

# CUNA REGTRAC

## MORTGAGE LENDING REGULATIONS



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## Legal Review

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The RegTraC books are designed to provide general information regarding regulations affecting credit unions. They are not intended to substitute for legal advice based upon specific facts in any individual case, and credit unions with regulatory concerns are advised to consult with attorneys or specialists to obtain advice directed to their specific circumstances.

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## SECTION 1 – TRUTH IN LENDING AND REGULATION Z





# Section 1 – Truth In Lending Act and Regulation Z

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## The Importance of Knowing Applicable Laws and Regulations

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Prior to the 1960s there were few federal laws regulating the relationship between lenders and consumer borrowers. There were no requirements regarding the disclosure of loan terms, the taking of a security in a consumer's property, or the reporting of credit information. Likewise, there were no requirements or limitations regarding related issues such as the prevention of discrimination in the regulated lending industry. Thus in 1968, Congress passed the Consumer Credit Protection Act (CPA). The CPA is a sweeping and extensive law governing virtually every aspect of the relationship between a consumer borrower and regulated lenders.

Various federal regulators have been given authority to interpret and enforce the CPA. In addition there are extensive regulations and official commentaries which provide further instruction that lenders must understand to insure they are "in compliance."

The primary laws and regulations arising from the CPA are:

- The Equal Credit Opportunity Act (15 USC §1691, et al.), Regulation B (12 CFR §1002, et al.) and 12 CFR §701.31 (NCUA).
- The Fair Credit Reporting Act (15 USC §1681, et al.).

- The Truth In Lending Act (15 USC §1601, et al.), Regulation Z (12 CFR §1026, et al.) and The Fair Credit Billing Act (15 USC §1666).

In addition, the following federal laws and regulations also govern the lending process:

- The Federal Trade Commission Act and 12 CFR §706 (NCUA).
- Important NCUA Regulations such as §§701.21, 701.31 and 723.
- The Consumer Leasing Act and Regulation M (15 USC §1667, et al.) and (12 CFR §1013.1 et al.).
- The Soldiers' and Sailors' Civil Relief Act (50 USC §501, et al.).
- The Fair Debt Collection Practices Act (15 USC §1692, et al.).

## State Laws

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Generally, federal law preempts contrary state laws. This means the matters described in this book generally govern; and contrary state laws have no affect. However, many states have adopted various laws and/or regulations that place additional disclosure requirements or other burdens on a creditor. Due to the fact that there is no uniformity as to all such laws and regulations, they cannot be addressed in a general work such as this book.

As a general rule, the matters

discussed here will govern credit unions' relationships with members. Nonetheless, every credit union should consult with local legal counsel in each state in which it does business to insure that it is aware of and complies with any additional "state" requirements.

This book provides a detailed analysis of the regulations addressed; discusses relevant cases; and provides tips to assist your credit union in maintaining compliance. Where appropriate, compliance checklists have been provided to assist you in the process of "self-assessment."

## Truth In Lending Act and Regulation Z

### Purpose — full and fair disclosure of credit terms

The Truth In Lending Act (TILA) is the **mother of all consumer protection laws**. TILA and Regulation Z were adopted to "promote the informed use of consumer credit by requiring disclosures about its terms and cost" **in clear and conspicuous disclosures**. Unfortunately, this law has evolved into an extremely complex set of rules that are difficult to understand. Illustrating this is the fact that various regulatory agencies reported in 1994 that 50% of the institutions they examined had significantly violated Regulation Z. In 1974, Congress passed the Fair Credit Billing Act, which among other things, added to Regulation Z a set of error resolution rules that creditors must follow regarding claims of errors on credit card accounts.

### Scope and exemptions

The Truth In Lending Act and Regulation Z apply to credit offered or extended to a consumer primarily for personal, family or household purposes. It also applies to all creditors who regularly (for example, more than 25 times per year, or more than five times for transactions involving a dwelling) extend credit that is either subject to a finance charge or is payable in more than four installments.

