CH#: 54580

WASHINGTON DEPARTMENT OF FINANCIAL INSTITUTIONS EXPANDED REPORT OF EXAMINATION FOR *HOUSEHOLD FINANCE CORPORATION III* AS OF APRIL 30, 2002

INTRODUCTION

This expanded report of examination dated April 30, 2002, is delivered for the licensee's review and response as of May 15, 2002.

SCOPE OF EXAMINATION

The scope of the examination included a review of the licensee's loan documents relative to specific complaints as well as findings from the Department's 2001 scheduled examination. The Department's examination continues to date and may be supplemented with additional information, documentation or testimony obtained or subpoenaed from the licensee or other parties. The purpose of this examination is to ascertain compliance with chapter 31.04 RCW, and chapter 208-620 WAC, the Consumer Loan Act (the Act), and applicable federal statutes and regulations as cited.

In addition to a review of loans originated and made by specific licensed locations of HFC, the Department's examination includes a review of loans and business conducted with Washington consumers by unlicensed locations and companies affiliated with HFC.

The Act requires an examination of the records of the licensee at least once every twenty-four months. The Department conducted examinations of HFC in 1999 and 2001. The on-site examination of 2001 commenced at the licensee's file storage facility located at 577 Lamont Road, Elmhurst, Illinois 60126 (currently an unlicensed location) on July 30, 2001, and concluded on August 3, 2001. A report of examination for the 2001 examination was delivered to HFC on March 4, 2002. The Act further provides investigative authority to the Director for the purpose of discovering violations.

BACKGROUND

Household Finance Corporation III (HFC) is a wholly owned subsidiary of Household International, Inc. located in Prospect Heights, Illinois. Household International, Inc. is a large consumer lender providing consumer loans, credit cards, non-prime auto finance and credit insurance products in the United States, United Kingdom and Canada. The corporation was founded in 1878 and operates consumer financing under the names HFC and Beneficial. A review of Household International, Inc.'s organizational chart shows over 375 business entities operating worldwide.

Household International, Inc. (through its various entities) employs nearly 300 people in Washington from its consumer lending branches. The company claims more than 400,000 customer accounts and $2.3 billion in financing to Washington consumers in 2001. HFC is licensed for 45 locations for conducting business with consumers in the State of Washington. The company reports that all business to Washington consumers, with respect to consumer branch lending business conducted by HFC and Household Realty Corp. (discussed below), is through either a branch or a central processing center.

The company further reports that all origination, closing and funding is performed through its branch locations. Underwriting activities are performed through processing centers in Elmhurst, IL, Carmel, IN, and Chesapeake, VA. Loans are serviced in London, KY, Brandon, FL, Virginia Beach, VA, Pomona,

BACKGROUND continued

CA, Carmel, IN and Elmhurst, IL. All loan documents and records are stored at 577 Lamont Road, Elmhurst, IL.

The licensee reports revenue breakout in Washington as follows:

Branch Entity	2001	2002	Total
HFC	$ 68,736,000	$ 72,062,000	$140,798,000
HRC	$ 51,222,000	$ 32,865,000	$ 84,087,000
	$119,958,000	$104,927,000	$224,885,000

RELATED ENTITIES

Beneficial Finance Corp. of Washington (Beneficial) is a consumer loan licensee that was acquired as a wholly owned subsidiary of Household International, Inc. in 1998. Beneficial is licensed to conduct business with Washington consumers from 36 locations. While this report makes reference to Beneficial, any issues with Beneficial are currently handled as a separate matter outside of this examination.

Household Realty Corp. (HRC) is identified by HFC as the lending entity that makes first mortgage loans to Washington consumers in the HFC branch offices. The company states that HRC has no employees and that it makes first mortgage loan products exclusively. Branch costs are dictated by product and then allocated between HFC and HRC. The company reports, however, that HFC carries all non-loan related expenses (including salaries) until the end of the year when they are allocated based upon a percentage of business conducted.

Employees conducting business for HFC and HRC are carried under a unique employment structure as noted below. HFC claims that employees conducting lending business for either HFC or HRC, and the documents produced by these entities, clearly delineate which company is transacting the business. The Department has found, however, that this claim is not true. In none of the transactions discussed within this report has the Department found that employees have delineated the appropriate company, and in certain transactions, file documents appear to confuse and merge the two companies. Despite a significant number of consumer complaints related to the lending activities of HRC, all complaints have been made against HFC, indicating to the Department that consumers are unaware of any differentiation between the two companies or possibly even the existence of HRC. This matter is discussed in greater detail elsewhere in this report.

Household Payroll Services, Inc. (HPS) is identified by HFC as a central company that employs all branch employees. Neither HFC nor HRC employ their own staff. Employees of HPS apparently

conduct the sale of first mortgages for HRC and the sale of second mortgages and unsecured products for HFC. It is unclear to the Department whether regional and corporate management, underwriting staff and loan servicing staff conducting business in Washington are employed by HPS. Apparently, HPS employees also originate and process loans for an unrelated entity known as MBNA Consumer Services, Inc. of Wilmington, DE as well.

STATUTORY AMENDMENTS

The Act was amended effective July 22, 2001. The amendments provided, among other things, increased requirements in disclosures, certain prohibited practices, expanded investigative authorities and penalties for non-compliance. The majority of the transactions, activities and practices discussed herein were reviewed under the prior version of the Act. However, the Department additionally discusses these matters under the amended Act and provides statutory citations under the amended Act for informational and discussion purposes. In certain situations, the Department makes findings under the amended Act when the activity noted occurred subsequent to July 21, 2001. These citations pertain to failures to comply with the amended investigation authorities, unlicensed activity and business practices that continued beyond July 21, 2001, constitute serious violations. While this report does not address the very recent complaints received by the Department, it is likely that those complaints will carry violations of lending practices falling under the amended statute.

REGULATORY CONCERNS IN OTHER JURISDICTIONS AND RECENT LITIGATION

While the Department's concerns are not driven by activity in other jurisdictions or litigation filed as administrative actions or private claims, it does not ignore the large amount of activity in these areas currently revolving around HFC and its affiliates. Recent actions filed in California Superior courts by the Department of Corporations and the Association of Community Organizations for Reform Now (ACORN) and a class action suit filed in Chelan County, Washington are examples. The Department is also aware of lending practice concerns in other states where the allegations are very similar to those identified in Washington.

COMPLAINT HISTORY

The Department has received 92 consumer complaints filed against HFC since September 1995. A summary of the number of complaints received each year from 1995 through 2001 follows:

Year	# of Complaints
1995	1
1996	5
1997	12
1998	12
1999	8
2000	17
2001	22
2002	15 (annualized = 60)
Total	92

This large number of complaints is comparable only to the number filed against Beneficial (87 complaints since 1995). While the Department notes that HFC, HRC and Beneficial are nationwide corporations transacting a large volume of loans in Washington each year, the complaint activity relative

to its peers is disproportionate, and a large increase in the last two years is cause for concern. The Department is also concerned with the nature of the allegations of deception and harm raised by consumers in these complaints and the Department's own findings in reviewing the complaints.

COMPLAINT HISTORY continued

Additionally, HFC has become less and less responsive to the Department's investigative requests concerning these complaints. In general, the Department allows a response time to each complaint of 15 days. While the Department realizes that occasionally a licensee may experience a realistic delay in responding to a complaint directive, HFC and its affiliate Beneficial have consistently responded slowly to the Department's directives. In 2000, HFC took an average of 28 days to provide a response. In 2001, that average grew to over 97 days and a similar trend appears to continue into 2002.

As an example of late responses, complaint #2374 filed in December 2000 required two directives and three examiner phone calls before a response was finally received after 63 days. As noted, the response times became worse in 2001 with several complaint responses well exceeding the 100-day mark and a significant number of complaints not receiving an adequate response whatsoever.

So many outstanding issues remained that on February 22, 2002, the Department found it necessary to serve HFC with a subpoena commanding production on 14 outstanding complaint responses.[1] Examples of these are complaint #2751 in which the response took 137 days, complaint #2797 in which the response took 137 days, and complaint #2808 in which the response took 116 days and HFC still did not provide the all of the information subpoenaed.

Failure to provide an adequate response to a directive has been a repetitive pattern with HFC. Upon receipt of a complaint, the Department sends a directive to HFC specifically identifying the documents to be provided for review. However, HFC has frequently chosen to ignore the Department's directive and provide other documents, or sometimes just a short letter and no documents at all. Inadequate responses cost the Department additional time and resources and delay the Department's ability to apply its investigative authority authorized under the Act. Examples of inadequate responses follow:

Complaint #2077: No information provided on second mortgage, even when subpoenaed.
Complaint #2378: No disclosures or HUD1 provided. In response to the subpoena, HFC simply sent to the Department documentation that the Department had previously received from the borrower and forwarded to HFC for their files.
Complaint #2460: No GFE provided. On May 24, 2001, Tom Schneider provided a written response stating that he was providing the GFE and other disclosures. None were ever received, even when subpoenaed.
Complaint #2508: No application or GFE provided until subpoenaed. Documents were produced 343 days after the initial request.
Complaint #2550: No Good Faith Estimate (GFE) provided until subpoenaed. The GFE was produced 296 days after the initial request.
Complaint #2715: No right of rescission provided. On October 18, 2001, Carla Madura promised a written response to DFI within 30 days. The written response was received 113 days later, but still rescission document was not produced, even after subpoena.

[1] Note, Subpoena no. 2002-140-S01 also contained requests for additional information for which HFC was not in default of production, but was more expediently requested through one subpoena rather than multiple subpoenas.

FINDINGS AND VIOLATIONS

The findings and violations contained herein are considered "apparent" findings and violations based upon information and documentation provided to date. Additional information, or lack thereof, may be cause for amended findings and violations. This report does not contain charges or orders by the Director and should not be considered a trigger of rights or procedures under chapter 34.05 RCW, the Administrative Procedure Act. This report does contain directives to respond to specific issues, allegations or requests for clarification.

