
- the monthly payment amount,
- the number of payments,
- the total of monthly payments,
- whether there is a purchase option,
- excess mileage charges, and
- the early termination formula.

However, the proposal would provide this same information in a more simplified, tabular format which may assist consumers.

<u>Disclosure of name of early termination formula</u>. Consumers will receive no benefit at all from the disclosure merely of the name of the early termination formula, as proposed by Section 182(b)(9). The terms "adjusted lease balance formula" or "present value method" not only mean nothing to typical consumers, but will not tell even experts anything at all whether the early termination formula is attractive or onerous to the consumer.

Instead, as currently required in some states, the lessor should provide the consumer with a disclosure which includes an estimated dollar figure for what the early termination charge would be if the consumer terminated at various intervals during the lease term. The mere mention of the name of the formula with no other information would provide consumers with *no* useful data, but would merely increase confusion about an already confusing subject. The tabular disclosure proposed in the bill will not alleviate this confusion. The effect the proposal to require the disclosure of the *name* of the early termination penalty would be particularly harmful to consumers if this tabular disclosure were used as a justification to reduce the requirement currently in the law mandating that the method by which the early termination penalty is determined is fully explained. The current law requires that there be a clear and conspicuous disclosure to consumers of the exact amount or method of computing the dollar value of the early termination liability. This requirement must be maintained.

<u>Disclosure of capitalized cost</u>. The legislation does create two new Consumer Leasing Act disclosures -- the capitalized cost and the residual value. Requiring disclosure of the capitalized cost and residual value is an improvement for consumers over existing law, but care must be taken as to how capitalized cost is defined so as not to mislead consumers.

Is this the car's cost before or after adjusting for trade-ins and downpayments? What about negative trade-ins or situations where one lease is traded in for another? What about manufacturer rebates? Our experience is that dealers sometimes fail to credit consumers for trade-ins or downpayments and that consumers frequently do not know what car value is being used to compute lease payments. Consumers need to know how much they are paying for the car, and then how this amount is adjusted up or down to account for trade-ins, downpayments, rebates, and the like.

Section 155 - Consumer Lease Advertising. This advertising provision reduces the amount of information required to be disclosed in advertising if the lessor makes pricing representations. The lessor would no longer need to disclose: 1) the total of payments, 2) certain information concerning early termination liability, or 3) purchase option information. All of this information is generally helpful to consumers.

Part 4

Proposed Resolution to the Issues Raised by H.R. 1362

There are two issues raised by the proposed changes to the Truth in Lending Act and RESPA in H.R. 1362: prospective changes to TILA (and RESPA), and some response to the lending industry's cries that the secondary market is going to collapse under the weight of *Rodash* actions.

We offer a proposal regarding the simplification of the disclosure requirements under TILA and RESPA. Regarding retroactive relief which would cut off existing consumer rights under existing law, we urge extreme caution. At a minimum all individual actions for violations of existing law should not be compromised. Further, to the extent that liability under class actions is limited, it should be only for those violations that Congress is certain are so *de minimus* that the equities truly lay with the lenders.

Regarding the prospective changes in the laws, generally we propose to change the definition of finance charge to include *everything related to the cost of credit*. This makes compliance very easy for creditors, and it places all lenders on a level playing field. It thus strengthens the role that competition can play in the marketplace, to the advantage of efficient lenders. The finance charge would be itemized in all transactions secured by a principal dwelling. RESPA disclosures would be dropped altogether. In their stead, lenders would be required to provide a good faith estimate of the finance charge, itemized, as well as the amount financed, also itemized.

More specifically, the finance charge would be disclosed as one figure, under which two separate disclosures would also be made: the finance charge to be paid during the term of the loan (which would include interest, mortgage insurance premiums, etc.), and prepaid finance charges (which would include settlement charges - individually itemized - as well as insurance premiums). All the specific items making up each of the two components of the finance charge would also be itemized.

