TILA – Right of Rescission: The Impact of the Supreme Court's Recent Decision in *Jesinoski v. Countrywide*

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Overview

In *Jesinoski v. Countywide*, 135 S.Ct. 790 (2015), the Supreme Court clarified 2 important issues regarding a borrower's 3-year right of rescission under the Federal Truth in Lending Act ("TILA").

- *Issue 1*: To exercise the 3-year right of rescission, does the borrower have to sue the lender? Or is sufficient for the borrower to serve the lender with a rescission notice?
  - *The Supreme Court's holding*: Serving a notice is sufficient.
- *Issue 2*: Is returning the lender's funds ("tender") a strict condition precedent to enforcing a rescission notice?
  - *The Supreme Court's holding*: No, tender is not a strict condition precedent to enforcing a rescission notice.

Why Do We Care?

- Though not a perfect result, in past years most rescission concerns were resolved by judicial interpretation.
  – The requirement that a borrower return funds prior to the rescission being effective provided useful leverage to the lender or assignee.
- All components of the rescission process are now back on the table.
  – State and federal court decisions have to be homogenized to the *Jesinoski* decision.
  – State courts in particular are not familiar with the complexities of TILA in general and rescission in particular.
  – It will likely take time for appellate precedent to emerge to provide guidance when responding to an alleged rescission notice.

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Key Implications for Borrowers

- Pre-*Jesinoski*, rescission already was a somewhat useful strategy for a delinquent borrower.
  – If successful, rescission essentially gave the borrower a free house for a period of time.
  – Lenders frequently were forced to modify loans and provide more favorable terms to borrowers.
  – Even if ultimately deemed invalid, a rescission claim delayed, for years, the disposition of any pending or future foreclosure action. (In the meantime, the borrower can continue living in the home for free.)
- Under *Jesinoski*, a borrower who defaults has an even greater incentive to rescind.
  – The borrower does not need to draft or file a complaint.
  – Initially, the borrower does not necessarily need to return any money.

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Key Implications for Lenders

- Pre-*Jesinoski*, most jurisdictions incorporated into TILA's rescission scheme the common law obligation that a borrower had to return the loan proceeds before the rescission was effective.
  - The penurious nature of most defaulting borrowers provided lenders the opportunity to negotiate a compromise.
  - In most jurisdictions there was not a necessity to immediately challenge in court the validity of a rescission.

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Key Implications for Lenders

- Post-*Jesinoski,* it is now riskier for a lender to ignore, or reject, a rescission notice.
  - A borrower can argue that a lender's failure to honor a rescission notice is a violation of TILA.
  - A lender who disputes the validity of a rescission notice should consider whether to promptly seek judicial relief.
- It is more important than ever to document that a borrower has received the requisite material disclosures and notices under TILA.
  - If the borrower receives these items, the 3-year extended right of rescission does not apply.
- Lenders in all 50 state jurisdiction will have to closely monitor how initial rescission challenges by borrowers will be addressed by the courts.

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In this presentation, we will discuss:

- The details of the *Jesinoski* decision.
- What lenders can and should do upon receipt of a rescission notice.
- What to expect from the Consumer Financial Protection Bureau ("CFPB").
- How lenders should adjust their practices in light of the decision.

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The *Jesinoski* Decision

<u>The Statutory Framework</u>

- TILA distinguishes between 2 types of rescission:
  - Rescission within 3 days.
  - Rescission within 3 years.

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The *Jesinoski* Decision

The Statutory Framework, Continued

- A borrower initially has 3 days to rescind.
  - Lenders cannot disburse funds during this time. *See* 12 C.F.R. § 1026.23(c).
  - Not really "rescission" – rather, a "borrower's remorse" provision.
  - Strategic rescission is not a major concern in this context.
  - The right is exercised by service of a notice. *See* 15 U.S.C. § 1635(a).
  - First, within 20 days of receipt of the notice, lender must fulfill its obligations by unwinding the transaction. Second, borrower tenders.
    - A court can change this sequence. *See* 15 U.S.C. § 1635(b).
    - If the lender has not disbursed funds, this sequence is not necessarily relevant.