REVIEW OF RECENT COMPLAINTS

The following complaints filed between May 2000 and January 2002 either remain unresolved by the Department or have been reopened for review by the Department. In many of the complaints the Department initially found no violation in its review. Upon further review and with a better understanding of HFC's business practices (as discussed in this report), the Department has found cause to reopen the complaint issues and cite apparent violations here. In certain situations, citations are provided for actions that would be identified as violations had they occurred under the amended Act effective July 22, 2001. Provision of these citations does not mean that a violation actually occurred, but rather if the action had occurred subsequent to the amended Act taking effect, the action would constitute a violation for which the Department could take administrative enforcement action.

Complaint #2073 Michele Merryman – (Edmonds, WA branch)
Loan date: June 1999
Loan date: January 2000Complaint date: May 2000

The borrower alleges that she was promised by HFC that, "after 12 months of perfect payments she would qualify to have her interest rate substantially decreased (by 4 – 5%)." When the borrower attempted to get HFC to lower the rate a year later, she was apparently told that these things were not in writing and such a promise could not be made to her by HFC. The initial loan was made in June 1999. In January 2000 a refinance was done by HFC. Subsequent to this complaint being filed, HFC stated it would reimburse the borrower for prior fees charged and rewrite the loan at a lower rate at no additional charge to the borrower. The borrower notified the Department on May 23, 2000, that she was satisfied with this resolution. The Department initially found no violations in its review of this complaint, however, it indicated strong concern over the allegations raised by the borrower and noted that were it to find additional support to the allegations, action may be taken.

Analysis

The loans made in this complaint were made by Household Realty Corporation (HRC). The Department's review of file documents in the June 1999 loan shows that the borrower was disclosed discount points (line 802 of the GFE) ranging from $4,000.00 to $5,500.00. At closing, the borrower paid $5,471.70. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrower's interest rate, there is no evidence that the discount points were used in this way for Merryman. The GFE delivered to the borrower is dated June 16, 1999. The assumption put forth by HFC is that the borrower would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points within the range. However, a review of file documents (application and underwriting review) provided to the Department shows that as late as June 23, 1999 (two days before closing), HFC had

Complaint #2073 Michele Merryman continued

yet to determine a rate to be paid by the borrower in the offer of this loan program. Since HFC itself appears to have not identified a rate or range of rates to be offered the borrower, it is unclear what rate was being bought down when the borrower's discount points were increased.

The Department's review of file documents for the January 2000 loan shows that the borrower was disclosed discount points (line 802 of the GFE) ranging from $2,200.00 to $8,600.00. At closing, the borrower paid $6,268.98. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrower's interest rate, there is no evidence that the discount points were used in this way for Merryman in this second loan either. The GFE delivered to the borrower is dated January 11, 2000. Again, the assumption put forth by HFC is that the borrower would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that as late as January 18, 2000, (date of closing), HFC had identified a rate of 12.49% in the offer of this loan program. The rate closed with the borrower, however, was 14.985%, nearly 2 percentage points higher. Such a rate increase, accompanied by discount points closer to the top of the range than the bottom of the range does not support a claim that discount points were used to buy-down the rate. In fact, the Department is unable to identify a correlation between points and rate in this transaction.

The borrower further complained that she was led to believe that agreeing to take out a Home and Auto Security Plan (insurance) was required to obtain the loan. HFC did not respond to this part of the borrower's complaint. As will be evident in other complaints addressed within this report, the Department is concerned with apparent deceptive practices by HFC representatives in the solicitation and sale of insurance products, including requiring insurance products in violation of state and federal law.

Apparent Violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and AfBA relationship.
WAC 208-620-130(5) Noncredit insurance: Required insurance. Note, the Department was unable to determine if the premiums for insurance were included in the principal amount of the loan. HFC did not respond to this portion of the complaint and the borrower claims to have ultimately had the insurance removed.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Complaint #2073 Michele Merryman continued

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.

RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA).

Complaint #2077/2092 Linda and Jerry Connell – (Vancouver, WA branch)
Loan date: July 1999Complaint date: May 2000

The borrowers allege that HFC overcharged them on "points" and when they asked about the points being charged they were told that the amount was the "normal rate charged." Borrowers claim that they were required to take out a second mortgage line of credit in order to cover the costs charged on the first mortgage.

Analysis

The first mortgage loan made in this complaint was made by HRC. The Department's review of file documents on the first mortgage shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $6,600.00 to $13,200.00. At closing, the borrowers paid $12,381.53. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly, and apparently requiring the addition of a second mortgage line of credit in the amount of $10,426.00, by HFC. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Connells. The GFE delivered to the borrowers is dated July 20, 1999. The assumption put forth by HFC is that the borrower would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that as late as July 21, 1999, (one day before closing), HFC had identified a rate of 9.29% in the offer of this loan program. The rate given the borrowers at closing, however, was 9.388%. A rate increase, accompanied by discount points closer to the top of the range than the bottom of the range calls into question any correlation between points and rate in this transaction and does not support a claim that discount points were used to buy-down the rate.

Tom Schneider of HFC provided a written response to this complaint on May 18, 2000. In his letter he stated, "Under the provisions of this section [1735f-7a, Title 12, USC], we are allowed to charge points of 7.5%. The points charged on this loan were clearly disclosed on her good faith estimate, loan agreement, truth in lending disclosure and settlement statement." The Department takes exception with this statement by Mr. Schneider. The points charged on this loan were not clearly disclosed on the borrowers' GFE. The borrowers' GFE disclosed discount points over a $6,600.00 range. There is nothing clear about this whatsoever. Further, Mr. Schneider makes reference to a percentage charge of 7.5%. First, no percent format is given to the borrowers on the GFE. Second, no loan amount is disclosed to the borrowers at the time of the GFE. Therefore, it is impossible for the borrowers

to even derive an answer of what percent of the loan amount is made up in fees that are disclosed only as dollars.

At closing (two days after the GFE date) the loan amount was $170,779.75. The upper end of the points disclosed on the GFE were equal to 7.73% of the loan amount, not 7.5%. The Department believes that "talking" percentages and "showing" dollars, or in the reverse, "talking" dollars and "showing" percentages, is intentionally confusing to the borrower. There is no evidence in the documents provided by HFC that the range of discount points disclosed and marketed by the HFC representative were not discussed over a larger loan amount. For example, if the HFC representative had verbally discussed a $181,205 loan amount (the actual amount of loan to the borrowers once the second mortgage is factored in), then the borrowers would believe that the upper range of discount points was 7.28%, not the 7.5% that Schneider argues. The fact that the loan ultimately carried only a 7.25% charge in discount points is

no defense for confusing the borrowers at the outset of the transaction. Just as easily, the borrowers could have been left with the impression that their discount points would be only 3.64% based upon the lowest amount of discount points disclosed on the GFE. Despite the claims of clarity, the disclosures in this transaction were anything but clear.

A second mortgage line of credit in the amount of $10,426.00 was taken out by the borrowers with HFC at the same time the first mortgage was made by HRC. HFC failed to provide the Department with any information relative to this loan despite requests made by the Department on May 11, 2000 (complaint #2077) and May 17, 2000 (complaint #2092). The Department reiterated its request for this information by subpoena on February 22, 2002. To date, HFC has provided no response relative to the second mortgage. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required.

In response to the Department's subpoena, HFC did produce documentation relative to another loan taken out by the Connells on December 21, 1999. Despite the Department's two requests for loan information on the Connells in May 2000, this was the first production of information related to this loan. The December 1999 loan was an HRC loan made to replace the two prior loans held by HRC and HFC with the borrowers. It does not appear that HRC provided the borrowers with a GFE in this new loan transaction.

Further, it appears that HRC charged the borrowers a prepayment penalty on the prior first mortgage despite its agreement with the borrower that "No prepayment penalty will be imposed . . . at the time this loan is refinanced by another loan with HFC." The Department observes that while the original first mortgage was made by HRC, the prepayment penalty section of the note refers to HFC. The Department is unsure whether this is a mistake or an intentional act to deceive the borrower about whether subsequent loans will contain a prepayment penalty.

Complaint #2077/2092 Linda and Jerry Connell continued

Apparent Violations

RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points, and failure to provide disclosures as required pursuant to RESPA and Regulation X, and TILA and Regulation Z.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).
RCW 31.04.145 Investigation authority. Failure to comply with subpoena.

Complaint #2224/2508 Jennifer & Cory Dodge (Bellingham, WA branch)
Loan date: June 2000Complaint date: July 2000

The borrowers claim that promises, delays and misrepresentations during the refinancing of their home loan ultimately put them into a far worse situation than they originally had. Specifically, the borrowers complain that rather than receiving the single loan that was originally offered to them, they received a first and second mortgage which has left them paying one and half times the amount of monthly payments they previously were making. The borrowers also complain that they were unaware of the high fees paid on the first mortgage or the existence of a prepayment penalty. Finally, the borrowers claim that they did not want the life insurance offered to them, however, their loan was made with insurance included.

Analysis

The first mortgage loan made in this complaint was made by HRC. In its initial resolution of this complaint the Department identified application dates that did not correspond with the disclosures provided by HRC. In response to the Department's resolution HFC responded that the borrowers had made application on May 15, 16 and June 9, 2000, but "turned down" these offers. However, HFC has provided no evidence of the borrowers' turn down of these applications, nor any evidence that disclosures were made in association with these applications. The first disclosure (GFE) provided to the borrowers is June 15, 2000. This disclosure does not appear to hold any relationship to an application date as it falls beyond the required disclosure date for the June 9 application. Further, HFC has provided no information that it made adverse action disclosures as required under Regulation B when these loan offers were apparently cancelled.

