

SUBJECT: Reg. Z – Right of Rescission

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INTRODUCTION

This release applies to all credit unions that make real estate or mobile home loans. It provides the details about the right of rescission, more commonly known as the Right to Cancel, and a description of how to use The League's Notice of Right to Cancel form (#82034). The League form can be used for (1) new closed-end loans, (2) refinancings, and (3) granting open-end lines of credit.

EXECUTIVE SUMMARY

Regulation Z (Truth in Lending) gives consumers a right to cancel, lasting three business days, for most non-purchase mortgage transactions involving a consumer's primary residence. (A consumer, for this purpose, includes any person whose ownership interest in his or her principal dwelling is subject to the risk of loss even if they are not a borrower on the loan!) Credit unions granting real estate loans, including mobile home loans, must give the consumers a special notice of this right. If any of the consumers choose to cancel, the credit union must refund any fees or payments the consumer has made, even payments to third parties. The consumer must be made whole, as if the transaction had never occurred.

Loan proceeds may not be disbursed until the three business days expire and the credit union has assured itself that the consumer(s) have not cancelled the transaction. The consumer's right to cancel may not be circumvented by postdating documents or granting waivers in improper circumstances.

WHY RIGHT OF RESCISSION?

The right of rescission law was enacted primarily for two reasons: (1) to protect the consumer against unscrupulous home repair contractors who sometimes use pressure tactics to sell their products and services, and (2) to force the consumer to think twice when one of his most valuable assets is to be mortgaged to secure personal debt. A three day cooling off period allows the consumer to reconsider the effect of the mortgage loan and to weigh the pros and cons of the transaction.

WHAT IS THE RIGHT OF RESCISSION?

The right of rescission is a right of the consumer to change his mind about the transaction and receive a full refund of all fees, charges, and payments. Basically, the right of rescission is available until midnight of the third business day after the latest of the following events: (1) the loan closing, (2) the consumer(s) receiving the Truth in Lending disclosures, or (3) the consumer(s) receiving the Notice of Right to Cancel.

For purposes of the right to rescind, Truth in Lending defines a business day as all calendar days except Sundays and the following federal holidays:

- New Year's Day (January 1),
- Martin Luther King, Jr.'s Birthday (third Monday in January),
- Washington's Birthday (third Monday in February),
- Memorial Day (last Monday in May),
- Juneteenth (June 19),

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| <ul style="list-style-type: none"> • Independence Day (July 4), • Labor Day (first Monday in September), • Columbus Day (second Monday in October), | <ul style="list-style-type: none"> • Veterans Day (November 11), • Thanksgiving Day (fourth Thursday in November), and • Christmas Day (December 25). |
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The definition of business day is not affected by whether or not the credit union is actually open, or whether the holiday is “observed” on another day. Thus, January 1, June 19, July 4, November 11, and December 25 are federal holidays. If they fall on a weekend, they are still the only federal holidays, even if the credit union is actually closed on the Friday or Monday.

WHAT LOANS ARE AFFECTED?

Real estate and mobile home loans are subject to the right of rescission if they meet all three of the following requirements:

1. A lien is taken on the consumer's current principal residence.

A consumer, for this purpose, includes any person whose ownership interest in his or her principal dwelling is subject to the risk of loss even if they are not a borrower on the loan!

This requirement may be met by a new first or subordinate lien in connection with a new loan. It is also met, by a new extension of credit secured by an already existing mortgage on the principal residence, e.g., future advance or refinancing by which the consumer receives additional funds. Finally, it is met when a lien on consumer’s principal residence is added to an existing extension of credit.

The current principal residence can be a house, condominium, or even a boat if that's where the consumer usually lives. A mobile home can be the principal residence regardless of whether it is attached to real estate or whether the consumer owns the land it rests on.

2. The loan is for a purpose other than to acquire or construct the current principal dwelling.

If the loan is to buy property for immediate use (that is, within one year or upon completion of the dwelling) as the principal residence, the rescission notice is not required.

