December 23, 2010

VIA ELECTRONIC MAIL: regs.comments@federalreserve.gov

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Proposed Truth-in-Lending Mortgage Regulations
(FRB Docket No. R-1390)

Dear Ms. Johnson:

This letter is written by Oregon lawyers and consumer advocates who represent the interests of mortgage borrowers. Some lawyers have previously filed Truth in Lending ("TILA") rescission claims; some have not.

We write to oppose certain proposed regulations which would unsettle long-standing principles applicable to TILA rescission cases. As we will show in this letter, these changes would severely weaken statutory consumer protections. Reduction of consumer protection is clearly inconsistent with the Congressional recognition in the enactment of Dodd-Frank that enhanced consumer protections are required to prevent a recurrence of the predatory lending practices that precipitated the 2008 collapse of the housing and lending markets.

## Background

Congress enacted TILA more than four decades ago to standardize consumer credit disclosures and thereby to enable borrowers to make more informed credit decisions. The enforcement of TILA relies to a significant degree upon litigation brought by individual borrowers acting as private attorney generals. The failure of a lender to make certain material disclosures gives borrowers an extended right to rescind non-purchase money loans that are secured by their residence.

In our experience, clients do not come to lawyers believing that they have TILA rescission claims. Instead, they come with mortgage origination or servicing issues or facing foreclosure. TILA rescission claims are only asserted when a borrower who has not received proper material disclosures sees, before the three year extended right of rescission expires, a lawyer who is sufficiently knowledgeable to identify the violations and who is willing to represent the client on an affordable financial basis.

The upshot is that only a small percentage of viable TILA rescission claims are asserted. The Board should be looking to facilitate private statutory enforcement rather than to

create additional barriers to such enforcement.

This letter will not comprehensively discuss the proposed changes. For that, we refer you to the comments of the National Consumer Law Center. Instead, we will show the deleterious effect of three specific aspects of the proposed rules: (1) the proposal that, in litigation, a borrower must tender funds back to the lender or its assignee before the latter releases its security interest, (2) the proposal for a $100 tolerance for erroneous disclosure of the monthly payment amount and (3) the proposal to terminate the extended right of rescission upon refinancing or payoff.

Order of Rescission

Current 12 CFR 226.23(d), following the language of 15 USC §1635(b), requires a creditor to void its security interest before the borrower is required to tender back the net proceeds of a loan, unless a court orders differently. Proposed 12 CFR 226.23(d)(2)(ii) would reverse this order for rescission claims in litigation, so that the consumer must tender these funds before the creditor has to release its security interest, unless a court orders differently "when the equities dictate."

Putting aside the question of how the Board can reverse the order of events dictated by Congress, this proposed regulation is terrible public policy. Even in the current market, some TILA rescission plaintiffs have the ability to tender through refinancing. In every refinancing, the new lender will permit funds to be disbursed only after that lender is placed in the security position, usually first, required by its loan documents.

**Thus, the Board's proposal would make it impossible for any borrower to tender by refinancing the property in question.** Only extremely rich borrowers having enough other assets to secure a loan for hundreds of thousands of dollars would be able to tender by refinancing.

**The Board's proposal would also impair the ability of borrowers to tender by selling the property in question**. This currently is a potential mechanism for tender when a borrower has equity in the property. The proposed regulations would prevent a new purchaser from obtaining a purchase money mortgage, since the new purchaser's lender could not be placed in first position on the property.

In theory, the new purchaser could assume the tendering borrower's financing. But there are two practical barriers. The old loan may not permit assumption. Or the old loan could have oppressive terms unacceptable to potential purchasers.

Proposed 12 CFR 226.23(d)(2)(ii)(C), which empowers courts to modify the order

of rescission, is not sufficient to mitigate the harmful effects of the Board's proposal for at least two reasons.

First, there are textual differences between existing 12 CFR 226.23(d)(4) and proposed 12 CFR 226.23(d)(2)(ii)(C). The former gives a court an unqualified right to modify the order of rescission events. The second sentence of the latter suggests that the court does not have unlimited discretion but must find a specific reason in a particular case to be able to modify the order.