Complaint #2224/2508 Jennifer & Cory Dodge continued

On February 22, 2002, the Department subpoenaed HFC again asking for an application and GFE. In response, HFC simply reproduced what it had previously produced for the Department. Further, the second page to the GFE carrying information related to particular providers of settlement services, and required to be delivered at the time of the GFE, has had the original production date altered. The original date appears to have been June 22, 2000, but was changed in pen to June 15, 2000, the date on page one of the GFE.

The Department's review of file documents for the first lien loan shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $0.00 to $8,300.00. At closing, however, the borrowers paid $8,578.00. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Dodges. The GFE is dated June 15, 2000. The assumption put forth by HFC is that the borrowers would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that on June 15, 2000, (one day before closing), HFC had yet to identify a rate of interest for this loan program. The rate closed with the borrowers was 11.994%. Since HFC itself appears to have not identified a rate or range of rates to be offered the borrowers, it is unclear what rate was being bought down when the borrowers' discount points were increased from a low of $0.00 to $8,578.00.

HFC has informed the Department that a factor in increased discount fees may be that the borrowers requested a higher loan amount. In the Dodge's case, the application dated June 15, 2000, shows that HFC was contemplating an amount financed of $105,000.00. While the amount financed for the Dodges did increase the next day at closing to $109,750.31, this increase is represented by a $4,750.50 life

insurance premium which the Dodges have stated that they did not want (see discussion following). Therefore, it seems highly unlikely that the resulting discount points above the range even disclosed by HFC, could have been the result of a loan amount increase request by the borrowers.

The borrowers have claimed that they were unaware of the large amount of discount points being charged by HFC. This claim is not dissimilar to that made by many other consumers in complaints filed with the Department. Also like many other consumers, the Dodges claim that they were never informed of a prepayment penalty associated with their loan. While the TIL disclosure given to the borrowers does include the minimum statement concerning a prepayment penalty, the Department believes that sales practices can easily mislead or misdirect a borrower about the existence of the penalty (see comments associated with DEPARTMENT'S EXPERIENCE WITH HFC BRANCH IN WASHINGTON below).

The borrowers additionally claim that their loans contained credit life and unemployment insurance that they did not wish. After review of the pertinent documents relative to the insurance, the Department is very concerned as follows:

1. The Optional Credit Insurance Disclosure (both loans) are multiple page documents. The request for optional insurance appears on page one of each document as a series of boxes to be checked by the borrower if insurance is desired. Subsequent pages contain a short statement about satisfaction with the insurance followed by a signature and date blank.

Complaint #2224/2508 Jennifer & Cory Dodge continued

It is obvious that the separate signature pages could be signed and dated, while the boxes on page one are left blank, and that later the boxes on page one could be checked indicating that insurance has been chosen. The borrowers would have no knowledge of the subsequent "choice" and no way of proving that their intention was to not choose insurance.

2. The Department believes that the Optional Credit Insurance Disclosures discussed in 1 above, were either completed after the borrowers' signatures were obtained, or possibly, forged with the borrowers' signature without the borrowers' consent. Although the Department has not requested law enforcement handwriting exemplars of these documents, a simple review of the borrowers' signatures on other documents concerns the Department that the signatures may have been written by someone other than the borrowers. The Department's opinion here is supported by the borrowers' claim that they did not choose insurance when they accepted the loans.

A second mortgage line of credit in the amount of $2,688.67 was taken out by the borrowers with HFC at the same time the first mortgage was made by HRC. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required. While the required disclosure form under this section is dated the same date as the HFC application date (June 15, 2000), it does not appear that the borrowers were actually provided with this disclosure until the day of signing (June 16, 2000). In fact, based upon the borrowers complaint allegations it appears that the borrowers never actually "applied" for a second mortgage with HFC, rather HFC "took" the borrowers application without their knowledge on June 15, 2000.

Apparent Violations

RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.

WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of, GFE, discount points and AfBA relationship. Failure to provide disclosures as required pursuant to TILA and Regulation Z for second mortgage. Failure to provide disclosures as required pursuant to Regulation B.
WAC 208-620-210 Business only under licensed name. HFC conducting business as HRC.

Complaint #2224/2508 Jennifer & Cory Dodge continued

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA and/or ECOA).
RCW 31.04.027(7) Violations of chapter: Engage in bait and switch advertising.
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).
RCW 31.04.145 Investigation authority. Failure to comply with subpoena.

Complaint #2374 Annie Jones – (Seattle, WA branch)
Loan date: October 2000Complaint date: December 2000

The borrower alleges that HFC lied to her about what her interest rate would be and when she got her first billing the payments were nearly twice the amount she was told she would have to pay.

Analysis

The borrower provided the Department with a copy of the Home Equity Credit Line Revolving Loan Agreement provided to her by HFC. Page one of this agreement (the page containing the periodic rate, annual percentage rate, credit limit, date, margin, finance charge, initial annual fee, and subsequent annual fees) is blank. In other words, the borrower appears to have not received the required disclosures for this loan.

In response, HFC provided a completed agreement and explained that the borrower's agreement had misprinted. HFC proceeded to explain to the Department how the borrower's monthly payment would be calculated. However, it is clear to the Department that the borrower did not have the basic information needed to derive the payment. The borrower claims that she was solicited with loan terms other than she obtained. HFC is clearly unable to refute her claims when they have failed to make the basic disclosures required to the borrower.

Pursuant to Regulation Z, §226.15(a)(3), if the required notice and material disclosures are not delivered, the right to rescind shall expire three years after the occurrence giving rise to the right of rescission, or upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act. It is apparent to the Department that the borrower's right to rescind is still in effect at this time.

Apparent Violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower as to amount of monthly payment.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with TILA and Regulation Z.

Complaint #2374 Annie Jones continued

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: (TILA).

Complaint #2378 Anne & Michael Bley – (Spokane,WA area, unknown branch)
Loan date: November 2000Complaint date: December 2000

The borrowers allege that when they rescinded their loan transaction HFC put a lien on their property and would not remove it. Also, the borrowers state that they were told that after 30 days the credit life insurance could be removed (the borrowers apparently did not want the credit life insurance) and it would be taken off the top of the loan. Further, the borrowers claim that they were told that they were shown a different interest rate than that ultimately provided in the loan agreement.

Analysis

HFC provided only limited documentation in response to the Department's request for information, despite two written directives. The documentation produced included a copy of the loan agreement and a letter stating that the loan was made by HRC under the Washington Usury Act and therefore outside of the Department's jurisdiction. On February 22, 2002, the Department subpoenaed HFC for the previously requested information. Specifically, HFC was commanded to produce all disclosures and the final HUD-1 settlement statement. HFC provided none of the requested information. Instead they produce for the Department copies of documentation that the borrowers had given to the Department and the Department had forwarded to HFC for its review. Included with this production, however, was an additional loan taken out by the borrowers with HFC at approximately the same time as the loan discussed in this complaint. HFC had withheld this information from the Department in its prior requests.

To date, HFC has provided no loan application or GFE for the Department's review. The HUD-1 settlement statement provided by the borrowers shows discount points on line 802 of $9,235.50, or 7.25% of the loan amount. Based on its experience with HFC, the Department must assume that either no GFE was given to the borrowers, or the GFE given contained a large range of discount points as discussed frequently throughout this report.

The borrowers claim that HFC placed a lien against their property despite their insistence that they did not wish to take out this loan. The Department notes that the loan agreement provided by HFC in response to the complaint contained no borrower signatures, indicating that no such agreement for the loan was actually entered with HFC. Without a signed loan agreement the Department can only assume that HFC illegally placed a lien against the borrowers' residence.

As with other complaints reviewed by the Department, these complainants stated that they did not desire credit life insurance on the loan. However, the HUD-1 reflects that $4,750.00 in credit life insurance premiums were financed into the loan and likely were included in the lien placed against the residence.

Complaint #2378 Anne & Michael Bley continued

The insurance disclosure form produced by the borrowers shows that a box requesting the insurance was pre-checked for the borrowers. HFC has produced nothing showing that the borrowers desired the insurance and therefore it appears that HFC's intent was to make the insurance a requirement. A review of the TIL disclosure provided by the borrowers shows that the insurance premium was not included in the finance charge as is required when a creditor "requires" the inclusion of the premium. Regardless of this disclosure violation, however, state law specifically prohibits requiring credit life insurance.

Despite HFC's response that the loan made in this transaction was made under the Washington Usury Act, the loan was made by HRC, an unlicensed entity in the State of Washington. However, the borrowers clearly believed that the company they were transacting business with was HFC, not HRC. Such a belief is supported by the HUD-1 settlement statement which shows Household Finance Corp. III as the lender, not HRC. It is evident to the Department that in this transaction, HFC itself was unclear whether it or HRC was making the loan.

The borrowers also claimed confusion about the interest rate. The Department has reviewed documentation (E-Z Pay Plus) that does show a discrepancy between the rate shown and the rate charged. The document provided to the borrowers on November 14, 2000, shows an APR of 11.751%, while the TIL disclosure produced on the same date shows an APR of 12.997%. Upon questioning, the HFC representative apparently informed the borrowers that the E-Z Pay Plus disclosure was for sales presentation only. However, the disclosure contained the borrower name, the loan amount equaled the amount financed and the monthly payment amount was the same, making it clear that rather than a sales presentation in general, the document was specific to these borrowers. Such "disclosure," especially if used during a sales presentation, is considered deceptive by the Department.

Further, the Department finds the very use of the E-Z Pay Plus disclosure in this transaction to be deceptive. By showing the "Amount Financed" as the "Loan Amount" on the disclosure the borrower is led to believe that the Amount Financed ($118,150.64) is the Loan Amount ($127,386.14). Such a practice is clearly intended to deceive the borrower about the amount of loan they are transacting for. In fact, inclusion of certain material TIL disclosures on the E-Z Pay Plus disclosure is a deceptive practice in violation of Regulation Z:

> Pursuant to §226.17(a)(1), the creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. **The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures required under §226.18.** The itemization of the amount financed under §226.18(c)(1) must be separate from the other disclosures under that section.

