

LENDERS COMPLIANCE GROUP

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Truth in Lending Act offers an Unwaivable Defense

Tolerance for Accuracy

The Truth in Lending Act (TILA)¹ was amended in 1995² to permit minor disclosure inaccuracies on the part of lenders, in order to prevent creditors from being subject to “extraordinary liability” for those disclosure errors. The amendment provided a tolerance range regarding finance charges, so that errors in disclosure of finance charges will be treated as accurate if such errors do not vary from the actual finance charge by more than \$100, or, in a claim seeking rescission of a loan, if the amount disclosed does not vary from the actual finance charge by more than half a percent of the loan total.

Until a recent ruling by the 3rd U.S. Circuit Court of Appeals, it was argued that an “affirmative defense” regarding the tolerance for accuracy must be raised by the defendant or forfeited if not raised in response to a pleading. The 3rd Circuit has just ruled,³ however, that the TILA’s tolerance for accuracy provision is a “general defense,” which is not required to be raised in order for a lender to avoid liability for disclosure errors within the tolerance range.

Brief Synopsis

Debtor Sterten took out a \$132,000 loan from Option One Mortgage Corp. in February 2001 to refinance a second mortgage on her home. Nearly two years later, Sterten contended that Option One’s closing of the loan did not comply with the TILA and demanded rescission of the loan. Option One disputed Sterten’s right to rescind. Sterten filed a Chapter 13 bankruptcy petition. Option One filed a proof of claim. Sterten brought an adversary proceeding seeking rescission of the loan.

Sterten’s suit alleged that neither the TILA disclosure nor the rescission notice was provided. Further, Sterten alleged that the finance charges were not accurately disclosed. Option One denied both allegations. The Court concluded that Sterten had received the required forms.

The Court found that there were only two items pertaining to disclosure errors in the finance charges: a \$25 “mark up” in the appraisal fee, and a \$32 charge for notary services. The Court sua sponte applied the TILA’s tolerances for accuracy provision, determining that the \$57 in disclosure errors of these finance charges were within the tolerance range; consequently, Option One’s disclosure was “accurate as a matter of law.”

Affirmative versus General Defense

Sterten then argued that the Court should not have applied the tolerances for accuracy provision, because Option One had failed to raise it as an affirmative defense, thereby waiving it. The Court responded by vacating the judgment and declared for rescission.⁴

Option One appealed to U.S. District Court. The USDC reinstated the original verdict, holding that the tolerance for accuracy provision is not a defense that can be waived.⁵

And the 3rd Circuit has now ruled that the USDC correctly ordered the original verdict in favor of Option One to be reinstated, on the grounds that the “tolerance for accuracy” should not be treated as an affirmative defense,⁶ since an affirmative defense is required in order to prevent “surprise and undue prejudice,” declared the Court.⁷

Reasoning that the “analysis a plaintiff must undertake to show *any* [emphasis in original] undisclosed finance charges under the Truth in Lending Act -- that there were discrepancies between what was charged and what was disclosed in the Truth in Lending Disclosure Statement, and that those undisclosed fees fall within the Act's definition of a 'finance charge' -- is the same analysis required to show that the undisclosed charges exceeded § 1605(f)'s⁸ range of error,” the 3rd Circuit held that there was no basis to argue that Sterten suffered any “unfair surprise” as a consequence of Option One's failure to plead the tolerances for accuracy defense.

Effect of Ruling

A lender does not forfeit the defense afforded by the TILA tolerances for accuracy provision by failing to raise it in a bankruptcy proceeding. The defense is general and the sua sponte application of TILA's tolerance for accuracy by the bankruptcy court was upheld. Therefore, a lender's denial that it has committed any disclosure violations is sufficient to preserve the tolerance for accuracy provision. This ruling will benefit creditors, because TILA provides for a general defense of the tolerance for accuracy provision with respect to disclosure errors of finance charges, thus assuring that creditors are not subject to "extraordinary liability" for errors in disclosure within the tolerance range.

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¹ 15 USC § 1601, et sequi.

² 141 Cong. Rec. H9514-01 (daily ed. Sept. 27, 1995); 15 USC §1605(f)

³ In Re: *Sterten v Option One Mortgage Corporation*, 11/04/08, No. 07-2237

⁴ In Re: *Sterten*, Bankr. No. 03-14014 (Bankr. E.D. PA January 4, 2006)

⁵ *Sterten v Option One Mortgage Corp.*, No. 06-651, 2007, USDC

⁶ Federal Rules of Civil Procedure, III “Pleadings and Motions,” Rule 8(c) “Affirmative Defenses,” which provides, in effect, that an affirmative defense is deemed waived, unless asserted. FRCP 8 is applicable to Sterten's bankruptcy proceedings under Bankruptcy Rule 7008.

⁷ *Robinson v. Johnson*, 313 F.3d 128, 134-35 (3rd Cir. 2002); *Ingraham*, 808 F.2d at 1079.

⁸ Tolerance for accuracy.