However, the loan is rescindable, even if it is to build or acquire a principal residence, when it is secured by equity in the current principal residence. Thus, the typical “bridge” loan is subject to the right of rescission.

3. The loan is for a personal, family, or household (consumer) purpose.

Truth in Lending specifically exempts loans to organizations and loans for business, commercial, or agricultural purposes. However, if the purpose is mixed, both personal and business, the primary purpose prevails. The Official Staff Commentary on Regulation Z § 1026.3(a) provides guidance for close calls.

EXAMPLES OF LOANS REQUIRING THE NOTICE OF RIGHT TO CANCEL

The following examples help illustrate which loans involve a right to rescind:

Refinanced Loans

- Suppose the consumer refinances a credit union home mortgage loan with the same credit union. The amount of the new transaction does not exceed the amount of the unpaid balance plus any earned unpaid finance charge on the existing obligation, and the costs of refinancing. In other words, no new money is advanced.

The right of rescission *does not apply*. The terms of credit may change, but as long as no new money is advanced, no right of rescission is necessary.

- The consumer refinances a credit union home mortgage loan with the same credit union, but adds new money for home improvements.

The right of rescission *applies*. However, it applies only to the additional funds requested for the home improvements. The funds represented by the unpaid balance are not rescindable.

- The consumer refinances a Savings & Loan home mortgage loan with your credit union.

The right of rescission *applies* to the entire obligation.

Summer Home Purchases

- The consumer purchases a summer cottage for family use with a loan secured by a mortgage on the primary residence.

The right of rescission *applies* because it's for personal, family or household use and the lien is taken on the principal residence, but was not to acquire the principal residence. It doesn't matter if it is a first or subordinate lien.

- The consumer purchases a summer cottage for family use and grants a mortgage lien only on the summer cottage.

The right of rescission *does not apply*. Although it's for personal, family or household use, the lien is not placed upon the borrower's principal residence.

- The consumer purchases a cottage primarily to rent out year-round for additional income and grants a lien on the principal residence.

The right of rescission *does not apply* because the purchase is for a business purpose. However, if it were only rented out several weeks each year and used by the consumer's family for a much greater amount of time, the loan would have a primarily consumer purpose and a right to rescind would exist.

- The consumer buys an unimproved lot, placing a lien on his current residence. The lot is to be used for construction of a future principal residence to be built immediately.

The right of rescission *does apply*, since the lien is on the principal residence, and is not securing a loan to buy or construct the current principal residence.

Loans Secured By Mobile Homes And Other Dwellings

The same results are obtained in the above examples, regardless of whether the principal dwelling involved is a mobile home, duplex, condominium, or house trailer, as long as it is in fact used as the principal residence. It doesn't matter whether a mobile home is on land owned by the consumer or in a trailer park; it is still a dwelling.

Land Contracts

- The consumer takes out a credit union mortgage to pay off a land contract on the primary residence.

The right of rescission *applies*. Such a loan is not considered to be a loan to acquire the dwelling.

Future Advances

A future advance clause is a statement within a mortgage document that claims a lien for additional extensions of credit to the consumer. The additional advance would not require a new mortgage to be recorded to be effective against the consumer as long as the sum of the unpaid balance and accrued and unpaid finance charges does not exceed the amount stated on the original mortgage recorded with the Register of Deeds. For closed-end loans, a new note and disclosure statement must always be written.

Not all mortgage documents provide for a future advance clause. If a future advance clause is contained in the mortgage, there are certain cautions in granting them. Please see *ii Release No. B048*.

- The consumer wants to borrow against the principal residence to buy a boat. The credit union currently holds the closed-end mortgage loan that financed the acquisition of the home at \$70,000. The loan now has a \$50,000 balance and the consumer borrows another \$10,000.

The right of rescission *does apply* to the \$10,000 future advance, but not to the \$50,000 outstanding balance.

- The consumer's R.E.A.P.[®] loan is secured by the principal residence and is intended for consumer purposes.