This issue is discussed in greater detail elsewhere in this report.

Complaint #2378 Anne & Michael Bley continued

Apparent violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate and APR.
RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: HRC and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X by failing to provide GFE, disclosure of discount points and AfBA relationship. Failure to comply with TILA by requiring credit life insurance and failure to segregate material disclosures.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).
RCW 31.04.145 Investigation authority. Failure to comply with subpoena.

Complaint #2382 Julian and Terry Johnston – (Bellingham, WA branch)
Loan date: September 2000Complaint date: December 2000

The borrowers allege that HFC promised, even after closing, that the loan rate would be 7%, and that the refinance would consolidate and payoff all of their other debts, however; the interest rate received was 11.99%, and the loan did not payoff the previous loan and other debts. A home equity line of credit was added to the transaction by HFC to take care of the unpaid debts. The borrowers' attorney explains that the consumers originally held a first mortgage with a rate of 8.5%, which was replaced by HFC with a first mortgage of 11.99% and a second mortgage line of credit with an APR of 24.9%, with little of the benefits the borrowers expected to obtain. The attorney points out that the borrowers were vulnerable people, living on limited means, that were apparently led to believe that the new loan would carry a rate of only 7%. After closing, Mr. Johnston, realizing that the interest rate was actually 11.99%, attempted to rescind the transaction, but was assured by the HFC representative that the loan really would be carried at a 7% rate based upon the bi-weekly payment plan.

Analysis

The lender on this transaction is shown as MBNA Consumer Services, Inc. of Wilmington, DE (MBNA). It is apparent from the borrowers' complaint that they had credit card debt with MBNA that they wished to retire and that MBNA referred them to HFC. MBNA appears on all of the disclosures as well as the loan agreement and closing statement. However, HFC responded to the complaint. In HFC's response to the Department's February 22, 2002, subpoena, they explain that HFC was acting as a mortgage loan processor for MBNA and that MBNA was the lender on the loan.

Complaint #2382 Julian and Terry Johnston continued

HFC further explains that after funding HFC became the servicer of the loan and at some point in time purchased the loan from MBNA. It is apparent to the Department that regardless of how HFC characterizes its part in this transaction, HFC was clearly in control of the transaction from start to finish. In fact, the borrowers appear to be unaware that any other party other than HFC was involved in the making of their loan.

Even Tom Schneider of HFC believed that HFC was the lender in this transaction. In his complaint response dated March 19, 2001. Mr. Schneider explains that the borrowers bought their "HFC" rate down with the discount points, however, he did not address one of the main allegations: putting the borrowers into a worse financial position. The other main allegation, that HFC promised a 7%, rate was addressed in Mr. Schneider's letter: ". . . with respect to the customer's allegation that he was promised a 7% interest rate, the branch was not quoting the interest rate but an 'equivalent rate' based on the effect of having the loan paid biweekly instead of monthly."

The Department addresses the two main allegations here:

1. While it is difficult for the Department to decipher HFC's underwriting report, it is apparent that the borrowers derived little, if any, benefit from its dealings with HFC and in all likelihood entered the transaction to their detriment. Disbursement of funds on the two loans made to the borrowers break out as follows:

First Mortgage	Amount	2nd Mortgage	Amount
1st Mtg payoff	$160,000[2]	MBNA card	$8,198
Prepay penalty	7,000	Texaco card	127
Target card	900	Citibank card	1,407
WFFNB credit	108	Fees and costs	522
SOANB credit	206	To borrowers	180
Fees to HFC	13,230		
Other costs	1,041		
Totals	$182,485	Totals	$10,434

The analysis above shows that the only gain the borrowers achieved in the first mortgage was $1,214 in credit reduction to Target, WFFNB and SOANB. Although these small debts may have carried a rate higher than the 11.99% rate in the new loan, the rate was likely only marginally higher and in any event, the small amount of debt paid versus the large amount of fees to pay the debt makes absolutely no sense. The remainder of the loan traded $160,000 at 8.5% for $181,271 at 11.99% (net of credit reduction). To spell this out more clearly, the borrowers essentially gave HFC $21,271 of new debt for no apparent reason, plus the opportunity to earn a high rate of interest on the entire amount for no apparent reason.

Although the borrower stated that HFC claims it was unaware of the prepayment penalty on the paid off underlying lien until just before closing (September 20), a review of the HFC underwriting documents shows that HFC was aware of the actual loan balance as well as the amount including prepayment

penalty as early as September 7. Such information would have aided HFC in making the easy determination that this loan was a bad loan for the borrowers.

The second mortgage shows similar disadvantages to the borrowers. In this loan the borrowers traded three credit card debts for a single debt of nearly $10,434 at a rate of nearly 25%. It is highly unlikely that any of the paid off debts were costing the borrowers 25%. At best, the borrowers appear to have paid $522 in fees to HFC for no net gain in debt position. Additionally, the borrowers appear to have been left with several other unpaid credit accounts.

The Department has performed a rough review of the monthly cash outflow situation for the borrowers before and after the new loans. The result shows that the borrowers were paying approximately $1,925 per month in credit payments prior to encountering HFC and $2,293 per month in credit payments after

[2] This amount is an estimate made by the Department after review of the documents. While the underlying first mortgage holder was actually paid $167,000 at closing, it appears that approximately $7,000 of this amount was for a prepayment penalty on the loan.

encountering HFC. An increase of $368 per month. The Department can find no other word to describe this loan other than, "predatory."

2. The Department has received several complaints and other information alleging that HFC representatives inform borrowers that their loan will carry a 7% rate when it actually carries a much higher rate. HFC has provided various responses to the Department ranging from statements that the borrowers were mistaken to claims that the practice is isolated to a single branch in Washington. In his response letter to this complaint, Mr. Schneider clearly indicates that HFC is aware of representatives disclosing an "equivalent rate" of 7%. The Department is unaware of any regulation, guideline or common sense approach that would allow a loan representative to create the impression that the interest rate to be paid is anything other than the interest rate to be paid.

The Department's review of file documents shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $12,100.00 to $14,100.00. At closing, the borrowers paid $13,230.14 in discount points. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Johnstons. The GFE delivered to the borrowers is dated September 7, 2000, and carries a range of discount points spanning $2,000.00 from low to high. The assumption put forth by HFC is that the borrowers would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that no rate was identified until September 20, 2000 (the date of closing). HFC had yet to determine a rate to be paid by the borrowers in the offer of this loan program when the range of discount points was shown on the GFE. Since HFC itself appears to have not identified a rate or range of rates to be offered to the borrowers, it is unclear what rate was being bought down when the borrowers' discount points were increased from a low of $12,100.00 to $13,230.14.

The second mortgage line of credit with HFC in the amount of $10,434 was taken out by the borrowers at the same time the first mortgage was made. There is no evidence that the borrowers made a second application for this loan with HFC, indicating that the initial application of September 7, 2000, was used for both loans. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered

Complaint #2382 Julian and Terry Johnston continued

the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required.

The HUD settlement statement for the first mortgage transaction with these borrowers shows a company known as Integrated Real Estate Processing of Pittsburgh, PA (IREP) as the closing agent. HFC explained to the Department that they engaged the services of IREP to close this loan. IREP is not now, nor has it ever been licensed to conduct the business of an escrow agent in the State of Washington.

<u>Apparent Violations</u>

RCW 31.04.135 <u>Advertisements or promotions</u>: Misleading borrower about interest rate.
WAC 208-620-120(1) <u>Contents of disclosure statement to borrower</u>: Failure to comply with RESPA and Regulation X in the disclosure of discount points. Failure to provide disclosures as required pursuant to TILA and Regulation Z.

<u>Amended Act</u>

RCW 31.04.027(1)-(3) <u>Violations of chapter</u>: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.

RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(7) Violations of chapter: Engage in bait and switch advertising.
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

Complaint # 2446 Josephine Robinson – (Burien, WA branch)

Loan date: May 2000Complaint date: February 2001

The borrower alleges that her monthly payments are more than she had agreed to with HFC. Notably, her payments were over $500.00 more than her Social Security income. She makes $1,100+ a month and her payments for the loan were $1,684.80. She alleges that she accepted the loan under duress and HFC used her deceased husband's income to qualify her for the loan and told her that they only needed his income documents to prove that she had the ability to pay.

Analysis

The loan discussed here was first lien mortgage made by HRC. The Department's review of file documents shows that the borrower was disclosed discount points (line 802 of the GFE) ranging from $5,950.00 to $12,325.00. At closing, the borrower paid $11,889.11 in discount points. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrower's interest rate, there is no evidence that the discount points were used in this way for Robinson. The GFE delivered to the borrower is dated August 15, 2000, and carries a significant range of discount points. The assumption put forth by HFC is that the borrower would have been

Complaint # 2446 Josephine Robinson continued

offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that no rate was identified until August 25, 2000 (the date of closing). HFC had yet to determine a rate to be paid by the borrower in the offer of this loan program when the range of discount points was shown on the GFE. Since HFC itself appears to have not identified a rate or range of rates to be offered the borrower, it is unclear what rate was being bought down when the borrower's discount points were increased from a low of $5,950.00 to $11,889.11.

It is further apparent to the Department that the borrower was not clear that the amount of her monthly payment would exceed her monthly income by nearly $600.00. On July 31, 2001, HFC informed the Department that they had reduced the borrower's loan rate and principal in order to reduce the borrower's monthly payment to an amount that could be paid.

Apparent Violations

WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and AfBA relationship.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.

RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA).