The following types of credit are exempt from Regulation Z:

- Nonconsumer credit (for example, credit extended to other than a natural person, or extended primarily for a business, commercial, or agricultural purpose).
- Credit where the amount financed is more than the threshold as determined by 1026.3(b) of the regulation, although credit secured by real property is subject to the regulation even if the loan is for more than the set threshold.
- Certain student loans that are made, insured, or guaranteed pursuant to a program authorized under the Higher Education Act of 1965.

**If exempt, document the exemption well.** *Maddox v. St. Joe Papermakers Federal Credit Union*, 572 So. 2d 961 (Fla. App. 1990). Maddox was a co-maker on a note with five others. When the principal defaulted, the credit union filed a complaint against all makers and co-makers. The credit union did not provide appropriate Truth In Lending disclosures (apparently due to the fact that

the loan was intended as a “business” loan, which is exempt from TILA and Regulation Z). This was not documented in the loan file presented by the credit union; and Maddox claimed the loan was for a consumer purpose. Therefore, the credit union’s failure to provide the disclosures or properly document the nature of the loan resulted in Maddox’s ability to assert a counterclaim against the credit union by way of offset against the amount of the loan.

## Payday loans

In March 2000, the Regulation Z Commentary, Section 1026.2 at 2(a) (14), was revised to clarify that transactions commonly known as “payday loans” constitute credit and are covered under TILA. Typically in payday loans, a cash advance is made to a member in exchange for the member’s personal check, or the member’s authorization to debit his or her share account electronically. The member typically pays a fee in connection with the advance. Either the member’s check is not cashed or deposited for collection until a future date, or the share account is not debited until a designated future date. A fee charged in connection with a payday loan may be a finance charge for purposes of Section 1026.4, regardless of how the fee is defined under state law. Where the fee charged constitutes a finance charge under Section 1026.4, the credit union is required to provide Regulation Z disclosures.

## Overdraft protection /bounce protection programs

The Interagency Guidance on Overdraft Protection Programs issued in February 2005 by the OCC, FRB, FDIC, and NCUA indicates that fees for paying overdraft items are not considered finance charges if the credit union has not agreed in writing to pay overdrafts. Even where the credit union agrees in writing to pay overdrafts as part of the membership account agreement, fees assessed against a checking account for overdraft protection are finance charges only to the extent the fees exceed the charges imposed for paying or returning overdrafts on a similar account that does not have overdraft or bounce protection.

Closed-end loans offered to members who are unable to repay their overdrafts and bring their accounts to a positive balance within a specified time, will require Regulation Z disclosures, if the loan is payable by written agreement in more than four installments. Regulation Z disclosures will also be required when such closed-end loans are subject to a finance charge.

## Liability provisions

The Truth In Lending Act contains a criminal liability provision for willful violations of the Act and provisions that provide for civil liability and restitution.

### Criminal liability

Under the Truth In Lending Act, any person who willfully and knowingly does one or more of the following could be fined up to \$5,000, imprisoned for up to one year, or both:



- Gives false or inaccurate information, or fails to provide information required to be disclosed under the Act or Regulation Z
- Uses any chart or table in a manner that consistently understates the annual percentage rate (APR).
- Fails to comply with any of the requirements imposed under the Act.

### Civil liability and restitution

Creditors that violate the Truth In Lending Act or Regulation Z are subject to penalties, monetary damages, and restitution which are more fully explained in this section.

**Civil Liability** — Generally. The Truth In Lending Act authorizes a member to commence legal action against your credit union for a failure to comply with the rules for:

- Providing disclosures in connection with a credit transaction.
- Following prescribed procedures when handling billing error claims.
- Establishing an interest rate cap on adjustable-rate mortgage loans.

In an individual action, noncompliance with any of the above will make your credit union liable for the sum of:

- The amount of actual damages sustained by that person as the result of the failure to comply.
- An additional amount equal to twice the amount of any finance charge, in an action involving an open-end consumer credit transaction (not secured by real property) with a \$500 minimum and \$5,000 maximum.