The right of rescission *does apply* when the transaction is consummated but not later, when individual advances are made within the credit limit. If the consumer increases the R.E.A.P.[®] loan limit, a new right of rescission arises.

WHO IS THE NOTICE OF RIGHT TO CANCEL (AND TRUTH IN LENDING DISCLOSURE) GIVEN TO?

A separate Notice of Right to Cancel (#82034) and material Truth in Lending disclosures must be given to “each consumer whose ownership interest is or will be subject to the security interest.”

The term “consumer” here means anyone with an ownership interest in the dwelling being mortgaged, even if that person is not a borrower. This includes all joint owners as well as spouses who the credit union requires to sign the mortgage, assuming it is their primary residence.

- For example, John Smith and his brother, James, inherited a home from their parents. Since acquiring the home, each brother has married. Each contributes to the maintenance, taxes, and insurance from his own wages. James and his wife reside in the home, John and his wife live elsewhere. Now James wants to get a mortgage loan to put new siding on the house.

Who is entitled to Notices of Right to Cancel and material Truth in Lending disclosures? Since John and James are joint owners, the credit union will insist that both of them sign the mortgage. However, of the two brothers, only James has a right to rescind. The loan will be secured by his principal dwelling, whereas John's principal dwelling is elsewhere.

Does anyone else have a right to rescind? James' wife likely has an interest by virtue of Wisconsin homestead and marital property laws. The credit union would require her signature on the mortgage and provide her with a Notice of Right to Cancel and material Truth in Lending disclosures.

John's wife may well have a marital property interest; however, she has no right to rescind because the property is not her primary residence.

- As another example, suppose parents mortgage their home to secure a loan being taken out by their child. The parents each have the right to rescind, since their primary residence is subject to the mortgage even though they are not the borrowers.

WAIVER OF RIGHT OF RESCISSION

The consumer may waive his right to rescind a transaction but it should occur only in rare circumstances. Any frequency in waiver of modification of the rescission right may be viewed by a Truth in Lending enforcement agency as an indication that such waiver has become subject to abuse by the credit union. For this reason, the regulation strictly prohibits preprinted waiver forms.

A waiver of right of rescission is subject to the following:

- The extension of credit is needed in order to meet a bona fide personal financial emergency of the consumer;
- The consumer has determined that a delay of three business days will jeopardize the welfare, health or safety of natural persons, or endanger property which the consumer owns or for which he is responsible; and
- The consumer furnishes the credit union with a separate dated written statement with language modifying or waiving the right to rescind. It must also describe the emergency. The waiver must be signed by all who are entitled to rescind in order to be effective.

Of course, the consumer is the best judge of what constitutes a “personal financial emergency” or what will “jeopardize the welfare, health or safety of natural persons, or endanger property” for which he is responsible. Nevertheless, the credit union must exercise reasonable care and diligence where any doubt exists as to the validity of the reason given for waiver or modification.

GIVING THE NOTICE OF RIGHT TO CANCEL AND MATERIAL TRUTH IN LENDING DISCLOSURES

Two copies of the Notice of Right to Cancel form must be given to each consumer who has the right to rescind under Truth in Lending. (One copy is enough if the notice is given electronically, as explained below.)

Multiple copies of the Notice of Right to Cancel are required at closing. Each consumer entitled to the notice signs the acknowledgement of receipt at consummation. The credit union retains one copy, while each consumer gets their own two copies. Any consumer may use one copy to cancel the transaction and still have another for permanent retention.

These copies are usually given simultaneously with the note, disclosures and mortgage because of the rule that the three day waiting period for rescission does not begin until the loan is “consummated,” material Truth in Lending disclosures are provided and the rescission notice is given, whichever is later. Each consumer who is entitled to the rescission notice must also be given their own copy of the material Truth in Lending disclosures.

It is *not* proper to give a Notice of Right to Cancel at the time the application is submitted. This practice would not allow the consumer the full three business days to rescind since he has not entered into a transaction until the note is signed.

