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SUPPLEMENTAL RESPONSE TO REQUEST FOR PUBLIC COMMENT

From: Edelson McGuire LLC (KamberEdelson LLC, prior to January 15, 2010)

To: Board of Governors of the Federal Reserve System

Re: SUPPLEMENT TO Analysis of Proposed Rule Governing Home Equity Lines of Credit ("HELOCs") Regulation Z, 12 C.F.R. 226.5(b) and Commentary 12 C.F.R. Part 226, Supp. I and Response to Request for Public Comment, Fed. Reg., Vol. 74, No. 164, published August 26, 2009

Date: May 15, 2010

I. The *Hickman* Case and Recent Decision

A. Background

A recent court decision in the case of *Hickman v. Wells Fargo Bank, N.A.*, Case 1:09-cv-05090 (N.D. Ill., May 11, 2010) (Dkt. 48) has warranted the submission of a brief supplement to our law firm's Response to the Board's Request for Public Comment, previously submitted on December 23, 2009.

The *Hickman* case challenges Wells Fargo's suspension of Mr. Hickman's HELOC under TILA and Regulation Z. Hickman obtained a $75,000 HELOC secured by his home from Wells Fargo in May 2006. On October 14, 2008, Wells Fargo sent Hickman a letter indicating that the bank was lowering the credit limit on his account to $31,039.83, an amount just over his outstanding balance. When Hickman requested information regarding Wells Fargo's basis for the credit limit reduction, Wells Fargo responded that it had based its decision on an AVM obtained on May 1, 2008—over 5 months prior to the issuance of the reduction.

Hickman filed a lawsuit seeking to hold Wells Fargo liable for violating TILA and Regulation Z. Hickman alleged that Wells Fargo improperly reduced his HELOC in the absence of a significant decline in value. Hickman also alleged that Wells Fargo violated TILA because, among other things, in using an AVM obtained over 5 months before the reduction, Wells Fargo acted without the necessary sound factual basis for concluding his home value had significantly declined.

Wells Fargo challenged the allegations that purported to state a TILA claim (and derivative Illinois Consumer Fraud Act claim) based on Wells Fargo's failure to act with a sound factual basis. In response, Hickman pointed to guidance issued by the Federal Deposit Insurance Corporation ("FDIC") as well as the Office of Thrift Supervision ("OTS") requiring Wells Fargo act with such a basis prior to issuing HELOC suspensions or reductions. *See* FDIC, *Home Equity Lines of Credit, Consumer Protection and Risk Management Consideration When Changing Credit Limits and Suggested Best Practices*, FIL-58-2008, 2008 WL 2552743, at *2

(2008) (institutions should act with "a sound factual basis for determining that a property has experienced a significant decline in value"); *see also* Timothy T. Ward, OTS, *HELOC Account Management Guidance* (August 26, 2008), http://www.files.ots.treas.gov/252761.pdf ("While Regulation Z does not require a savings association to obtain an appraisal to determine whether collateral value has significantly declined, an association should have a sound factual basis for reaching this conclusion.") Both of these pronouncements were submitted to the *Hickman* court by Wells Fargo in Wells Fargo's Request for Judicial Notice.

For further support, Hickman pointed to the Board of Governor's Official Commentary to Regulation Z that suggested Wells Fargo could not simply fabricate that a significant decline in value had occurred so as to push the burden of seeking reinstatement onto its aggrieved HELOC borrowers:

> Contrary to Wells Fargo's assertions, several provisions in the Official Commentary, which Wells Fargo concedes is binding, caution against such an interpretation. (Def. Mot. 7.) For example, suspensions and reductions are temporary in nature. *See* 12 C.F.R. pt. 226, supp. I, ¶ 5b(f)(3)(vi), par. 2 (2010) ("Temporary nature of suspension or reduction. Creditors are permitted to prohibit additional extensions of credit or reduce the credit limit only while one of the designated circumstances exists. When the circumstance justifying the creditor's action ceases to exist, credit privileges must be reinstated, assuming that no other circumstance permitting such action exists at that time.") If Wells Fargo did not have to act with a sound factual basis, it could keep a HELOC suspension or reduction in effect permanently. Similarly, Paragraph 4 instructs that, "A creditor may require a reinstatement request to be in writing if it notifies the consumer of this requirement on the notice provided under §226.9(c)(3). Once the consumer requests reinstatement, the creditor must promptly investigate to determine whether the condition allowing the freeze continues to exist." *Id.* at ¶ 5b(f)(3)(vi), par 4. If Wells Fargo did not need to act with sound factual basis, there would be no need for any such investigation.
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> Furthermore, the Commentary holds that although a bank is not required "to obtain an appraisal before suspending credit privileges...a significant decline *must* occur before suspension can occur." *Id.* at ¶ 5b(f)(3)(vi), par. 6. (emphasis added). Wells Fargo's argument reduces the word "must" in this part of the Commentary to a mere suggestion and acts as if Wells Fargo should be permitted to guess the value of a borrower's property when determining whether there has been a significant decline and then force the borrower to pay for an appraisal.