Complaint #2460 Marty & Debra Fenton – HFC (Bellingham, WA branch)
Loan date: March 2000Complaint date: March 2001

The borrowers allege that the loan they received was not the loan they were told they would be provided by HFC. The borrowers claim that they were told the loan had a lower interest rate of 7% and that it did not have a prepayment penalty. At closing it was discovered that the rate was 13.99%. The borrowers claim that they were informed that by making bi-weekly payments the effective rate would be 7%. Further, the borrowers claim that they did not receive any documents until closing and that they were told not to make any payments on their debts during the refinance process because these debts would be paid off in the refinance. These debts were apparently not paid off and the borrowers had to take out a second mortgage with HFC to pay the unpaid debts. The borrowers also claim that they were specifically told by the HFC representative that their loan would not have a prepayment penalty, although it did. The borrowers also stated that they were surprised to find that they had paid discount points on the loan and that they were told the credit life insurance was required.

Complaint #2460 Marty & Debra Fenton continued

Analysis

These transactions include a first mortgage made by HRC and a second mortgage made by HFC. HRC appears to have violated the Real Estate Settlement Procedures Act (RESPA) by not providing the GFE within the time required. The Department's review shows that HFC held credit application information on February 24, 2000, but a GFE was not produced by HRC until March 10, 2000, 11 days after the required date of provision. On May 24, 2001, Tom Schneider wrote to the Department stating that the missing GFE disclosure proving compliance was enclosed, however, nothing other than Schneider's letter was included in the mailing. On February 22, 2002, the Department issued a subpoena commanding HFC to produce the referenced documents in Schneider's letter. In response, HFC again produced what it had previously given the Department, but failed to provide the February 24, 2000, GFE it was specifically commanded to produce.

Further, the TIL disclosure is dated five days after the date of closing. The borrowers signed documents on March 24, 2000, however; the TIL is not even dated by HFC until March 29, 2000. It is apparent to the Department that the borrowers were not afforded the disclosure required under the Truth in Lending Act prior to consummation. Pursuant to Regulation Z, §226.15(a)(3), if the required notice and material disclosures are not delivered, the right to rescind shall expire 3 years after the occurrence giving rise to the right of rescission, or upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act. It is apparent to the Department that the borrower's right to rescind is still in effect at this time.

It should be noted that the borrowers claim that they received no disclosures for review until the time of signing and that HFC personnel made various statements in order to induce them to close the transaction. In conjunction with its file review, the Department believes this claim to be credible.

The Department's review of file documents in the first mortgage shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $6,800.00 to $15,800.00. At closing, the borrowers paid $14,754.07 in discount points. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no

evidence that the discount points were used in this way for the Fentons. The GFE delivered to the borrowers is dated March 10, 2000, and carries a significant range of discount points. The assumption put forth by HFC is that the borrowers would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that no rate was identified until March 21, 2000 (three days before closing). HFC had yet to determine a rate to be paid by the borrowers in the offer of this loan program when the range of discount points was shown on the GFE. Since HFC itself appears to have not identified a rate or range of rates to be offered the borrowers, it is unclear what rate was being bought down when the borrowers' discount points were increased from a low of $6,800.00 to $14,754.07.

Complaint #2460 Marty & Debra Fenton continued

A second mortgage line of credit in the amount of $23,888.95 was taken out by the borrowers with HFC at the same time the first mortgage was made by HRC. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required.

The borrowers claim that they were misled by the HFC representative into believing that their loan had no prepayment penalty when in fact it did. This claim is consistent with the claims of other borrowers as well as the borrowers' claim that they were told their loan rate would be only 7%. Additionally, the borrowers were led to believe that the credit life insurance on their loan was a requirement for obtaining the loan (although the borrowers referred to the insurance as "disability" insurance, they correctly identified the dollar amount of the credit life insurance). As discussed in greater depth under Insurance Packing below, specific requirements under TILA are triggered when credit life insurance is required on the loan. There is no evidence that HFC met these requirements.

Apparent Violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate.
RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the provision of GFE, in the disclosure of discount points and AfBA relationship. Failure to provide disclosures as required pursuant to TILA and Regulation Z.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(7) Violations of chapter: Engage in bait and switch advertising.
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

RCW 31.04.145 Investigation authority. Failure to comply with subpoena.

Complaint #2477 Georgia Smart – (Seattle, WA branch)
Loan date: August 1999Complaint date: March 2001

The borrower alleges that the terms of the loan were not what she was told they would be and she was deceived by HFC when HFC told her the loan was equal to a 7% rate. Additionally, she alleged that she was told the loan did not have a prepayment penalty when it actually did. The borrower claims that the loan officer intentionally misrepresented the early payoff benefits to be derived from the proposed payment plan. HFC responded that there are two types of payment plans. A bi-weekly payment program where the borrower makes payments every other week resulting in an extra payment annually, and a bi-monthly payment program where the borrower makes half payments twice a month. While the bi-weekly increases the reduction in principal owed (thereby reducing the term to maturity), the bi-monthly does not. HFC implies that the borrower was mistaken as to which program she was marketed. The borrower has stated to the Department that there was no confusion on her part.

Analysis

This transaction involved a first lien mortgage made by HRC. The Department's review of file documents shows that the borrower was disclosed discount points (line 802 of GFE and HUD) ranging from $5,958.00 to $6,358, however, the borrower paid $22,668.31 in discount points. Such a drastic difference in discount points is alarming and clearly bears no correlation to a buy-down of the rate. The borrower's loan amount at closing (August 25, 1999) was $312,666.35. The Department has seen no information that a lower loan amount was discussed at the time of the GFE on August 10, 1999. In fact, the HFC application reflects that as early as August 6, an amount financed of $295,000 was contemplated for this borrower. Based on the actual loan amount HFC's disclosed discount points range from 1.9% to just over 2.0%. Such a disclosure does not follow HFC's pricing practice as explained below (see DEPARTMENT'S UNDERSTANDING OF HFC'S POLICY AND PRACTICE). Based upon the explained pricing practice the Department would expect discount points of this amount to correlate with a loan amount of approximately $85,000.

It is significant to the Department that the borrower clearly stated an understanding of the bi-weekly program as communicated by the loan officer. In support of her understanding, the borrower provided copies of two automatic debit authorizations, one unaltered and the other alleged by the borrower to have been altered after her signature. The unaltered authorization does not reflect a payment amount nor a date upon which the last payment would be due (which are known factors in either payment program). However, the borrower states that the loan officer informed her that with the bi-weekly program the date of last payment was uncertain due to an accelerated rate of amortization.[3] While this statement is not truthful, the loan officer's alleged making of the statement appears supported by the unaltered authorization with a blank "Date of Last Debit."

The Department is further concerned that the borrower signed an incomplete document that appears to have been completed eight days after the date the borrower received and signed the original. While the purpose of the later completion remains unclear, it does support the borrower's claim of intentional deception by the loan officer. The borrower further explains that the closing process was "gloss[ed] over" and that the loan officer "paraphras[ed] the specific terms and conditions of the loan" which prevented her from having a clear understanding of the transaction she was entering with HFC.

[3] There is no basis for such a statement. The program's accelerated payments are a known variable allowing the company to identify a last date of payment as easily as if the loan was amortized monthly over the term.

Complaint #2477 Georgia Smart continued

In response to the claims of deception, on September 5, 2001, HFC's Tom Schneider stated: "I would like to address the issue of deceptive sales techniques by one of our sales employees. This type of behavior or misrepresentation of our loan products by our employees is not tolerated. Please be assured that this was [an] isolated incident and we have taken the necessary steps to correct this type of behavior." The Department believes that the numerous complaints discussed in this report refute Mr. Schneider's claim that this borrower's experience was an isolated incident.

In the case of borrower Smart, HFC appears to give strong credence to the borrower's claims, ultimately reducing the principal balance of the loan by over $16,000 (reflective of the difference between line 802 on the HUD1 and the GFE), and reducing the interest rate from 10.788% to 7.00%.

Apparent violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and AfBA relationship.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA).

Complaint #2489 Justin and Jami Lundquist – (Bellingham, WA branch)
Loan date: January 2001Complaint date: April 2001

The borrowers state in their complaint that they were contacted by HFC in early January 2001 soliciting them for a refinance on their residence. The borrowers claim to have told the representative that they were a difficult loan prospect and did not believe a refinance would work. The HFC representative apparently convinced the borrowers that a refinance transaction could be obtained and encouraged them to cease making payments on a debt consolidation plan they had previously arranged. The borrowers claim that delays occurred on the refinance transaction and ultimately HFC informed them that a refinance was not possible, however; they could be placed into a high rate line of credit. The borrowers state that late fees had accrued due to HFC's advice to stop other payments and they were left with no choice but to accept the loan offered.

Complaint #2489 Justin and Jami Lundquist continued

The borrowers further allege that the payment on their loan was nearly double the amount discussed and agreed to be automatically debited from their account. HFC responded that there was an error in calculating the payments on the Authorization to Debit Account form and that the payments for

automatic withdrawal should have been set at $393.00 every other week rather than the $199.00 actually set. To correct the miscalculation HFC offered to allow the automatic withdrawal amount to remain the same, provided that the borrower makes additional monthly payments of the unpaid portion. In other words, the borrower pays the full amount regardless of the agreement.

In a follow-up conversation with the borrowers, the Department learned that they were led to believe that the loan was not possible without the added life, disability and unemployment insurance. The borrowers stated that they would never have accepted, or chosen the insurance if they had not believed it was required in order to obtain the loan.

Analysis

The transaction entered with these borrowers is a second mortgage line of credit in the amount of $31,000 at an annual percentage rate of 21.90%. A review of the loan agreement shows no monthly payment amount disclosed in a dollar format (note: pursuant to Regulation Z, no such specific disclosure is required). The borrowers would be required to calculate the monthly payment themselves based upon a relatively difficult formula. While the Authorization to Debit Account form is not a payment disclosure form, it is clear to the Department that the borrowers, in lieu of any other monthly payment amount disclosure, relied on this document in making their decision to accept the offered credit. HFC has even stated that its representatives completed the form incorrectly. The borrowers' claims of reliance on this form, as well as claims of misinformation by the representative lead the Department to believe that the representative likely misinformed the borrowers as to the required monthly payment as well.