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The *Jesinoski* Decision

The Statutory Framework, continued

- A borrower also potentially has 3 years to rescind.
  - This borrower:
    - Has taken the lender's money.
    - Likely is in default.
    - May want to rescind for strategic reasons.
  - This 3-year period applies if the borrower did not receive (1) the notice of right to rescind, and/or (2) material disclosures.
    - Written acknowledgement only a "rebuttable presumption." 15 U.S.C. § 1635(b).
  - Pre-*Jesinoski*, lenders contended that, here, a rescission notice was void.
    - The statute is arguably ambiguous.
    - Would lead to absurd results.
    - Where accepted, this argument:
      - Shifted the onus to the borrower to sue.
      - Meant that the lien remained secure.
      - Acted as a potential deterrent against frivolous rescission claims.

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The *Jesinoski* Decision

The Pre-*Jesinoski* Circuit Split

- Circuits holding that notice is sufficient → Third, Fourth, and Eleventh Circuits.
- Circuits holding that notice is insufficient → First, Sixth, Eighth, Ninth, and Tenth Circuits.

The Court's Reasoning

- Congress meant for rescission in the 3-year context to work the same way as rescission in the 3-day context, in that:
  - Notice is sufficient.
  - The borrower does not necessarily have to tender first.
  - Regardless of whether the lender disputes the validity of the rescission.
- At oral argument, the Justices discussed the problem of borrower windfall.
  - But the decision does not address this issue.

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What to Do Upon Receipt of a Rescission Notice

- Contact the borrower (or borrower's counsel) to negotiate a potential extension of the 20-day deadline (to the extent it applies).
- Determine if there are any potentially valid defenses to rescission.
- Decide whether to honor the rescission and whether to sue the borrower.

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Potentially Valid Defenses to Rescission Post-*Jesinoski*

- TILA does not apply.
  - Is it a purchase-money mortgage?
  - Is it the borrower's primary residence?
  - Was it a refinancing by the same lender, not in excess of the original principal balance?
- The disclosures were demonstrably accurate and sufficient, and therefore the borrower is not entitled to a 3-year extended right to rescind.
- The borrower is unable or unwilling to tender.
- The borrower did not serve the notice within 3 years of the origination of the loan.

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The Lender's Options

- The two key issues are: (i) whether to rescind; and, (ii) whether to sue.
- What is rescission?
  - "[T]ake any action necessary to reflect the termination of any security interest." *See* 15 U.S.C. § 1635(b).
  - "[R]eturn any money or property that has been given to anyone." *See* 12 C.F.R. § 1026.23(d)(2).
  - The borrower "is not liable for any finance or other charge." *See* 15 U.S.C. § 1635(b).
  - After the creditor has performed its obligations, the borrower must tender. *See* 15 U.S.C. § 1635(b).

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Potential Theories of Liability

Theory	Basis	Relief
Breach of contract.	The borrower's default; rescission notice as anticipatory breach.	The unpaid balance of the loan.
Foreclosure.	The borrower's default; rescission notice as anticipatory breach.	Sell the property to satisfy the unpaid balance of the loan.
Declaratory judgment that the rescission notice is void.	TILA is inapplicable; no disclosure violations; inability or unwillingness to tender; failure to serve notice within 3 years of origination.	Equitable mortgage (if lender already filed release).
TILA: borrower's obligation to tender.	If the lender has already unwound the transaction, but the borrower has failed to tender, the lender can seek an order requiring tender.	Damages equivalent to the unpaid principal balance of the loan.
TILA: sequence for unwinding the transaction.	If the lender has not yet unwound the transaction, the lender can seek an order requiring the borrower to tender before the lender performs.	Re-sequencing of the steps for unwinding the transaction.

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Pros and Cons

Option	Pros	Cons
Comply and sue.	• Borrower cannot argue that lender violated TILA by failing to rescind. • Lender can seek prompt relief from the court. • Will resolve any doubts regarding the validity of the rescission notice.	• The loan is now unsecured; only the court can reinstate the lien. • Reinstating the lien may require notice to other lien-holders. • Litigation costs.
Comply and do not sue.	• Borrower cannot argue that lender violated TILA by failing to rescind. • Initially, no litigation costs. • If there is no viable defense to rescission, then a lawsuit would not be appropriate.	• Borrower may argue that lender has waived potential defenses to rescission. • The loan is now unsecured. If the borrower fails to tender, the lender may find that the borrower is judgment-proof.
Do not comply; sue.	• The lender's lien arguably remains intact. • Will resolve any doubts regarding the validity of the rescission notice. • No costs associated with unwinding the transaction.	• Borrower potentially can argue that lender violated TILA by failing to rescind. • Litigation costs.
Do not comply and do not sue.	• No litigation costs. • No costs associated with unwinding the transaction.	• Borrower potentially can argue that lender violated TILA by failing to rescind. The lender is taking a gamble that a court will agree that (i) there is a valid defense to rescission, and (ii) the lender did not waive that defense by failing to sue.

