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MORTGAGE FINANCE NEWSLETTER

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Federal District Court Finds That Listing Total Number Of Payments Does Not Sufficiently Disclose Payment Intervals

The United States District Court for the Northern District of Illinois recently held that a Truth in Lending disclosure statement that listed the number of payments to be made over the life of a loan and the due dates for the first and last payments nonetheless violated the federal Truth in Lending Act, 15 U.S.C. § 1601 *et seq.* ("TILA"), because the statement did not list the payments' intervals or frequency. In the same opinion, the court further held that a document providing a one-week cancellation period offered in conjunction with a Notice of Right to Cancel form also violated TILA because the one-week cancellation policy could potentially mis-

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Montgomery County "Anti-Predatory" Lending Ordinance Enjoined

On March 7, 2006, Montgomery County Circuit Court Judge Michael D. Mason granted a motion for a preliminary injunction filed by the American Financial Services Association ("AFSA") and seven local mortgage brokers and lenders enjoining Montgomery County from enforcing the provisions of Montgomery County Bill 36-04. Bill 36-04 was scheduled to become effective on March 8, 2006. The Court's ruling also suspended the effective date of Bill 36-04 until a trial on the merits is held.

It should be noted that Judge Mason did not rule on the viability of Bill 36-04 or the merits of the case. His ruling merely enjoined Montgomery County from enforcing the provisions of Bill 36-04. A trial on the matter, including a hearing on a permanent injunction, is scheduled for July 6, 2006.

In his reasoning, Judge Mason indicated that he found persuasive the argument that Bill 36-04 is suspect in light of established law, and that irreparable damage could result to the mortgage lending and brokering community, as well as Montgomery County consumers, if the enforcement of Bill 36-04 were not enjoined on a preliminary basis.

Many secondary market investors and lenders previously announced that they were planning to discontinue mortgage loan activities with respect to mortgage loans secured by Montgomery County properties.

After Judge Mason issued his decision, the Montgomery County Council introduced a measure that would repeal Bill 36-04. At this point, it is unclear whether this repealing legislation will be enacted.

As previously reported, Bill 36-04 amends the anti-discrimination provisions contained within the Montgomery County Code by adding anti-predatory lending measures. Montgomery County Bill 36-04 is drafted broadly and attempts to define as discriminatory certain abusive lending practices. Such overbroad and vague language, among other factors, prompted both the planned exodus by lenders and investors from the County as well as AFSA's lawsuit against the County. ■

Payment Intervols *continued from page 1*

lead ordinary consumers to their prejudice.

In *Jones v. Ameriquest Mortgage Company*, the plaintiff borrower obtained a thirty-year loan from the defendant lender in March 2002. At loan closing, the borrower was presented with a Truth in Lending disclosure statement stating that payments would be due beginning on March 1, 2002. The disclosure statement also indicated the total number of payments (360) and that the due date of the final payment would be on April 1, 2032. Finally, the statement indicated that the borrower was to make 359 payments of $480.01 beginning March 1, 2002, and one payment of $462.79 on April 1, 2032.

The borrower was also given a Notice of Right to Cancel at closing. The Notice informed the borrower of her right "under federal law to cancel this transaction, without cost, within three business days from whichever of the following events occurs last," after which the Notice listed the closing date, the date the Truth in Lending disclosure statement would be received, or the date she received the Notice of Right to Cancel. Concurrently with the Notice of Right to Cancel, the borrower was given a document entitled "One Week Cancellation Period," which likewise stated that she had the right "under Federal or state law to three (3) business days during which you can cancel your loan for any reason. This right is described in the Notice of Right to Cancel you have received today." The "One Week" form further stated, however, that "[t]o give you more time to study your loan documents, obtain independent advice and/or shop for a loan that you believe suits you better, we provide you with one-week (which includes the day you sign the loan documents) to cancel the loan with no cost to you."