There would be a specific, and limited exception for third party charges imposed by a settlement agent, the total of which could not exceed $50, and over which the lender has no control and no reasonable way of knowing the amount of the charge. Concerns that lenders express regarding their inability to know the charges that would be imposed by settlement agents would thus be alleviated. At the same time, consumers would be protected from abusive attempts to hide lender charges within the third party exception.

In lieu of the RESPA disclosures currently required, lenders could provide their good faith estimates of the total and the itemization of the finance charge as well as the amount financed. In addition, they would disclose other charges to be paid outside of closing. In this way the lenders are preparing, and consumer are receiving, all disclosures related to the transactions in the same format, and using the same language.

This proposal would benefit lenders who try to keep their settlement and closing costs down, because the annual percentage rates on their loans would reflect these cost savings. Consumers also would benefit from the new competitive environment created by including the settlement charges in the annual percentage. Rate comparisons between lenders would, for the first time, truly reflect all of the costs of credit with the particular lender.

I. The following amends TILA to include *all* charges within the definition of finance charge.

Section 106 of the Truth in Lending Act is rewritten as follows:

"SECTION 106-DETERMINATION OF FINANCE CHARGE.

"(a) Except as specifically provided in section (b) of this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. The only charges imposed by the creditor not included in the finance charge are those of a type payable in a comparable cash transaction.

(b) So long as the total of these charges does not exceed $50, charges imposed on the consumer by a settlement agent are not finance charges if the creditor:

1) has no control over the imposition of the charge;
2)has not required the service inducing the charge;
3)has no reasonable way of knowing the amount of charge at the time the disclosures are prepared;
4)has not required the use of the third party incurring the charge; and
5)is not related to or affiliated with the third party.

(c) In conjunction with the disclosure of the finance charge, a creditor shall provide a statement of the consumer's right to obtain, upon a written request, a written itemization of the finance charge. The statement shall include spaces for a "yes" and "no" indication to be initialed by the consumer to indicate whether the consumer wants a written itemization of the finance charge. Upon receiving an affirmative indication, the creditor shall provide, at the time other disclosures are required to be furnished, a written itemization of the finance charge, except that a written itemization of the finance charge shall always be provided in the case of an extension of credit secured by the consumer's principal dwelling. For the purposes of this subparagraph, `itemization of the finance charge' means a disclosure of the following items, to the extent applicable:

1)Finance Charge to Paid During the Term of the Loan. This excludes pre-paid interest, or other similar charges paid at the time of, or prior to, loan settlement or consummation, and includes items to be paid during the term of the loan including, but not limited to the following items, to the extent applicable:
   (A) interest,
   (B) time price differential,

(C) Mortgage insurance premiums,
(D) Other items added to the balance after consummation.

2)Prepaid Finance Charges. This includes all charges to be paid by the borrower in cash or its equivalent, or withheld from the amount of credit extended, prior to, or at settlement or consummation of the extension of credit which are incident to the extension of credit, as defined in subsection (a), including:

(A)Settlement Charges. All charges to be paid at the time of, or prior to, loan settlement, specified as a lump sum, and further itemized as applicable:

(i)Prepaid interest;
(ii)Interim interest;
(iii) Loan discount fee;
(iv) Loan application fee;
(v)Points, or other charges payable directly to the creditor at the time the credit is extended;
(vi) Finder's fee, or broker's fee;
(vii)Fee for an investigation or credit report;
(viii)Fees or premiums for title examination, title insurance, or similar purposes;
(ix) Fees for preparation of a deed, settlement statement, or other documents;
(x)Fees for notarizing deeds and other documents;
(xi)Appraisal and survey fees;
(xii)Fees for a closing agent; and
(xiii)Any other expenses related to closing;

B)Insurance Premiums. Premiums for insurance, written in connection with the transaction, against loss of or damage to property or against liability arising out of the ownership or use of property.

C)Credit Insurance Premiums. Premiums for credit life, accident, health or other insurance written in connection with the transaction."