Second, those courts which have dismissed TILA rescission claims after exercising their discretion pursuant to existing 12 CFR 226.23(d)(4) have focused on the fact that "the borrower cannot comply with the borrower's rescission obligations no matter what." Yamamoto v. Bank of New York, 329 F3d 1167, 1173 (9th Cir 2003). The proposed rule would change the inquiry from whether the borrower totally lacks the capacity to tender, to whether the borrower is able to tender prior to the creditor releasing its security interest.

Both these factors create the risk that courts will read the proposed regulations as significantly limiting their discretion to modify the order of rescission. If that occurs, many borrowers who can tender, but only if the creditor first releases its security interest, will lose their rescission cases.

If the proposed new rule is enacted, lawyers will not be readily able to predict how courts will exercise their discretion and thus whether any particular TILA rescission case will be successful. This will make lawyers in private practice far more reluctant to represent such plaintiffs on an affordable financial basis. Thus, **regardless of the Board's intent in promulgating this proposed rule, its enactment almost inevitably will gut the ability of borrowers to bring TILA rescission claims.**

Monthly payment tolerance

Our experience comports with your consumer testing: the amount of the monthly payment is one of the most important factors in consumer decision-making. We therefore support the Board's current proposal to make the payment schedule disclosure in proposed 12 CFR 226.38(c) a material disclosure and thus, if not complied with, a basis for an extended right of rescission. But we strongly oppose proposed 12 CFR 226.23(a)(5)(iv), which would create a $100 tolerance for underdisclosure of the payment schedule.

It is true that the Board's regulations often creates a $100 tolerance for underdisclosures. Proposed 12 CFR 226.23(a)(5)(iv), for example, would create a similar tolerance for underdisclosing the total of settlement charges or the prepayment penalty. We take no position on these tolerances.

But these other items can only be charged once during the life of a loan, so if such an item is underdisclosed by $100, the unexpected cost to the consumer is $100. In a thirty-year loan, the monthly payment is made 360 times, so **a $100 underdisclosure of the monthly payment will have a $36,000 impact on a consumer over the life of a loan.** According to USDA Economic Research Service data available as of December 21 at http://www.ers.usda.gov/data/unemployment/RDList2.asp?ST=OR, $36,000 represents nearly 75% of the median Oregon household income in 2009.

Tolerating an underdisclosure of this size would permit significant economic harm to consumers to go unremedied. It would also provide legal cover for loan originators whose business model is to exploit consumers. **In short, this proposed tolerance would have terrible consequences.**

Early termination of the extended right of rescission

15 USC § 1635(f) provides that the extended right of rescission expires three years after consummation "or upon the sale of the property, whichever occurs first." Current 12 CFR 226.23(a)(3) adds "transfer of all of the consumer's interest in the property" to the list of events terminating the extended right of rescission. The Board now proposes to expand the list of events terminating the early right of rescission in 12 CFR 226.23(a)(3) to include "refinancing with a creditor other than the current holder, or paying off of the obligation."

The Board is undoubtedly aware that a number of courts have considered whether refinancing or loan payoff terminates the extended right of rescission. Courts have divided on this question. In essence, the division reflects a disagreement over whether rescission simply involves the termination of the creditor's security interest and a tender back by the borrower, or whether it also affects the amount of the borrower's obligation to the creditor.

In seeking to justify its proposed regulation, the Board argues "the results [of refinancing] are substantively similar to those of rescission – namely, voiding of the prior creditor's security interest, release of the borrower from the obligation to make payments to that creditor, and return to the creditor of money borrowed." 75 FR 58612. The last portion of that statement is not true. The amount that the borrower must return on refinancing is greater, sometimes by tens of thousands of dollars, than it would be upon rescission.

The Board also notes that "[r]efinancing a consumer credit transaction extinguishes the prior creditor's lien on the consumer's property, and terminates the consumer's obligation to repay the creditor under the promissory note through satisfaction of that obligation. These results are the same as those of a 'sale of the property.'" Id. That observation was as true when Congress enacted TILA as it is today.

But Congress chose to create a single exception to the three year extended right of rescission, for sales of property. It did not create a similar exception when the borrower refinances or pays off the loan.

We share the belief of a majority of courts that this was a deliberate Congressional choice, so that borrowers should be able to get the financial benefits of rescission even after refinancing or paying off the loan. But even if the text of the statute would permit the Board to make a policy choice here, there is no justification for the Board to adopt the views of a small minority of courts.

Sincerely,

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OSPIRG (Jon Bartholomew, Policy Advocate)
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cc Senator Ron Wyden
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