In January 2005, the borrower brought suit against the lender, alleging that the Truth in Lending disclosure statement she received at closing failed to fully disclose her loan's repayment schedule in the manner required by TILA, and seeking rescission of the loan and statutory damages. The borrower further alleged that the "One Week" form conflicted with TILA's requirement that a creditor clearly and conspicuously disclose the right to cancel the transaction within three business days. The lender subsequently moved for summary judgment on both issues, arguing that the disclosure statement properly disclosed the repayment schedule and that the borrower's right to cancel had been adequately disclosed. In January 2006, the *Jones* court issued its opinion.

> A borrower in this Circuit need not have been misled or have suffered any actual damages from a TILA violation to recover under the act.

DISCLOSING THE TOTAL NUMBER OF PAYMENTS IS INSUFFICIENT

Addressing the Truth in Lending disclosure statement first, the court observed that the Federal Reserve Board's Official Staff Commentary requires creditors to disclose the repayment amounts and intervals, using words such as "monthly" or "bi-weekly" or, alternatively, listing all of the consumer's payment dates. The lender argued that it had disclosed the fact that monthly payments were to be made because the disclosure statement listed 359 plus 1 payments, thereby implying that the payments on the thirty-year loan would be due on a monthly basis. The court rejected this argument, stating that "[n]othing in the Federal Reserve Board's commentary or model forms (all of which use the phrases 'monthly beginning' or 'monthly starting'), suggests that numbers alone, not words, be used to disclose the frequency of payments unless, of course, the creditor lists all of the payment due dates."

The *Jones* court next rejected the argument that because the borrower had admitted to understanding that her payments were to be made monthly, there was no actionable injury. Relying on prior decisions from the Seventh Circuit Court of Appeals, the *Jones* court observed that "a borrower in this Circuit need not have been mislead [sic] or have suffered any actual damages from a TILA violation to recover under the act."

Finally, the court declined to follow a September 2005 decision reached in *Hamm v. Ameriquest Mortgage Company*, a case in front of a different judge in the Northern District of Illinois. Examining facts virtually identical to those presented in *Jones*, the *Hamm* court had concluded that an ordinary consumer would understand from the Truth in Lending disclosure statement that her payments would be monthly. The *Jones* court expressly disagreed with that conclusion, stating that *Hamm* "ignores the rule that a borrower need not have been mislead [sic] or

actually confused by a creditor for a finding of a TILA violation."

THE ONE WEEK CANCELLATION PERIOD

With respect to the "One Week Cancellation Period," the borrower complained that that document failed to draw a clear enough distinction between the rescission rights gratuitously conferred by the lender and the rescission rights required by TILA. The borrower argued that if a consumer relied on the lender's one-week rescission period and waited to cancel the transaction after the third day, the consumer would no longer be entitled to TILA's statutory benefits, including the ability to access a federal court to hear the claim, and the ability to recover statutory damages and attorneys' fees. The borrower further argued that the "One Week" form conflicted with the Notice of Right to Cancel because it maintained a different method of counting days and prescribed a different procedure to follow to rescind the loan.

The *Jones* court again agreed with the borrower. Although the borrower admitted to not having been confused by the different forms, did not wish to cancel her loan, and did not act in reliance on the "One Week" form, the court nonetheless found this irrelevant because consumers need not actually have been misled to recover under TILA. Instead, the court found that providing the "One Week" form in conjunction with the Notice of Right to Cancel might encourage consumers to delay their cancellation decision without being advised of the risk of doing so, observing that "[n]othing that Defendants provide to borrowers explicitly states or guarantees that Defendants provide or intend to provide all of the TILA rights and remedies for a borrower who uses the One-Week form to cancel during days four-through-seven after closing."