II. This replaces TILA presettlement disclosures (now required for purchase money real estate mortgages under 128(b)(2)), and all RESPA disclosures (now required for virtually all residential real estate transactions) both of which are now required within three days after receipt of a written application, with a single specific requirement applicable to all transactions secured by dwellings.

1. Add a new section 106A:

"SECTION 106A - DISCLOSURES REQUIRED FOR REAL ESTATE SETTLEMENTS.

(a) In the case of any extension of credit which is secured by the consumer's principal dwelling, the creditor shall provide, within 3 days after application, and not less than three days prior to consummation, whichever occurs earlier, the following disclosures to any consumer for whom the creditor receives or for whom it prepares a written application to borrow money secured by a principal dwelling:

1)the creditor's good faith estimate of the finance charge, and a good faith estimate of the various charges included in the itemization of the finance charge, as defined by Section 106;
2) the creditor's good faith estimate of the amount financed, along with an itemization of the amount financed, as defined by Section 128(a);
3)any fees or charges to be paid by the consumer outside of the settlement; and
4)the creditor's good faith estimate of the annual percentage rate, and the payment schedule; and
5)the note rate, and points, as applicable.

(b) Disclosures which are good faith estimates and subject to change must be clearly and conspicuously denominated as `good faith estimates subject to change'. Disclosures which are good faith estimates shall be made in accordance with the regulations of the Board under section 121(c). After providing the disclosures required by this section, if any terms change, the creditor shall provide new disclosures before consummating the transaction.

(c) The Board shall develop recommended forms for the provision of all relevant information regarding the transaction at consummation or settlement."

2. Amend RESPA to delete provisions relating to disclosure requirements prior to settlement or at settlement:

§ 2603 of RESPA is deleted. §2604 would be rewritten with its current language, omitting subsection (c), and changing "Secretary" to "Board."

3. Remove other pre-settlement disclosure requirements from TILA:

"Section 128(b)(2) is deleted."

III. The following proposals would make amendments to TILA to respond to lender concerns while addressing consumer protections issues.

1. Amend TILA disclosure requirements to clarify that only a misstatement of the finance charge would be a material violation allowing rescission or imposition of a statutory penalty, as opposed to the misstatement of any of the items in the itemization of the finance charge. Misstatement of the individual items would *not* be a material violation.

"Section 128(a)(3) is rewritten to read:
(3) The `finance charge,' using that term."

2. Clarify that *overstatement* of the finance charge will not lead to liability under TILA:

Amend section (103)(z) to read as follows:

"The disclosure of a finance charge which is greater than that required to be disclosed under this title does not give rise to liability under §130 or §125 provided the total of payments is not affected by the overstatement."

Part 5

Case Histories Regarding the Importance of Various Measures Proposed to be Changed by H.R. 1362

Mrs. T.
The Right of Rescission

This is the story of a 77 year African American woman from North Carolina, referred to here as Mrs. T, who is about to lose her home due to a series of abusive home loans. Her problems began when she signed a contract with a now defunct home repair company for a new roof and some windows (for over $13,000). After a series of four refinancings, she is now obligated on a loan, secured by her home, for over $32,000.

This elderly homeowner subsists on a monthly $722 Social Security check, which is occasionally supplemented by her work as a nursing assistant for other elderly people. The payments on her current mortgage - to Ford Consumer Finance - are $455.75 a month. Although it is hard to imagine how this woman is able to live on the remaining $266 a month, she has been able to make most of the payments under the loan. Regardless of how hard she tries to make the payments for the seven year term of the note, however, she will never be able to make the last one - which is a balloon payment of $32,411. This means that, for 6 years and 11 months, Mrs. T.'s monthly payments are $455.75; the very last monthly payment is $32,411.08. The total of these payments is $70,238.33.

