Truth In Lending Regulation

Case Study

This case involves an excellent community bank that has long supported growth for its hometown in the Central Texas region. The bank provides retail and commercial banking services for its community, as well as a mortgage lending program to fill a gap in mortgage lending services not offered by secondary market lenders.

Technical Error

During a regular audit, an auditor discovered a highly technical error in the bank's finance charge calculations for certain adjustable rate mortgage loans. The bank contacted Farley Law to confirm whether the finding was accurate and to assist in resolving any regulatory issues. The bank was concerned about fulfilling its regulatory responsibilities and maintaining good relationships with its customers - as well as its regulator and examiners.

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Solution

We investigated by reviewing the auditor's findings against sample loan files and against the requirements of the Truth in Lending Act, Regulation Z, and its attendant commentary. It was determined that a miscalculation had been made which caused the APR for certain types of adjustable mortgage loans to be understated. It was also determined that the understated APR could be "cured" as permitted by the Truth in Lending Act by notifying affected customers and reimbursing customers for the amount of the charges in excess of those stated. It was also determined that, because the mortgage loans were adjustable-rate mortgages, the amount of the cure only needed to be determined for the time prior to the first-rate adjustment date, rather than for the life of the loan, which significantly reduced the amount of the required cure payment.

Actions

As the Truth in Lending Act permits lenders to "cure" violations upon their discovery, we assisted the bank in developing a plan for: a) identifying affected loans, b) determining the actions necessary for taking advantage of the regulatory "cure", c) developing a cure calculation methodology that could be implemented by bank staff, d) preparing a customer-facing communication plan including drafting template letters to be provided to bank customers, and e) coordinating with the bank's primary regulator for a tentative agreement on the bank's plan for curing the violation. Identifying the issue also assisted the bank with making adjustments to its loan originations to correct the APR calculation going forward.

Summary

- The bank was able to adjust and retain the mortgage lending program for the bank and for the communities it served.
- The "cure" amount was determined to be significantly less than anticipated since the cure payment only applied to the first several years of loan payments vs. the full 20 – 30 year term.
- Coordinating with the bank's primary regulator avoided a "second cure" scenario where the examination team may have disagreed with the reimbursement calculation and cure notices. As a result, the examination team remained complimentary of the bank, and no further actions were required of the bank.
- Lawsuits and enforcement actions were avoided.
- The bank retained its customer base and positive image and reputation
- The approach consisted primarily of developing a solid plan, calculation methods, and communications that could be executed by bank staff. This resulted in significant savings on legal services vs. having legal staff prepare and execute all relevant documents and communications.

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