If two or more parties are entitled to rescind the transaction, each gets his or her own set of copies of the rescission form with their own copies of the material Truth in Lending disclosures. In that case it is important that they each sign the acknowledgement of receipt.

What are the material Truth in Lending disclosures?

The term “material disclosures” requirement is met by providing the normal Truth in Lending disclosures that are required at loan closing, such as:

- The Closing Disclosure, for closed-end real estate loans subject to TRID,
- The Truth in Lending disclosure with an interest rate and payment summary, for closed-end loans secured by a non-real estate dwelling, or
- The TIL disclosures typically built into a combined HELOC loan agreement & TIL disclosure, for open-end lines, such as R.E.A.P.[®]:

If the loan is subject to HOEPA, the credit union must also provide appropriate HOEPA disclosures §1026.32(c) which must reflect the limitations required for HOEPA loans in §1026.32 and limitations on prepayment penalties.

Giving the Notice Electronically

If the notice is provided electronically, then only one copy has to be provided to each person entitled to rescind the transaction.

Reg. Z generally requires the credit union to provide required disclosures or notices, including the Notice of Right to Rescind, in writing and (with some exceptions) in a form that the consumer may keep. But Reg. Z also allows them to be provided electronically if the credit union complies with the requirements of the federal Electronic Signatures in Global and National Commerce Act (or E-SIGN).

Under E-SIGN, consumer disclosures or notices required by other laws or regulations can be made electronically to a consumer who voluntarily consents after receiving certain E-SIGN notices. For details on E-SIGN’s consent and notice requirements, see The League’s *ii Release No. 0175, “Electronic Signatures and Records.”*

CAUTION: If you have gone through the steps to permit electronic delivery of disclosures to the applicant – GREAT! But, have you gone through those steps separately with each other consumer who is entitled to their own Notice of Right to Cancel and their own material Truth in Lending disclosures?

The credit union can provide Reg. Z disclosures to consumers both in paper and electronic form and rely on the paper form to satisfy its compliance obligations. (A duplicate electronic form may be provided without worrying about the E-SIGN notice and consent requirements.)

COUNTING THE THREE DAYS

It is clear that the consumer can cancel up until midnight of the third business day after the Notice of Right to Cancel and material Truth in Lending disclosures are provided at closing. However, it is easy for a credit union to make errors in counting out the days, so an example may be helpful.

Suppose the notice and disclosures are given on Monday, when the loan is consummated. Remember, each person is entitled to rescind gets their own set of rescission notices and their own set of the material Truth in Lending disclosures. Assuming no federal holidays interfere, the consumer's right of rescission expires at the end of the day (midnight) on Thursday. Thursday's date is to be listed on the Notice of Right to Cancel as the time when rescission rights expire. If the

consumer (and all others with the right to rescind) supplies written confirmation that there has been no cancellation, funds can be disbursed anytime on Friday. If signed confirmation from all is not received, the funds must be held long enough for a cancellation mailed on Thursday to arrive at the credit union. Of course, any federal holiday would extend the rescission period another day.

DISBURSEMENT OF LOAN PROCEEDS; ACCRUAL OF FINANCE CHARGE

The credit union cannot disburse any money until after the rescission period has expired and the credit union has reasonably satisfied itself that the consumer has not exercised the right to rescind. The only exception to this rule is if the consumer decides to waive the right to rescind in the strictly limited circumstances discussed above (see “Waiver of Right of Rescission”).

Although the credit union is barred by law from disbursing the money during the rescission period, it is not directly prohibited by Regulation Z from assessing finance charges during this time. Although a consumer could try to challenge the practice in the courts, some lenders do assess interest during the three-day rescission period.

