



Credit Union National Association

cuna.org

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February 9, 2009

The Honorable John Conyers
Chairman
Committee on Judiciary
United States House of Representatives
Washington, DC 20515

Dear Chairman Conyers:

On behalf of the Credit Union National Association (CUNA), I am writing regarding Section 3 of H.R. 200, the Helping Families Save Their Homes through Bankruptcy Act of 2009. CUNA represents approximately 90% of America's 8,200 state and federally chartered credit unions and their 90 million members.

The bankruptcy law needs to fairly balance the rights of creditors and borrowers. Section 3 of H.R. 200 as reported, "Prohibiting Claims Arising from Violations of the Truth in Lending Act," fails the fairness test. However, CUNA believes that the language can be narrowed to address abusive mortgage lending practices that warrant relief in bankruptcy, and we would like to work with the sponsors to draft a substitute for Section 3.

Section 3 says that a mortgage loan secured by the debtor's principal residence will not be entitled to any payment if the mortgage loan is subject to the "right of rescission" under the Truth in Lending Act (TILA). Even a nonmaterial, technical and unintentional violation of Truth in Lending rules could result in the debtor getting to keep the house with the lender paid absolutely nothing. As currently drafted, this provision would apply in either a Chapter 7 or a Chapter 13 bankruptcy case, would not be limited to loans made prior to the date of enactment of this law, and would be a permanent change to the Bankruptcy Code.

Right of Rescission

For 40 years, TILA has allowed borrowers to cancel certain mortgage loans within a three-day period, which is called the "right of rescission." The fact that TILA and its implementing regulations (the Federal Reserve Board's Regulation Z) – including the application of the right of rescission provisions -- continue to be the subject of lawsuits demonstrates the complexity of the law.

The right of rescission does not apply to mortgage loans that are used to purchase the debtor's home, but it does apply to: Refinancings of first mortgages by the same creditor when additional money is advanced; refinancings of first mortgages by different lenders; home equity loans; home improvement loans; and any other second or junior mortgage loans. The right of rescission can be exercised by the borrower generally within three business days after the signing of loan documents.



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The Honorable John Conyers
February 9, 2009
Page Two

However, if the rescission notice or material disclosures are not provided to the borrower or not provided correctly, the rescission period is increased from three days to three years.

The right of rescission was incorporated into the federal law to adopt the concept of a "cooling off" period that had existed in numerous state laws in the 1960's -- to protect consumers who gave a lien on their property, for instance to home improvement contractors who appeared at their doorstep, and who had second thoughts about using that person or paying what the contract would require. The rules were written to make even technical or minor violations of the Truth in Lending regulations a violation which would provide a remedy for the borrower.

The remedy for violating the right of rescission is that the lender returns all the principal, interest and fees paid and releases the lien **and** the borrower returns all the funds originally borrowed. Obviously, it is the borrower's decision on whether this remedy is to his or her benefit, and the remedy makes sense in light of what it was designed to accomplish. If rescission takes place in a few days, the consumer is made whole. If there are compliance problems, the borrower has three years to reverse the transaction, which may require the person to obtain another loan to repay the creditor.

Here are some examples where a borrower has the right to rescind the mortgage transaction for up to three years (rather than the normal three business days). These are clearly violations of the Truth in Lending rules, but we do not think they warrant a bankruptcy judge disallowing a mortgage lender's claim in bankruptcy.

- The lender uses the wrong rescission notice form. The Federal Reserve Board has two model rescission notices -- one form is intended to be used where the original lender extends a new, larger loan and the other to be used when the lender is different from the original lender.
- The lender provides only one copy of the rescission notice to each person who is entitled to rescind, rather than providing two copies to each person, as required by the regulation.
- The lender understates the total finance charges by the greater of \$100 or one-half of one percent of the loan, which may not necessarily be a large amount when a mortgage is hundreds of thousands of dollars – and which drops to \$35 variance for a borrower in foreclosure.
- The lender puts the wrong date in the rescission notice, so the three business day rule is calculated incorrectly.

Impact of Section 3 in H.R. 200

H.R. 200 as currently written says that the bankruptcy judge cannot allow a creditor's claim that "is subject to a remedy for rescission under Truth in Lending...." Any of the instances cited above makes the claim "subject to a remedy for rescission." Therefore, if the lender used the wrong rescission notice or only gave the borrower – now the debtor - one copy rather than two copies, years later (probably only applicable for loans made

The Honorable John Conyers
February 9, 2009
Page Three

three years prior to filing for bankruptcy) the Truth in Lending violation allows the borrower/debtor to have the debt wiped clean. In the case of a refinancing of a first mortgage with no junior mortgages, the debtor can get the house free and clear.

This is clearly an unfair result, and we question if this was truly the intent of the supporters of this provision. Obviously, some egregious examples have been provided for this section to have been included as drafted. We can only speculate what the examples might be, but here is the type of situation where all of us should want a bankruptcy judge to have the authority to rectify:

Mr. and Mrs. Smith, an elderly couple who have lived in their house for years – maybe they do not even have mortgage on it – are approached by Sleazy Breezy Broker Lender who tells them he can loan them some money for repairs or to pay off medical expenses. Without understanding the ramifications of what they have signed, the couple ends up with a high rate mortgage with high monthly payments that have a lot of fees built into the mortgage. In fact, the Smiths end up not getting that much actual cash out of the transaction, but Sleazy has walked away with a pocket full of fee income because he could care less if the mortgage loan was appropriate for the Smiths. Sleazy had little regard about complying with a whole host of federal and state consumer protection laws, including TILA's right of rescission rules. The Smiths probably will have trouble figuring out what happened and what to do about it. And, they will fall further behind in making their large monthly mortgage payments, ending up in bankruptcy.

CUNA's position

CUNA agrees that a bankruptcy judge should have the ability to put the Smiths back to where they were prior to meeting Sleazy. If the Smiths previously had a mortgage on their home, then the bankruptcy judge should establish a mortgage loan secured by the property with the old rate, balance and monthly payments. This couple wouldn't necessarily be made whole by the mortgage cramdown provisions H.R. 200 (which only applies to Chapter 13 cases), which is why Section 3 is significant.

As CUNA has stated in our letter to you dated January 22, 2009, CUNA supports inclusion of a provision in the Bankruptcy Code for judges to deal with fraudulent and abusive mortgage lending situations. Such a provision would not only help to address specific cases that call out for equitable resolution, but also serve as a warning to the bad apples in the lending industry (both those that originate such loans and those that buy the loans without regard to their merits) that these loans are subject to modification by the bankruptcy court.

The Honorable John Conyers
February 9, 2009
Page Four

CUNA would be pleased to work with you to draft a substitute Section 3 that will address the concerns of reputable lenders while fulfilling what we believe is the intent of the current language. Thank you very much for your consideration.

Sincerely,

A handwritten signature in black ink that reads "Daniel A. Mica". The signature is written in a cursive style with a large initial "D" and "M".

Daniel A. Mica
President & CEO

cc: The Honorable Lamar Smith, Ranking Member