Although the borrowers did legally contract to pay the higher monthly amount it appears likely that they were deceived, whether intentional or not, into doing so. Further, the Authorization to Debit Account is a legal contract with the borrowers. The contract clearly states: "The debits are to be made in the amounts and at the frequency and on the dates set forth below or may be made for other amounts, frequencies or dates which I give Fort Knox notice by telephone, fax or in writing." HFC has provided no evidence that the borrowers, the only party capable of modifying this agreement, did so. It is apparent to the Department that HFC modified the agreement in violation of the contract.

On April 20, 2001, in response to the Department's inquiry, Tom Schneider wrote: "On January 23, 2001, Mr. Lundquist opened a fixed rate revolving loan agreement. The terms, conditions, manner in which payments are calculated and the interest rate are disclosed in his loan agreement . . . I Mr. Lundquist was in disagreement with any of the terms, conditions, rate or minimum monthly payment, he had the opportunity to rescind this transaction during his rescission period." Mr. Schneider's statement, however, assumes that the borrowers were not deceived about the amount of payment and terms of the loan, or otherwise somehow misled to believe that the monthly payment would be less. Schneider's letter continues: "Upon reviewing Mr. Lundquist's Authorization to Debit Account form, we have determined our local branch employee incorrectly entered $393.00 (plus $5.00 fee to Fort Knox) as his monthly standard payment when this is actually _ of his monthly standard payment."

Complaint #2489 Justin and Jami Lundquist continued

Mr. Schneider's explanation appears to be that a borrower should ignore verbal and written statements of payment from a mortgage professional, and absent any other disclosure of the monthly payment, turn to page two of a five page legal document and perform a series of calculations to ascertain if they are being told the truth. Such a statement appears to be made with the intent of removing the burden of knowledge and professionalism from the shoulders of the mortgage professional and placing it squarely on the uninformed and misled consumer. The Department finds Mr. Schneider's comment on this matter to be a corporate justification of what can only be described as an act of predatory lending.

Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination

practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section.

The borrowers only made a single application with HFC, which occurred in either late December 2000 or early January 2001. The switch to a home equity plan occurred in mid to late January 2001 by HFC's action alone. HFC produced a copy of the required disclosure pursuant to this section for the Department's review. The disclosure is dated January 18, 2001, however there is no evidence that HFC provided the borrowers with this disclosure as required.

The borrowers additionally claim that their loan contained insurance products that they did not wish. The Department's position is that if a borrower "believed" that insurance was required, then in fact, it was required.

Apparent violations

WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to provide disclosures as required pursuant to TILA and Regulation Z.
RCW 31.04.125(4) Lender may not require credit life insurance.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: (TILA).

Complaint #2505 Mark & Lisa Cabral – (Bellingham, WA branch)
Loan date: March 2001Complaint date: April 2001

The borrowers contacted HFC seeking approximately $10,000 in a second mortgage to make improvements on their property for a pending sale. The borrowers alleged that HFC required them first to refinance their low rate (7.0%) first mortgage before they could obtain the desired second mortgage. HFC apparently convinced them to accept the refinance of their first mortgage with HRC by promising

Complaint #2505 Mark & Lisa Cabral continued

an interest rate of 7.2%. HFC simultaneously provided the borrowers with a home equity line of credit in the amount of $10,000 with a rate of 21%.

The borrowers stated in their claim that the closing papers "kept getting shuffled" at signing. The borrowers further alleged that the closing papers contained unwanted credit life insurance that had to be removed, and that the closing documents, including material disclosures, were provided to them several days after closing when they returned to pick up their check. The borrowers state that upon reviewing the documents they discovered that the interest rate was actually over 13%. Further, the borrowers state that they indicated strongly that a loan with a prepayment penalty would not work for them since they were selling the home in six months, yet at closing the loan contained a prepayment penalty. The borrowers state that HFC claimed to have mailed all the required disclosures to them, however; the borrowers are adamant that no disclosures were ever received by mail. The borrowers claim that they attempted to have the loan corrected and when that failed asked to rescind the transaction, but HFC would not make corrections or accept a rescission.

HFC informed the Department that this transaction was in litigation and that they could not provide a response at this time.

Analysis

The borrowers' claim that they were promised a lower rate than they obtained (7.2% versus 13.464%) is consistent with complaints filed by other consumers. While the GFE is dated the date of application (March 1), the Department finds the borrowers claims of receiving no disclosures until after the date of closing credible. Supporting this position is the date on the TIL disclosure of March 16, 2001, four days following the date of signing closing papers.

The second mortgage home equity line of credit was taken out by the borrowers with HFC at the same time the first mortgage was made by HRC. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required. The only disclosures produced for the Department in this transaction were the disclosures dated the day of signing closing papers (March 12), however, documents show that application took place on March 1.

The borrowers also state that the loan documents contained credit life insurance that they did not want. HFC provided the Department with an Optional Credit Insurance Disclosure for the home equity plan second mortgage purported to be signed by the borrowers showing that the borrowers elected insurance. It is interesting to the Department that HFC did not provide the Optional Credit Insurance Disclosure for the first mortgage where the borrowers declined insurance. The Department obtained this disclosure form from the borrower's attorney who informed the Department that the borrowers were not in possession of the insurance disclosure for the second mortgage. The Department forwarded this disclosure to the borrowers and were informed that the signatures on the document showing acceptance of the insurance are not their signatures.

Complaint #2505 Mark & Lisa Cabral continued

The borrowers state that at closing they noticed that insurance had been included on the loan (they do not indicate which loan) and that HFC agreed to remove the insurance. Clearly, the borrowers did not desire insurance and with plans to sell the home within six months, inclusion of insurance made no sense. This claim by the borrowers is also consistent with complaints filed by other consumers. It is apparent to the Department that HFC consistently attempts to "require" insurance on their products by "slipping" the insurance past the borrower whenever possible. The Department reviewed the Optional Credit Insurance Disclosure (Revolving Lending) provided by HFC. Page two of this disclosure contains signatures and a date. It is obvious that this page could be signed and dated, while the boxes on page one are left blank, and that later the boxes on page one could be checked indicating that insurance has been chosen. Such legerdemain would be easily achieved if the closing documents were "shuffled" as the borrowers attempted to sign.

Apparent violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate.
RCW 31.04.125(4) Lender may not require credit life insurance. A violation of this section occurred when HFC attempted to include insurance in the loan knowing that the borrowers did not desire insurance.
RCW 31.04.145 Investigation authority. Responded late and did not include insurance disclosure on first mortgage.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.

WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of GFE and AfBA relationship, and failure to provide disclosures as required pursuant to TILA and Regulation Z.
WAC 208-620-130(5) Noncredit insurance: Required insurance.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

Complaint #2517 Pamela & Lawrence Brown – HFC (Tacoma, WA branch)
Loan date: May 2000Complaint date: April 2001

The borrowers alleged that HFC charged them excessive fees.

Analysis

The loan in this transaction was first lien mortgage made by HRC. The Department's review of file documents shows that the borrowers were disclosed discount points (line 802 of the GFE)
Complaint #2517 Pamela & Lawrence Brown continued

ranging from $0.00 to $9,425.00. At closing, however, the borrowers paid $10,489.98. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Browns. The GFE delivered to the borrowers is dated May 1, 2000. The assumption put forth by HFC is that the borrowers would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department does not reflect the contract rate of 13.484% until May 16, 2000 (date of closing). On the date of GFE disclosure there is no evidence that HFC had determined a rate to be paid or communicated a rate to the borrowers in the offer of this loan program. In fact, the borrowers indicate such surprise at the costs they paid that it is likely that the true cost of the loan was never explained to them. Since HFC itself appears to have not identified a rate or range of rates to be offered to the borrowers, it is unclear what rate was being bought down when the borrowers' discount points were increased from a low of $0.00 to $10,489.98.

Apparent Violations

WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and AfBA relationship.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA).

RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA).

Complaint #2530 Renee and Charles Brooks – (Edmonds, WA branch)
Loan date: July 1999Complaint date: May 2001

The borrowers allege that HFC told them that they would not have a prepayment penalty, but when they later attempted to refinance the HFC loan they discovered that they were being assessed a prepayment penalty. The borrowers additionally complain that they paid excessive and unknown costs which dramatically increased the amount borrowed, and that credit life and unemployment insurance were added to their loan when they clearly indicated they did not want the insurance. The borrowers have further pointed out that the GFE they received from HFC is not the GFE that HFC produced to the Department in review of this complaint.

HFC only responded to the issue of prepayment penalty by stating that they have waived the prepayment penalty. No other issues in the borrowers' complaint were addressed by HFC. The Department, however, addresses each of the borrowers' concerns in this analysis.

Complaint #2530 Renee and Charles Brooks continued

Analysis

This complaint involved a dual transaction of a first mortgage refinance by HRC and a second mortgage line of credit by HFC. HFC appears to have made written disclosure of the prepayment penalty within the regulatory guidelines set forth under Regulation Z to the Truth in Lending Act. However, such written disclosure does not show that the borrowers were not misled by HFC representatives concerning the prepayment penalty. HFC's subsequent removal of the prepayment penalty may be an indication that HFC itself is not convinced that the borrowers were not misled. The Department notes that the Brooks' claim of an unknown prepayment penalty is consistent with other similar complainant claims.

The Department's review of file documents shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $4,000.00 to $15,000.00. At closing, however, the borrowers paid $15,297.34. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Brooks. The GFE delivered to the borrowers is dated July 14, 1999. The assumption put forth by HFC is that the borrower would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that as late as July 27, 1999 (date of closing), HFC had yet to determine a rate to be paid by the borrowers in the offer of this loan program. Since HFC itself appears to have not identified a rate or range of rates to be offered to the borrowers, it is unclear what rate was being bought down when the borrowers' discount points were increased from a low of $4,000.00 to $15,297.34.

