In Search of TRUTH IN LENDING

By Alan E. Ramos, Esq. (2009)

The passage of the Truth in Lending Act ("TILA")[1] signified a great step forward in consumer credit legislation. Prior to the enactment of TILA, consumers had no easy way to determine how much credit would really cost, or how to compare among various creditors.[2] It is not possible in an article of this length to provide an in-depth explanation of TILA. The National Consumer Law Center guide to the Truth in Lending Act, its applications and defenses, runs more than 700 pages, plus another 270 pages of appendices.

The goal of TILA is to provide consumers with the information necessary to compare the cost of credit and make an informed decision. Prior to TILA, lenders were able to disguise the terms of loans so that the actual costs were not understood by the average consumer. One court opined: "[The] sufficiency of TILA mandated disclosures is to be viewed from the standpoint of an ordinary consumer, not the perspective of a Federal Reserve Board member, Federal Judge or English professor."[3] This includes a requirement to disclose the true rate of interest and the total cost of credit over the life of the loan.

Misperception or Misrepresentation?

Many borrowers argue that they didn't understand the terms of the loan they obtained. This argument is most often voiced by borrowers with adjustable rate mortgages ("ARMs"). In some cases, the borrowers chose to ignore the disclosures, because the initial payment was low. In others, the lenders violated TILA and its requirements. In addition, in other cases, lenders may have substantially complied with TILA but used language designed to disguise the true terms of the loan. A Wisconsin case, *Andrews*

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[1] 15 U.S.C. §§ 1601-1666J

[2] National Consumer Law Center guide to Truth in Lending, 6th Edition

[3] *Smith v. Cash Store Mgmt.* 195 F.3rd 325, 328 (7th Cir. 1999)

v. Chevy Chase Bank FSB[4], is a great case for attorneys to review as it provides a very thorough analysis of TILA. It also provides plaintiff's attorneys with a template for causes of action in TILA litigation. In *Andrews*, the lender advertised an Option ARM with an interest rate of 1.950% (disclosed as a "yearly rate"), with *fixed payments* for five years. The Plaintiffs in this case thought that the interest rate was fixed for the first five years. However, the 1.950% interest rate applied only to the first month's payment; the true interest rate of 4.047% applied for the next 59 months and the loan negatively amortized for those 59 months. On the 61st month the interest rate indexed up and the payment amount increased to conform to the new contract interest rate. The court held that the lender violated TILA.

The Role of Mortgage Brokers

The sub-prime meltdown brought to light a number of abuses that took place despite the requirements of TILA, some of which were not directly due to the actions of lenders. Mortgage brokers are agents for borrower and mortgage brokers owe a fiduciary duty to borrowers. There are many good, honest, hard-working mortgage brokers working for the best interests of their client/borrowers; however, the super-heated market attracted a large number of people who had only one interest – making the most money that they could for themselves. If a Yield Spread Premium[5] ("YSP") has been charged, without proper disclosure to the borrower, it may be evidence that a mortgage broker has violated their fiduciary duty to their client. In many cases, borrowers were assured by their mortgage brokers that they had obtained the lowest interest rate available on the market. A look at their HUD-1 closing statements, however, reveals a different story. In addition to a broker's fee (paid by the borrowers), many

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[4] *Andrews v. Chevy Chase Bank FSB* 474 F.Supp.2nd 1006 (E.D.Wis., 2007)

[5] The Yield Spread Premium is a commission paid to a mortgage broker for steering a borrower into a higher interest-rate loan. The YSP is listed on the HUD-1 closing statement as a cost to the lender and not paid by the borrower. Ultimately, the YSP is paid by the borrower in the form of a higher interest payment. It should be noted that a loan can be offered to a borrower at a lower rate with higher "points" to be paid at closing or at a higher rate with no "points". If the borrower chooses the higher interest rate (with no points) an YSP is appropriate, as it has been property disclosed and the borrower has made an informed decision.

mortgage brokers earned YSPs (1% to 2% or more) for steering his/her clients into a more expensive loans. In effect, the mortgage brokers received two commissions for the same transaction; one in which s/he allegedly serves the needs of the borrower and the other for serving the needs of the lender. It is important to note that a properly disclosed YSP is not a violation of TILA.

The Challenge for Counsel

The most significant challenge for plaintiffs' counsel is to determine what the plaintiffs knew before and at the closing of the loan. A very expensive loan, in and of itself, is not a predatory loan. Each document in the loan file must be reviewed and the attorney must be confident that s/he has reviewed a complete file. In the event that an attorney believes that there have been TILA violations, a rescission demand may be the most appropriate avenue to pursue (the right of rescission is discussed elsewhere in this magazine). However, if the mortgage broker is the culprit, the analysis is different. Is the mortgage broker still in business? Is there a pay-window at the end of litigation? These are hard questions, the answer to which will determine if there is a remedy for the client's rights. TILA provides a very useful platform from which to bring successful litigation; however, the cases are difficult and the ability to collect on a judgment clearly not a sure thing given the large number of lender bankruptcy filings.