Mrs. T. was induced to refinance the original loan *four* times in less than four years. After the original loan for her new $13,000 roof (although the house is less than 1000 square feet), and a few other extensions of credit along the way, Mrs. T. has received from the loan companies just under $23,000. Since this nightmare began, Mrs. T. has repaid the loan companies almost $18,000. Yet, today she still owes over $32,000. Despite her payments, the debts keeps rising because each time there was a refinancing, large prepaid finance charges and large settlement fees were added to the amounts owed.

Mrs. T. is about to lose the home that has been in her family for generations, despite her best efforts to maintain it, and pay the loans secured by it. North Carolina law, like the law of most states, allows lenders to charge whatever they want on loans like these extended to Mrs. T. She is using the one remedy that is available - Truth in Lending rescission - to try to save the home. In addition to taking advantage of Mrs. T. these lenders violated some of the disclosure requirements of the Truth in Lending Act. Although there is a clear pattern of abuse, because of the deregulation of interest rates and terms, no other state or federal law appears to have been clearly violated in this case. Truth in Lending rescission is the one law which may enable Mrs. T. to keep her home.

Congressional efforts to deal with abusive home lending in the 103rd Congress were helpful. But it should be noted, that not one of the loans extended to Mrs. T. would have been covered by the Home Ownership and Equity Protection Act of 1994.

Mrs. R.
The Right of Rescission

Mrs. R., a 67-year old Washington, D.C. resident went to Lender G who advertises on the radio: "$50 million to lend!" She contacted them about a consolidation loan: $9600, mostly unsecured debt.

Their representative came to her house, collected her bills and took them back. Three days later, they came out to her house again, picked her up and drove her to their office to sign some papers. These papers purported to be a 16% loan -- secured, of course, by her home.

What she didn't realize -- until 4 years later -- was that Lender G was not the lender. It was a broker, acting for a national bank.

The loan was for significantly more than $9600. There was a nearly $4,500 brokers fee, $250 for an appraisal that never took place, $440 of other closing costs. And, oh. There was a $6765 charge. Unbeknownst to her, this was a premium for a $40,000 term life insurance policy. Both the lender and the broker profit from this insurance (a commission for one, and the lender gets an extra $10,900+ in interest on this loan from it.) Mrs. R., (or rather her children) can never possibly benefit from it, as the lender and broker knew. It requires the insured to be working, and, as her application made clear, she was retired at the time.

This $28,000 loan -- of which only $9600 was actual consideration for her benefit -- had her paying over $400 a month until she is 77 years old.

This loan -- from a national bank -- disclosed as a 16% loan -- is really a 29+% loan. One fully secured by her home.

Had Congress not preempted D.C.'s usury ceiling for first liens, this loan would have been usurious. As it is, Mrs. R. can use TIL rescission to stop the foreclosure sale scheduled on her home.

If Congress now curtails her rescission right, too, what will older homeowners like Mrs. R. do when the foreclosure auction comes?

Ms. M

The Right of Rescission As a Defense

Ms. M. is an 84 year old Maryland resident taking care of three young great grandchildren. She recently faced a foreclosure proceeding on her home after falling behind on her mortgage payments. Her only source of income was social security and AFDC.

Ms. M. fell behind on her mortgage payments because her Social Security check had been stolen in the same month as she had provided her small savings to a family who was in even worse shape than hers. The mortgage she fell behind on secured a loan for $11,000 at a 20% annual interest rate. It was a first mortgage, not used to purchase her home. Settlement charges on the loan totalled approximately $3,400, over 30% of the loan amount.

After the lender moved to foreclose, Ms. raised her rescission rights as a defense, although the statute of limitations on rescission had expired. At the hearing on the temporary restraining order, the creditor agreed to stop the sale. Later the creditor settled by voiding the mortgage, eliminating the debt, dismissing the foreclosure, and paying some attorney's fees. Ms. M. would have lost her house and become homeless with her three great grandchildren but for the protections provided by the Truth in Lending Act.

If H.R. 1362 passes, this elderly woman would have had no remedy because rescission by recoupment would be barred.