HOW THE CONSUMER RESCINDS THE TRANSACTION

The consumer may cancel a transaction during the rescission period by any of the following methods:

- By signing and dating the Notice of Right to Cancel received from the credit union and either mailing it to the credit union address shown on the notice or delivering the notice to the credit union address, personally or by messenger;
- By sending a telegram to the credit union at the address shown on the notice. A brief description of the transaction which the customer wishes to cancel should be included in the telegram; or
- By preparing a letter (or other writing) which includes a brief description of the transaction which he wishes to cancel and either mailing it or delivering it personally or by messenger to the credit union address given in the notice.

The consumer is not allowed to telephone a cancellation. If one attempts to do so, advise him or her that it must be in writing.

Notification by mail is considered given at the time mailed. Notification by telegram is considered given at the time filed for transmission while notification by other writing is considered given at the time delivered to the credit union address shown on the notice. For these reasons, the credit union must allow time for a mailed letter or telegram sent within the three day period to be delivered before disbursing proceeds, or otherwise reasonably determine that the consumer has not canceled the transaction.

One way of “reasonably” determining that a consumer has not rescinded is to have the consumer sign that portion of The League's Notice of Right to Cancel that is headed “Confirmation.” In doing this, the consumer certifies that the transaction has not been rescinded. However, the Truth in Lending Commentary provides that “when more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.” Thus, if more than one person has received a Notice of Right to Cancel, each person's signature would be necessary for the confirmation to be reasonably relied upon.

Again, if the credit union does not obtain a confirmation (1) signed by all parties who have the right to cancel, or (2) signed after the rescission period expires, the credit union must “wait a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.” Post-dated confirmations are invalid.

EFFECT OF RESCISSION

A consumer who exercises the right to rescind the contract within the allowed time period is not liable for any finance or other charge. When a credit union receives the rescission notice, it must act within 20 calendar days to terminate the security interest and return any money paid in connection with the transaction. This includes charges such as application and commitment fees, title fees, appraisal fees, whether paid to the credit union or directly to a third party. Furthermore, if the consumer has made any payments on the loan, they must also be returned. Payment may have been made, for example, where the credit union had not properly given notice to rescind, and the consumer decides to rescind after having made a number of payments. Keep this in mind if tempted to backdate documents!

If the credit union has delivered any money or property to the consumer prior to rescission the consumer must return it, but not until the credit union has fulfilled its obligation in the preceding paragraph.

TIME LIMIT FOR UNEXPIRED RIGHT OF RESCISSION

If the credit union fails to deliver the required Notice of Right to Cancel or all of the “material” Truth in Lending disclosures (e.g., the Closing Disclosure and, if applicable, HOEPA disclosure) to each person entitled to receive them, the right to rescind shall not expire until the earlier of (1) three years after the date of consummation of the transaction, or (2) the date the consumer transfers or sells all his interest, both equitable and legal, in the property.

For example, suppose a husband and wife jointly owned property and were granted a mortgage loan subject to right of rescission. Say the husband received a Notice of Right to Cancel (and chose not to cancel) but the wife was never given a notice. The wife would have up to three years to rescind the contract. This would be true even if the proceeds of the loan were already spent, say on remodeling.

The Home Ownership and Equity Protection Act (HOEPA) requires certain disclosures for high-cost mortgage loans. (See The League’s *ii Release No. B062* for details.) These are “material” disclosures, meaning that the credit union’s failure to give the disclosures or observe the various limitations that HOEPA imposes would extend a consumer’s three-day rescission period to a three-year period.

In addition, Reg. Z imposes several restrictions on “higher priced mortgage loans,” meaning any closed-end mortgage loans to consumers that are secured by the consumer’s principal dwelling, if the APR is greater than certain tolerances. Among the restrictions, prepayment penalties are prohibited if the payments on a higher-priced mortgage loan can change during the first four years after the loan is made. Even if payments cannot change, a prepayment penalty may only be assessed for two years after the loan is made, as long as the penalty is permitted by other applicable law. See The League’s *ii Release No. B068* for details. Federal regulators have made it clear that a higher-priced mortgage loan (whether or not it is a HOEPA loan) having a prepayment penalty that violates Reg. Z is subject to a three-year right of rescission.

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Legal Affairs Department

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