The court stated that a material issue of fact existed with respect to

States Licensing Update

INDIANA – **Loan Originator Education Requirements**

Effective February 16, 2006, regulations issued by the Securities Division of the Indiana Secretary of State clarify Loan Originator education requirements for Loan Broker Licensees. The Securities Division now requires that Loan Originators complete 24 hours of live academic instruction prior to registration as a Loan Originator. Accordingly, after March 1, 2006, on-line correspondence courses will not be accepted as evidence that an individual has met applicable pre-licensure education requirements. The regulations also clarify that Loan Originators may not be independent contractors, but the Securities Division has concluded that it is beyond its jurisdiction to determine whether Loan Originators may be compensated on a 1099 basis. We note that loan processors and those individuals that do not communicate loan terms or conditions with borrowers or prospective borrowers are not required to be licensed as Loan Originators.

MARYLAND – **Mortgage Originator Licensing Requirements**

In connection with upcoming Mortgage Originator licensing requirements, the Maryland Commissioner of Financial Regulation recently issued regulations clarifying certain aspects of mortgage originator licensing. Specifically, in order to qualify for licensure, mortgage originator applicants will be required to demonstrate that they either: (1) have three years of experience in the mortgage lending business and have completed applicable continuing education requirements; or (2) have completed 40 hours of approved continuing education and passed an examination within the previous 24 months.

WASHINGTON – **Amendments to the Mortgage Broker Practices Act and Consumer Loan Act Regulations**

Effective January 1, 2007, the Mortgage Broker Practices Act will require that Loan Originators of Mortgage Broker Licensees obtain a license in order to conduct Washington business. Individuals that engage in purely administrative or clerical tasks, such as loan processors, will not be required to be licensed. The Washington Department of Financial Institutions is moving forward with revising its regulations, and those updated regulations are expected later this year. The revisions to the Mortgage Broker Practices Act also remove the exemption from licensing for subsidiaries and affiliates of Consumer Loan Licensees, and clarify that entities conducting business under the Consumer Loan Act are exempt from the Mortgage Broker Practices Act only to the extent that they conduct such business under the authority and coverage of the Consumer Loan Act.

Effective March 1, 2006, the Washington Department of Financial Institutions ("Department") has amended its Consumer Loan Act Regulations, which purport to clarify certain licensing and registration requirements. Among other things, the regulations clarify that branch locations that only conduct underwriting and "other back-office services" and which only have incidental contact with borrowers are not required to be licensed as branch locations. Also, Consumer Loan Licensees now must either use their full business name, as it appears on their license, or include their Consumer Loan License number on all advertisements.

both parties' claims regarding the "One Week" form, and stated that neither party was entitled to summary judgment on that issue. However, under TILA, if a creditor fails to deliver to the consumer the required notice of her right to rescind or any other "material disclosure," the consumer's right to rescind automatically extends from three business days to three years. 12 C.F.R. § 226.23(a)(3). "Material disclosures" include disclosure of the total of payments, the number and amount of payments, and the due dates or periods of payments scheduled to repay the indebtedness. 15 U.S.C. § 1602(u). On this basis, the *Jones* court held that the borrower was entitled to rescission of her loan and to statutory damages for the lender's failure to honor her notice of rescission. The court, however, denied statutory damages for the lender's failure to clearly disclose the borrower's payment schedule. Recovery for that TILA violation was barred by the applicable statute of limitations. ■

> A trial on the matter, including a hearing on a permanent injunction, is scheduled for July 6, 2006.

OTS Opines Montgomery County "Anti-predatory" Lending Ordinance is Preempted

On March 7, 2006, the Chief Counsel of the Office of Thrift Supervision issued a legal opinion concludng that the Home Owners' Loan Act, and its implementing regulations, preempt recent Montgomery County, Maryland "anti-predatory" lending provisions as applied to Federal Savings Associations and their operating subsidiaries (together, "Federal Thrifts"). The predatory lending provisions were scheduled to become effective March 8.