- If the matter goes to court, the costs of the action plus reasonable attorneys' fees.

### Minor technical violations of TILA are sufficient to allow a consumer to recover statutory damages.

The terms “annual percentage rate” and “finance charge” appeared in the same type print and identical boxes as “amount financed” and “total of payments.” As a result the court awarded \$1,000, plus attorneys' fees to a debtor in a bankruptcy case. See, *In re: Pittman*, No 91-5-717-1-JS (Bkrcty. MD. 3-17-94).

### Supreme Court Rules On Truth In Lending Damage Issue (January 2005)

Much to lenders' relief, the U.S. Supreme Court has ruled that the \$1,000 cap on damages for violations of the Truth In Lending Act (TILA, 15 USC 1601) is still valid. The high court's decision reversed an earlier ruling by the Fourth Circuit Court of Appeals, which had held that Congress in 1995 had limited the \$1,000 cap to apply only in cases involving consumer leases.

The case before the court arose when a used car deal went wrong in a number of ways. The car buyer sued the dealer/lender for TILA violations and numerous other claims. The jury awarded \$24,192.80 — double the finance charge — in TILA damages.

The jury verdict was entered despite TILA appearing to impose a cap of \$1,000 on such damages. As first enacted, the law (15 USC 1640(a)(2)(A)) generally limited damages to “twice the amount of the finance charge in connection with the transaction, except that the liability under this paragraph shall

not be less than \$100 nor greater than \$1,000.”

### Confusing Statute

The trouble is the paragraph in the law that includes the damage cap has been amended several times. These amendments set a \$2,000 ceiling for damages in real estate loans, created separate rules for damages in class-action lawsuits, and extended TILA’s coverage to include consumer leases. With all due respect to Congress, these amendments were clumsily drafted.

By the time Congress was done, one reading the statute might conclude that the damage cap applied only to the clause dealing with leases. That would mean lenders violating TILA’s provisions could be assessed damages up to double the amount of the finance charge, with no limitation — even though comparable lease transactions would be subject to the \$1,000 cap.

The Fourth Circuit Court of Appeals upheld the jury’s verdict. That appeals court simply read the statute, declared its meaning to be perfectly clear, and refused to inquire as to what Congress might have intended. The appeals court could find no ambiguity or confusion in what the law said so it could see no reason to look behind the words to find Congress’s true intent.

But the Supreme Court disagreed. In an opinion by Justice Ruth Bader Ginsburg, the court observed that any attempt by Congress to deliberately repeal the \$1,000 cap would have been very controversial and would have led to extensive debate. The fact that Congress had not even discussed repealing the damages cap suggested that no such

repeal had been intended.

Also, Ginsburg observed, it would be “passing strange” to read the statute as providing a relatively low cap on damages in cases involving mortgages and none at all for consumer loans — especially when Congress said it was raising the damage ceiling for violations involving mortgages to \$2,000 to provide greater protection for mortgage borrowers.

The Supreme Court reversed the Fourth Circuit’s ruling, reducing the plaintiff’s TILA damage award to just \$1,000. So lenders have successfully dodged a bullet. The TILA limits on damages remain unchanged. (*Koons Buick Pontiac GMC v. Bradley Nigh*, No. 03-377.)

In a successful action brought on behalf of a class (for example, a “class action” on behalf of all members), the claimants can recover:

- The amount of actual damages.
- An additional amount, with no statutory minimum, but with a maximum of \$1,000,000 or an amount equal to 1% of your credit union’s net worth, whichever is less.

**Two relatively minor violations = \$500,000 + in damages.** A court imposed the maximum class action damages for two minor violations of *Regulation Z* in *Jones v. Goodyear Tire & Rubber Co.*, 442 F. Supp. 1157 (ED La. 1977). In this case, the plaintiff purchased a television set pursuant to a retail installment sales contract. The defendant failed to disclose the type of security interest it retained in the television; and it did not disclose the finance charge and APR more conspicuously than other terms.