The Department takes note of the borrowers statement upon subsequent review of her closing documents: "When I took a closer look at my loan papers I was so flabbergasted. I was never told that my loan was for more than 100% of the value of my home. I thought the amount over what my house appraised for was interest. I didn't know that they maxed out the value of my house then added all of their fees on top of that. I would have never signed for a loan that was for more than the value of my house. I also couldn't believe what I saw as far as their fees. The good faith estimate put the Loan Discount Fees (Points) at 4000-15000.00. They charged me 15,291.84 just for the points. It made me sick to my stomach. The Mortgage Broker [that was later used to refinance the loans] told me that he couldn't understand why they would charge me so much for this loan because our credit was great." The Department also notes that both borrowers carry credit scores of nearly 700 and show no history of late payments.

In its response to the complaint, HFC provided the Department with a GFE dated July 14, 1999. This GFE reflects a discount point range on line 802 of $5,000.00 to $16,000.00. The borrowers claim that the only GFE they received on this date was the lower cost GFE discussed above. Although directed to produce all disclosures in the transaction, HFC did not provide the GFE it gave to the borrowers. It appears to the Department that HFC has "produced" this second GFE to show that the discount points ultimately charged the borrowers actually fell within the range initially disclosed.

The second mortgage home equity line of credit was taken out by the borrowers with HFC at the same time the first mortgage was made by HRC. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is

Complaint #2530 Renee and Charles Brooks continued

provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section (note: in this transaction the borrower claims that HFC never even took an application, but simply took it upon themselves to update information from an old file). There is no evidence that HFC provided the borrowers the disclosure as required. The earliest disclosure relative to the home equity line of credit is dated July 27, 1999, the date of closing.

Another area of complaint unaddressed by HFC concerns credit life and unemployment insurance being charged to the borrowers despite their claim that they chose not to accept such coverage. A review of documents shows that the insurance was added to the second mortgage line of credit, but not the first mortgage refinance. After review of the pertinent documents relative to the insurance, the Department is very concerned as follows:

1. The Optional Credit Insurance Disclosure (Revolving Lending) is a two page document. The request for optional insurance appears on page one as a series of boxes to be checked by the borrower if insurance is desired. Page two contains a short statement about satisfaction with insurance followed by a signature and date blank.

Page two contains signatures and a date. It is obvious that this page could be signed and dated, while the boxes on page one are left blank, and that later the boxes on page one could be checked indicating that insurance has been chosen. The borrowers would have no knowledge of the subsequent choice and no way of proving that their intention was to not choose insurance. It is important to note that this disclosure form differs from the form used for optional insurance on the first mortgage. The first mortgage form clearly contains the statement above the borrowers' signature, "I acknowledge that no Credit Insurance is provided with this loan."

2. The Department believes that the Optional Credit Insurance Disclosure (Revolving Lending) discussed in 1 above, was either completed after the borrowers' signature was obtained, or more likely, forged with the borrowers' signature without the borrowers' consent. Although the Department has not performed handwriting exemplars of this document, a simple review of the borrowers' signatures on other documents shows that it is unlikely that the signatures were made by either borrower. Additionally, the date provided next to the signatures does not match the style of dating used by the borrowers in other documents with the same date. The Department's opinion here is supported by the borrowers' claim that they did not choose insurance when they accepted the loan.

The borrowers claim to not only have been unaware of the insurance added to their loan, but state, "When asked about the unemployment and life insurance that they offered, we turned it down on both loans." Such a statement shows clarity and intent on the part of the borrower. The fact that the loan ultimately contained insurance they did not want can only be explained as "required" insurance.

Complaint #2530 Renee and Charles Brooks continued

Apparent Violations

RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority. Failed to produce all disclosures.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and AfBA relationship. Failure to provide disclosures as required pursuant to TILA and Regulation Z, both in relation to required insurance and disclosures for the home equity credit line.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

Complaint #2550 Juan & Maria Guzman – (Renton, WA branch)
Loan date: November 2000Complaint date: May 2001

The borrowers claim that they responded to HFC mailers for a $10,000 loan. The HFC representative apparently convinced the borrowers that it would be to their benefit to refinance out of a 7.0% first mortgage into a 12.531% mortgage. The borrowers claim that they were told that their monthly payments would drop and that they would pay off the new loan in 15 years. The borrowers made their complaint through an interpreter and claim that they do not speak English. They state that they were promised an interpreter at closing by HFC to help them understand the paperwork, however; no interpreter showed up at the time of signing. The borrowers also claim that they received no disclosures in this transaction other than the note and the HUD 1A. HFC stated that the borrowers' total monthly payments decreased by $136.00 through this debt consolidation loan, and that all the terms and conditions of the loan were fully disclosed and explained to the borrowers at the time of closing.

Analysis

The borrowers were solicited by HFC and responded to HFC for a loan. This loan, however, was made by Household Realty Corp. (HRC). The borrowers provided the Department with the note for their original first mortgage with FT Mortgage Companies. This loan carried a fixed rate of 7.0% and monthly payment of $1,042.52 with no prepayment penalty. The new loan closed with the borrower was made at a rate of 12.531% and a monthly payment of $2,224.22 with a significant prepayment penalty. Further, the new loan carries a term of 30 years rather than the 15 years the borrowers claimed they were promised.

Complaint #2550 Juan & Maria Guzman continued

Initially, HFC failed to produce a GFE that would have been provided to the borrowers. Such failure supports the borrowers contention that no disclosures were provided. Under subpoena issued February 22, 2002, HFC produced a GFE dated November 3, 2000.

The Department's review of the subsequently produced GFE shows that the borrowers were "disclosed" discount points (line 802 of the GFE) ranging from $10,000.00 to $16,500.00. At closing, the borrowers paid $15,074.66 in discount points. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Guzmans. The GFE carries a significant range of discount points. The assumption put forth by HFC is that the borrowers would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. The Department believes that it is highly unlikely that the Guzmans, who have difficulty understanding English, were able to make an informed decision concerning the buy-down of rate in their loan. The Department believes it is more likely that the Guzmans, as with other consumers discussed in this report, were never provided any such option, or usable information that would allow them to make an informed decision about buying down the rate.

While the borrowers did not articulate to the Department concern over credit life insurance added to their loan, they did point it out to the Department on the HUD-1A settlement statement. Given the borrowers inability to communicate in English, the lack of disclosures apparently provided to the borrowers and this notation on the HUD-1A, the Department assumes that the borrowers complaint includes the financing of this insurance premium.

Apparent Violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate.
RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the provision of GFE and AfBA relationship.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(7) Violations of chapter: Engage in bait and switch advertising.
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

Complaint #2587 Jerry Smith – (Olympia, WA branch)
Loan date: May 2000Complaint date: June 2001

The borrower alleged that HFC raised his rates and the payoff on his loan was more than he originally borrowed. HFC stated that the rates have not been raised. HFC provided a history of the borrower's payments showing that the borrower had not made timely payments and therefore had failed to amortize the loan as expected.

Analysis

This transaction involved a first lien mortgage made by HRC and a second lien mortgage made HFC. The Department's review of file documents shows that the borrower was disclosed discount points (line 802 of the GFE) ranging from $3,500.00 to $10,800.00. At closing, the borrower paid $9,097.32. This amount (equal to 7.20% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrower's interest rate, there is no evidence that the discount points were used in this way for Smith. The GFE delivered to the borrower is dated April 21, 2000, and carries a significant range of discount points. The assumption put forth by HFC is that the borrower would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that on May 16, 2000, (one day before closing), HFC was using an interest rate of 12.99%. The Department must assume that under HFC's marketing scenario that 12.99% must either correlate to the lower discount points of $3,500.00, or to the higher discount points of $10,800.00, thereby giving the borrower the opportunity to buy the rate in one direction or another. The rate contracted with the borrower at closing, however, was 13.008%. The Department is unable to see any "buy-down" correlation between the rate received and the discount points paid.

Most of the documentation in this file is carried under the name MBNA Consumer Services, Inc., however, the documentation is all in the standard HFC format and the application information is contained within the HFC system. This raises serious questions of unlicensed activity, using an unlicensed name, and/or an undisclosed referral of business. The borrower clearly believes that he has transacted business with HFC, yet the documents do not reflect this. To compound the confusion, HFC was the sole responding party to this complaint. In response to the February 22, 2002, subpoena, HFC stated that it "processed" loans for MBNA and then purchased the loans. The Department believes that far more of the transaction than just processing took place by HFC. It is obvious that HFC originated the loan, underwrote the loan, and closed the loan. Although HFC may not have actually funded the loan, the quick purchase and subsequent servicing indicate that the "processing" explanation is a form over substance argument.

Apparent Violations

WAC 208-620-050(1) License required.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and possibly AfBA relationship.
WAC 208-620-210 Business only under licensed name. HFC doing business as MBNA.

Complaint #2587 Jerry Smith continued

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA).

Complaint #2588 James Moore – HFC (Service Center, CA)
Loan date: unknownComplaint date: June 2001

The borrower alleged that HFC was not posting payments when received and therefore collected late charges. HFC waived borrower's late charges and stated that they are relocating the address of the mail service in an attempt to improve service to a level that meets customer's expectations.

Analysis

The borrower provided the Department with a copy of a certified mail receipt and the June 2001 payment coupon for this loan. The receipt shows that the borrower placed this payment in the mail on May 7. HFC does not reflect receipt of this payment until June 6, nearly a month after the payment was made. HFC has argued that it has no control over the timeliness of the postal service, however; it appears to the Department that the payments may be received at an HFC facility (or box) in a timely manner, but may not be picked up by HFC in a timely manner. The borrower claims that HFC charged late fees when he has given plenty of time for payments to arrive. HFC does not refute that late charges have been collected in situations where borrower payments were posted after the date of receipt.

Further, HFC appears to be handling the servicing of loan payments through California and/or Florida locations. Servicing of Washington loans is a covered activity requiring a license for the servicing location. HFC does not hold licenses for these locations.

Apparent Violations

WAC 208-620-050(1) License required.