The Chief Counsel opinion responded to a request for clarity by a number of Federal Thrifts making mortgage loans in the county. These institutions argued that the new county ordinance would infringe on their mortgage lending activities in contravention of federal law, and could significantly impact the lending operations of such institutions and the opportunities for residents to obtain credit in the county.

The provisions that the Thrifts found objectionable purported to prohibit any mortgage loan that: (i) included the financing of single premium credit life insurance, (ii) provided for "excessive" upfront points, fees or prepayment penalties, or (iii) provided compensation paid directly or indirectly to a person from any source. Montg. Cnty. Code § 27-12(c)(2).

The OTS opinion held that the HOLA, and implementing OTS regulations, completely occupied the field of lending regulation for Federal Thrifts, preempting State and local regulation of any activities by such entities requiring insurance or other credit enhancements, particular terms of credit or loan-related fees. The opinion held that, in enacting the HOLA, Congress required the agency to provide for the organization, incorporation, examination, operation and regulation of Federal Thrifts. OTS regulations carry out this Congressional objective by giving such entities "maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation . . . leaving no room for state regulation." According to the opinion, this regulatory framework permits Federal Thrifts to efficiently deliver low-cost credit to the public, free from undue regulatory duplication and burden, while restricting abusive practices through such laws as the Home Ownership Equity Protection Act.

The opinion declined to address whether other provisions of the Montgomery County ordinance, such as specific anti-discrimination provisions, were preempted. The opinion noted, however, that only the OTS has the authority to examine, and enforce such laws against, Federal Thrifts. Investigations by local authorities are not permitted. ■

California Junk Fax Law Preempted by Federal Law

On February 27, 2006, in *U.S. Chamber of Commerce v. Lockyear*, the district court for the Eastern District of California issued a decision

holding that section 17538.43 of the California Business and Professions Code (as added by California Senate Bill 833, "S.B. 833"), which governs the sending of unsolicited

facsimile advertisements, insofar as it applies to interstate facsimile advertisements, is preempted by the Telephone Consumer Protection Act of 1991, as amended by the federal Junk Fax Protection Act of 2005.

The primary difference between the federal law and the California law is that the federal law expressly permits a party to transmit an unsolicited facsimile advertisement to those with whom an established business relationship exists, while S.B. 833 omits any such established business relationship exception, and instead requires any party seeking to transmit a facsimile advertisement into or out of California to obtain express prior consent from the recipient before doing so. Also, federal law permits senders to transmit unsolicited advertisement facsimiles under the established business relationship exception so long as the advertisement bears an "opt-out" alternative, while S.B. 833 requires senders to obtain an affirmative "opt-in."

The California district court concluded that S.B. 833 is unconstitutional to the extent it attempts to regulate the interstate transmission of unsolicited facsimile advertisements. The court reached this conclusion based on the language and congressional intent of the specific federal statute, stating that S.B. 833 stands as an obstacle to the execution of the full purposes and objectives of Congress, because it eliminates the established business relationship exception that Congress expressly codified in the federal law, and nullifies Congress' decision that unsolicited facsimile advertisements be governed by an opt-out rather than an opt-in scheme. However, the protections afforded to California consumers by S.B. 833 for intrastate facsimile transmissions remain.

The district court ruled on the U.S. Chamber of Commerce's mo-

States Legislation and Rulings

WISCONSIN – **To Allow Prepayment Penalties On Variable Rate Loans In Certain Circumstances**

Effective March 25, 2006, prepayment penalties will be permitted on variable rate loans in Wisconsin, provided certain conditions are met. Under 2005 Wisconsin Act 128, lenders may include a prepayment penalty on a variable rate loan during the first three years of the loan. The penalty may not be charged in connection with the sale of the property securing the loan. Additionally, the lender must also make variable rate loans without prepayment penalties and must provide the borrower with a written statement that the lender makes such loans. At the time of the offer, the borrower must provide written acknowledgment of receipt of statement described above.