In addition to this authority, Hickman reminded the Court that the danger in accepting Wells Fargo's argument would be an order permitting the nation's largest banks, in contravention of express OTS and FDIC guidance, to suspend and reduce credit limits arbitrarily and, so long as a borrower was unable to demonstrate the bank was ultimately in error, claim "no harm no foul." Rather than require a bank to first determine whether a significant decline had occurred and then suspend a customer's HELOC, a bank could simply fabricate that such a decline had occurred, and thus effectively push the burden onto the borrower to establish the bank's fictitious claim was in error in order to gain reinstatement. Under such a scheme one must wonder: why would a bank even need to obtain an AVM if the law does not require any sound factual basis prior to a bank taking adverse action?

B. The Court's Decision

The *Hickman* court discounted Plaintiff's reasoning and authority and instead found that the absence of an express requirement in the Official Commentary that a bank needs a sound factual basis means that Wells Fargo did not need to act with a sound factual basis. Rather, Wells Fargo could only be held to account in the event its claim – cut from whole cloth – was actually wrong. According to the *Hickman* decision:

> The only support Plaintiff provides for his claim that an institution needs a "sound factual basis" for making a valuation determination is citation to a non-binding Federal Deposit Insurance Corporation ("FDIC") supervisory guidance document and an Office of Thrift Supervision ("OTS") management guidance document. (R. 40-1, FAC, ¶ 10, R. 45-1, Plaintiff's Memorandum in Opposition to Defendant's Motion, p. 6; R. 16-1, Exs. 5-6.) As the Court has previously noted, however, only "the Official Commentary to TILA and Regulation Z is controlling in this context." *See Hamm v. Ameriquest Mortg. Co.*, 506 F.3d 525, 528 (7th Cir. 2007). Tellingly, Plaintiff cites no authority to demonstrate that the guidance espoused by either of these agencies is controlling in this context. Instead, Plaintiff attempts to circumvent this evident lack of authority by citing two provisions of the binding official commentary implementing TILA. These provisions of the official commentary, however, merely provide that HELOC suspensions are temporary while one of the enumerated circumstances for reduction of credit exists and that creditors must investigate consumers' requests for reinstatement. 12 C.F.R. § 226, Supp. I, ¶ 5b(f)(3)(vi). Contrary to Plaintiff's assertion, neither of these provisions imposes a requirement on Defendant to have a "sound factual basis" for its decision to reduce a HELOC.

Hickman, Case 1:09-cv-05090, at *2 (N.D. Ill., May 11, 2010) (Dkt. 48). Hence, the Court ruled that despite OTS and FDIC guidance, the Official Commentary's silence as to the sound factual basis requirement meant that none actually existed.

C. Effects of Decision

The *Hickman* decision poses potentially disastrous consequences for thousands of HELOC customers throughout the country. Under its reasoning, the FDIC and OTS guidance is not enough—because the Official Commentary lacks an explicit requirement that banks must first act with sound factual bases, banks cannot be held liable under TILA for their failure to do so. Thus, banks need not actually obtain AVMs or take any other steps to acquire such a basis—financial institutions can broadly suspend and reduce the HELOCs of all customers. Those customers who do not think their homes actually significantly declined in value can then pay for appraisals to challenge the bank's decision. According to the *Hickman* court, those customers may be able to obtain actual damages if they can show their home had not significantly declined at the time of the bank's decision, meaning appraisals obtained weeks following the bank's decision would potentially not be enough proof to demonstrate the bank acted during a time when no significant decline had in fact been present. Moreover, even if the appraisal shows no decline in value occurred, the bank need not refund the cost of the appraisal under the *Hickman* court's reading of the Regulations.

The *Hickman* decision, when read in conjunction with the current and proposed Official Commentary, would permit the banks to arbitrarily and systematically suspend or reduce HELOCs and then shift the burden onto borrowers to obtain an appraisal and demonstrate a "sound factual basis" for why the bank's decision was in error. Since many customers can't afford to spend hundreds of dollars of their own money to prove that the bank's actions were taken in error, the banks could literally arbitrarily act without having to answer to anybody. And in those situations where the borrower proves that the suspension or reduction was in error, the bank would suffer no adverse effects other than to reimburse – at its discretion – the borrower's appraisal fees in exchange for possessing an up-to-date, accurate appraisal of the collateral property. In short, the *Hickman* decision seems to establish a dangerous precedent that banks have no downside to systematically suspending and reducing HELOCs without any sound factual basis, much less any reasonable due diligence.

Adding insult to injury, the *Hickman* court's analysis means that even if a customer was to show through an appraisal that his or her home no longer suffered from a significant decline in value and gain reinstatement, financial institutions can merely fabricate the very next day that the customer's home has again significantly declined in value—after all, it need not have a sound factual basis for reaching this conclusion. Hence, banks can now effectively keep HELOCs suspended or reduced perpetually without meaningful recourse.

II. Conclusion

The Board of Governors should not permit such a one-sided abuse of the process. The current Commentary as well as the Proposed Commentary would be rendered meaningless if the banks did not have to act with a sound factual basis. Because at least one court has demonstrated a willingness to find no such requirement exists in the absence of an express provision in the Commentary, the Board should add such a requirement with haste. The Board should also consider requiring that if banks are going to use AVMs, then those AVMs should be obtained no greater than 30 days prior to the issuance of the suspension or reduction. Otherwise, financial institutions will be able to use the *Hickman* decision to avoid the "requirements" of TILA, Regulation Z and the Official Commentary since they need not act with a sound factual basis. The Board should avoid such a blatant evisceration of consumer rights.

Respectfully submitted,

Jay Edelson