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The *Jesinoski* Decision—Unanswered Questions

- What potential defenses, if any, does the lender have to a rescission notice?
  - The loan does not permit rescission.
  - The TILA disclosures were delivered and the material disclosures were accurate.
  - The 3-day initial rescission period passed.
- What is a lender expected to do if it believes that it has a valid defense to rescission?
  - Pre- and Post *Jesinoski* status has not changed – if a defense is valid, no action is required.
    - The mortgage lien remains valid.
    - The servicer should be aware of the rescission notice.

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The *Jesinoski* Decision—Unanswered Questions

- What is a rescission notice? Does the borrower have to use the official form? Does the notice have to use the word “rescission”?
  - Must be in writing.
  - Must be delivered.
    - Mailing a notice is effective immediately.
    - Most other notices effective upon delivery.
    - Whether delivery to a servicer / assignee is proper notice remains an open issue.
  - Regulation Z indicates that all is necessary is to state that the borrower elects to cancel.
    - Arguably 3-year extended rescission right *should* require additional information – sbut issue is unresolved.

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Jesinoski Decision—Unanswered Questions

- Does the 20-day deadline for unwinding a transaction apply to borrower's exercise of an extended right to rescind? How can a lender unwind a transaction within 20 days after the funds have already been disbursed?
  - Unwinding does not have to be completed within 20-day period – only commenced.
- Is the rescission notice self-executing, such that the mortgage is automatically rescinded upon service of the notice? Or, does the mortgage remain valid unless and until the lender, or a court, releases the mortgage?
  - According to TILA, the lien is void.
  - State real property law may still recognize the validity of the real property lien on title.
- If the lender ignores the rescission notice, what, if anything, is the statute of limitations for the borrower to enforce the notice or seek damages?

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Other Scenarios

- The loan was sold on the secondary market.
  - Assignee liability and delivery.
  - Servicer delivery and agency relationship to creditor/holder.
- The property is in a non-judicial foreclosure state.
  - Consideration must be given to so-called "one-action" statutes that may impact filing of a lawsuit challenging the validity of a rescission.

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What to Expect from the CFPB

- Acquired jurisdiction over Regulation Z in 2011.
- Federal Reserve previously was planning various lender-friendly reforms to Regulation Z with respect to the procedures for rescission.
- The CFPB filed an *amicus* brief on behalf of the borrowers in *Jesinoski*.

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How to Prepare for Rescission Notices Post-*Jesinoski*

- Consider receipt of an extended rescission notice from a litigation context – at least for the moment.
- Research relevant local law.
  - Characteristics of a rescission notice.
  - Whether the notice automatically invalidates the lien.
- Identify any loans with respect to which the borrower's TILA rescission claim was dismissed due to untimely commencement of litigation.
  - Did the borrower send a timely rescission notice?
  - Audit whether the TILA disclosures were proper, mindful that the results may be discoverable unless the review is performed by counsel.

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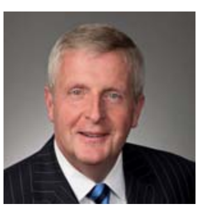
How to Prepare for Rescission Notices Post-*Jesinoski*

- Identify any other loans that are still within 3 years of origination.
  - Has the borrower sent a rescission notice?
  - Audit whether the TILA disclosures were proper, mindful that the results may be discoverable unless the review is performed by counsel.
- Institute systems for promptly identifying and processing rescission notices.
- Decide, in advance, on a protocol for evaluating and responding to rescission notices.
  - Determine whether to acknowledge receipt of rescission notice when delivered to a servicer.
- For new loan originations, consider additional steps to ensure that requisite disclosures are accurate and sufficient, and that compliance is fully documented.
- The bottom line: Until 3 years have elapsed, a mortgage is only as secure as the lender's proof of compliance with TILA.

Contacts



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