The Wisconsin law also repeals the current section of Wisconsin law that prohibits a prepayment penalty on variable rate loans which use an "approved index" or which are secured by a manufactured home. Also repealed is the provision permitting prepayment without penalty on other variable rate loans within 30 days after notice of an increase in the interest rate.

WASHINGTON, D.C. – **Enacts Law Requiring Domestic Partner's Signature on a Mortgage**

The "Domestic Partnership Equality Amendment Act of 2006" scheduled to go into effect on April 3, 2006, amends section 15-502 of the D.C. Code to provide that a mortgage or deed of trust is not valid unless signed by the borrower's domestic partner who is living with his or her domestic partner, as defined under the D.C. law governing health care benefits expansion. Currently, domestic partners who wish to qualify for certain health care benefits are required to register as domestic partners by executing a declaration of domestic partnership to be filed with the D.C. Mayor. D.C. Code Ann. § 32-702. Under this D.C. law, a domestic partner means a person with whom an individual maintains a committed relationship and who has registered as a domestic partner. D.C. Code Ann. § 32-701. Committed relationship means a familial relationship between two individuals characterized by mutual caring and the sharing of a mutual residence. In addition, each domestic partner must: (1) be at least 18 years old and competent to contract; (2) be the sole domestic partner of the other person; and (3) not be married.

Therefore, lenders will need to determine whether a borrower has a registered domestic partner, and if so, must obtain the domestic partner's signature on the mortgage, in the same way that the signature of a borrower's spouse is required under existing D.C. law.

tion for declaratory relief, but reserved its judgment regarding the issuance of injunctive relief, and stated that the court would address that matter, if necessary, after a full hearing on the merits. The U.S. Chamber of Commerce had initially sought a preliminary injunction, then changed the motion for a permanent injunction, and defendants had indicated more time would be needed to respond. While the scope of relief to this lawsuit was left undecided for future proceedings, the outcome of this case could affect the enactment of similar state laws governing the sending of unsolicited facsimile advertisements. ■

Denying Credit Based on Fraud or Active Duty Alerts is an ECOA Violation

On March 9, 2006, the FDIC issued Financial Institution Letter 22-06 (FIL 22-06) reminding its constituent institutions that the Equal Credit Opportunity Act (the "ECOA") and Regulation B prohibit discrimination in credit transactions against consumers who have, in good faith, exercised any right under the federal Consumer Credit Protection Act (the "CCPA"). The CCPA includes several consumer protection titles, including the rights provided to consumers by the Fair Credit Reporting Act (the "FCRA").

As amended by the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act"), the FCRA contains several new consumer rights, including the right of a consumer to place fraud or extended active duty military alerts on consumer reports maintained by consumer reporting agencies. The goal of these alerts is to prevent identity theft. Users of a consumer report containing such an alert must contact the consumer by using the telephone number provided in the alert or take reasonable steps to verify the consumer's identity and confirm that the application is not the result of identity theft.

The FDIC indicates in FIL 22-06 that it recently became aware of instances in which creditors denied applications for credit based on the presence of fraud or active duty alerts on applicants' consumer reports. FIL 22-06 reminds financial institutions that denying credit or taking other adverse actions related to credit because of the presence of a fraud or active duty alert constitutes unlawful discrimination based on the exercise of a right under the CCPA. This is a violation of the ECOA.

When a fraud or active duty alert is present on a consumer's consumer report, financial institutions must take steps to attempt to verify the identity of the applicant before the application for credit is denied based on the alert. Financial institutions should develop and adopt effective procedures to address these responsibilities. These procedures should ensure that the financial institution makes every effort to contact the consumer using the information provided by the consumer within the fraud or active duty alert. By taking such measures, consumers are protected from being further victimized by identity theft and financial institutions may guard against losses due to fraud.

While FIL 22-06 is directed at financial institutions regulated by the FDIC, the principles outlined in the guidance apply as well to lenders subject to the ECOA and the FCRA. ■

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