

# TNPA

## **Government study concludes 50% to 60% of all adjustable rate mortgages contain errors**

*October 2009*

*The National Public Accountant*

*By Ian Renert*

It's true! Federal regulators from the FSLIC (Federal Savings & Loan Insurance Corporation) have discovered that consumers are overpaying on their adjustable rate mortgages by more than \$8 billion as a result of interest rate miscalculations. Between 50% to 60% of all adjustable rate mortgages

Banks make two extremely serious mistakes in handling ARMs. One is failing to make proper initial disclosures on ARMs that feature discounted "teaser" rates. The second is some banks – reportedly a great many – are not making correct rate adjustments on outstanding ARMs.

The potential magnitude of both problems is daunting. With respect to inaccurate initial disclosures, there have been instances in the past several years of banks being required to reimburse customers hundreds of thousands of dollars for errors that arose out of innocent but careless mistakes.

### **Payment Adjustments**

The second potentially huge error that banks make is failing to adjust the payment properly on outstanding ARMs.

This issue hit the front pages of newspapers last year when a former FSLIC employee conducted a study which found errors in 50% of the ARMs examined. He charged that lenders are requiring payments at rate adjustment time that exceed the amount called for by the initial disclosures and/or contracts.

Among the most common potential sources of trouble are ambiguous contract language, inadequate computer programs, incorrect completion of documents and calculation errors. In the last category, the mistakes include everything from clerical errors in data entry to carelessness in entering index values or rounding of results. For example, sometimes staffers use the wrong date in selecting the index value or use the wrong index altogether. Index values change frequently, sometimes by the hour! This makes it difficult to calculate the interest charges. Sometimes adjustment amounts are not rounded off in conformance with the method in the initial documents. And that's only the beginning!

The biggest problem for ARMs is the fact that loans are sold – often times more than once – into the secondary market – to other banks, Fannie Mae and investors. Overcharges develop as data is transferred between computer systems.

### **Small Errors, Big Overcharges**

Overcharges that are not corrected continue to compound monthly with each payment at the rate being charged on the note. To understand how quickly even small errors can skyrocket, on a \$650,000 loan at 10%, the yearly rate would only have to be off 0.462% to result in an overcharge of \$250 each month. If not corrected, the total overcharge in just three years would amount to \$10,532.

Banks and mortgage companies are now rushing to comply with new accounting guidelines issued by the Federal National Mortgage Association for adjustable-rate mortgages. This comes four years after the disclosure of widespread overcharges by thrifts holding such mortgages. Many lenders since then have put audit programs into place. Inaccuracies, however, are said to persist.

It is important to understand that under truth in lending, lenders with some exceptions receive no leniency for errors because the institutions meant no harm. Nor is there leniency on the grounds that customers were given the correct information on some other form and understood the transaction.

Truth in lending is a technical regulation, and reimbursement penalties are imposed almost automatically for certain technical mistakes, regardless of cause or effect.

It is generally wise to correct understated APRs or finance charges that come to light by reimbursing the customer in accordance with agency guidelines. Unlike redisclosure or nonaction, reimbursement within 60 days of discovering the error will cure the violation and cut off further liability under truth in lending.

The Indianapolis Business Journal reported that Bane One Mortgage Corp., a division of Columbus, Ohio-based Banc One Corp., agreed to settle a class-action law suit charging that it miscalculated adjustable-rate mortgages. The case is one of more than a dozen filed against financial institutions throughout the U.S. by mortgagors who claim to have been overcharged on their adjustable-rate loans. To avoid a potential law suit or, worse yet, a class-action suit, a bank should audit its loan portfolio.

Fannie Mae's directive is aimed at reducing the number of faulty loans still circulating. The agency lists criteria that lenders must follow and details the results of adjustable-rate loan miscalculations and their effect on banks and consumers. The agency is requiring servicers to have in place systems and procedures to verify the accuracy of ARM adjustments.

### **ARMs Auditor**

Audit firms are taking advantage of the new regulations to drum up business. Many assist businesses in reducing their monthly mortgage payments – and obtain refunds for any overcharges paid to the lender. Typically, they will advise the client of any errors – including those in escrow accounts (taxes and insurance) and charges for late payments – and provide the lender with all documents to recover any overcharges. If the mortgagor lacks any necessary papers, the ARM's auditor will normally obtain them from the lender. Since the index values on an ARM change frequently – sometimes by the hour – a thorough ARM audit requires specialized training and expertise.

The ARM's auditor typically will negotiate with the lender to obtain retroactive credit for any overcharges made to the mortgagor's account over the life of the loan. Overbilling in the adjustable rate mortgage arena is real and often represents significant dollar amounts. For that reason, ARM's auditors often do not charge a fee for the audit. If a refund/credit has been obtained, they will typically charge 50% of all recovered funds. This includes 50% of all overcharges on past payments. Thus, if \$150,000 were recovered from the bank, the mortgagor would receive \$75,000 (half of \$150,000).

The current noteholder is responsible for all overpayments, regardless of the number of times that the loan has changed hands. The mortgagor is not legally responsible for returning any money resulting from a bank's error. Furthermore, since the audit typically is performed without charge on a contingency fee basis, the mortgagor has no downside risk. Upon completion of an audit, the mortgagors will either recover lost money or at least be satisfied in knowing that they have not been overcharged.

And here's something to keep in mind: Even if the ARM already has been paid off, the mortgagor may still be able to recover overcharges.