Complaint #2668 Reed and Mary Davis (Renton, WA branch)
Loan date: November 1999Complaint date: August 2001

The borrowers complain that HFC altered the terms of their payment plan without their permission and by doing so ended the shortened payoff period under the original payment scheme. HFC responded that the borrowers had originally agreed to a bi-weekly program with payments to be made on every other Tuesday of each month. In June 2000, HFC states that the borrowers requested a change in their payment plan to payments made on the 1st and 15th of each month. Although not stated in their response, it is apparent that this requested change altered the payment program from a bi-weekly program to a bi-monthly program (see discussion of these programs in IDENTIFIED PATTERNS OF RECENT COMPLAINT HISTORY). The borrowers have acknowledged that they made a request of HFC to change the days of payment each month, however; the borrowers also indicate that they did not

Complaint #2668 Reed and Mary Davis continued

believe such a change would alter the terms of the original bi-weekly program (i.e. converting the program to a bi-monthly program).

Analysis

The change of payment due dates discussed above appears to have had two detrimental effects on the borrowers: i) the bi-monthly program amortizes the loan at a slower pace of principal reduction, and ii) the switch of days appears to have caused an interruption in the payment stream and therefore additional significant interest charges to the borrowers. There is no evidence that HFC informed the borrowers of the results of making a request to change the payment days from Tuesdays to the 1st and 15th of each month. More important perhaps is that the payment days appear to have been changed (whether authorized by the borrowers or not) in violation of the EZ Pay Plus contract entered August 25, 1999. Changes to the frequency of payments in the contract may only be made by the borrowers directly contacting Fort Knox National Bank. Both HFC and the borrowers have stated that the request for change was made by the borrowers directly to HFC.

While it is clear that the borrowers were interested in the change, they did not possess sufficient information to understand the results of their request. HFC, however, did clearly understand the results

of the change (which was substantial additional income to HFC) and they did not provide the borrowers with this information, but proceeded to make the change themselves in apparent violation of the contract.

The Department's review of file documents shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $0.00 to $2,140.00. At closing, however, the borrowers were charged $19,929.45. The HUD1 shows that the discount points charged at closing were 7.25% of the loan amount, which was approximately $275,000. Assuming that 7.25% is at or near the upper range intended to be charged to the borrower, the upper range of the amount disclosed on the GFE would equate to a loan amount of only $29,517. The Department does not understand how the GFE provided to the borrowers bears any reasonable relationship to the loan entered with the borrowers for $275,000.

The loan made in this complaint was made by Household Realty Corporation (HRC), an unlicensed entity in the State of Washington. However, the loan transaction appears to have been originated and at least partially conducted by HFC. Specifically, the GFE was produced and provided by HFC and the EZ Pay Plus contract identifies HFC as the creditor on the loan.

Apparent Violations

WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the disclosure of discount points and AfBA relationship.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Complaint #2668 Reed and Mary Davis continued

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA).

Complaint #2715 Edith Byington (Seattle, WA branch)
Loan date: March 2001Complaint date: October 2001

The borrower claims that at closing the paperwork contained too many "unexplained" or "ignored" issues and rescinded the loan. The borrower makes the statement in her complaint that life insurance on this loan was a "requirement." She also complains that HFC representatives did not readily accept her rescission notice and were not cooperative in providing payoff information on a previous HFC loan she wished to pay off. The borrower further complained that HFC deducted money from her account in the month following rescission, and while the money was returned, no explanation was offered.

Analysis

HFC did not provide copies of the rescission notice under the initial directive by the Department. On February 22, 2002, the Department subpoenaed HFC for any rescission notices completed by the borrower. In response, HFC produced a rescission disclosure, but not the one completed and delivered by the borrower to rescind the loan.

The Department finds the borrower's claims of "required" credit insurance credible. This claim was not refuted by HFC. Also, while HFC's response claims, "One of Household's main goals is to provide each of our customers with the exceptional customer service they deserve and expect," the Department is frequently contacted on behalf of borrowers frustrated with delayed payoff information from both HFC and its affiliate Beneficial Finance Company.

Apparent Violations

RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority.

Complaint #2751 Joseph and Jeanie Luna (Bellingham, WA branch)

Loan date: July 2000

Loan date: February 2001Complaint date: November 2001

The borrowers claim that they responded to an HFC promotion that would lower their current interest rate. They claim that they were told by the HFC representatives that the interest rate on the first mortgage would be 6.99%. The borrowers also stated that when they questioned the prepayment penalty on the loan they were told by the representative that they "normally don't enforce it." The borrowers are also concerned with the costs they paid on the loan. The borrowers state that they were set up on a bi-weekly payment program, however; the loan did not amortize as they were told it would.

Complaint #2751 Joseph and Jeanie Luna continued

The borrowers also state that they were given a second mortgage home equity line of credit because the first mortgage provided insufficient financing. A new first mortgage was arranged in February 2001. In their complaint the borrowers also raise allegations that something is amiss with the appraised value of their home as it came in far too low.

HFC delayed its response to the Department for 107 days. HFC's response did not contain all of the requested documentation. Specifically missing were GFEs for the two first mortgage loans. Additionally, it is evident that the borrowers entered into a payment plan with HFC, however, the documentation for such a plan was not provided in the response. HFC's response addressed the appraised value concern, the pricing on the loans, the interest rate "confusion," the borrowers' concern of loan amortization and the prepayment penalty. HFC reports that the borrowers' interest rate has been lowered to 6.99% subsequent to filing this complaint. The borrowers' attorney claims this is a false statement.

Analysis

The Department directed HFC to provide documentation under this complaint on November 5, 2001. No response was received to this directive and on December 3, 2001, the Department sent a second directive to HFC. As stated above, HFC took 107 days to respond to the Department and this response still failed to provide all of the requested documentation. On February 22, 2002, the Department subpoenaed HFC for the missing GFEs, which were finally produced.

This complaint involves two first mortgage loans made by HRC. The Department's review of the July 12, 2000, first mortgage file documents shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $0.00 to $13,700.00. At closing, the borrowers paid $12,409.52 in discount points. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly.

The Department's review of file documents for the second first lien loan made February 8, 2001, shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $9,000.00 to $14,000.00. At closing the borrowers paid $13,014.73. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. What is alarming to the

Department is that only seven months after the July loan was made at 12.693%, the Lunas paid over $13,000.00 to lower their new loan rate to only 11.964%, a difference of less than 1%.

In response to the borrowers' concerns over the appraised value of their property HFC stated: "Interest rates are not driven by the appraised value of the home." This statement is contradictory to HFC's pricing matrix and to prior statements made by Tom Schneider and other officers of HFC. Clearly, appraised value is a determining factor in the interest rate "offered" as it holds a direct impact for the loan to value ratio (LTV). For example, the interest rates shown in the May 1, 2001, pricing matrix have a direct basis point increase as the LTV increases.

Further, a lower than expected appraised value offers HFC the opportunity to supplement the first mortgage with a very high rate second mortgage in order to obtain the original financing plans of the borrower. The Department is concerned with "convenient," but inconsistent statements in response to issues raised by consumers or the Department. Such inaccurate responses raise questions of credibility in other HFC responses.

Complaint #2751 Joseph and Jeanie Luna continued

In its response HFC goes on to state, "Our terms and conditions are disclosed with each of our loan offers, allowing potential customers the ability to make an informed decision as to whether our products can meet their financial needs." The Department finds exception with this statement as well. With this complaint and other complaints discussed in this report such a statement is simply untrue. Terms and conditions are not always disclosed with each offer; especially not in this complaint as is discussed below.

HFC argues that the consumers were likely confused about being offered a 6.99% interest rate. The Department agrees. It is apparent to the Department that many consumers have been confused about an alleged rate between 6.99% and 7.20% that never actually materializes for the borrower. What is incredible to assume, or propose, is that so many unrelated consumers have been confused by their own doing. HFC states, "A review of the loan documents clearly indicates the interest rate to be 11.96%." While this is an obvious statement, it does not mean that the borrowers were not confused by the HFC representatives and led to believe that the loan would be 6.99%. In fact, the borrowers provided more HFC documents referencing the 6.99% rate than the 11.96% rate. Apparently, HFC finds this claim to be credible as well by its statement that it lowered the interest rate to 6.99%.

In response to the concern over accurate principal reduction of the loan, HFC provides the Department with a short lecture on how mortgage loans amortize. While the Department always welcomes clarification, this response is simply non-responsive to the allegation. The borrowers claim that they were led to believe that the loan would amortize faster than it has. The response, rather than addressing an issue of deception, states, "To explain the details of the mathematical computations for loan repayment and amortization would be beyond the scope allowed in this response." The response then goes on to explain the effect of payments and late payments on principal reduction. The Department is unsure whether HFC is implying that the borrowers have been late on their payments, but a review of the payment history shows that they clearly have not.

The borrowers claimed that in response to their concerns over a prepayment penalty, the representatives told them that HFC doesn't "normally enforce it." Again, rather than address an issue of deception by its employees, HFC responds with a disingenuous reference to full disclosure in the note. Prepayment penalty deceptions are again and again a recurring theme in complaints against HFC. The fact that a paragraph, buried on page two of a note among a series of lesser-ramification loan terms, exists, is no defense to whether a borrower was lied to about the prepayment penalty. Borrowers have informed the Department that they are "steered" away from the details of the documents and directed to sign on signature lines, often times only seeing the signature page as the pile of documents is thumbed through. It should be noted that the prepayment penalty information is not carried on the same page as the signature blank and therefore it is highly likely it was not seen by the borrower when signing.

Further, the TIL disclosure carries the statement that there "may" be a prepayment penalty. While this statement is not inaccurate, it would provide support to a deceiving loan officer in convincing a

borrower that the prepayment penalty is not normally enforced. Regardless of any written disclosures provided to the borrowers, however, direct statements made by a mortgage professional, especially while steering a borrower away from written disclosures, are likely to be believed and relied upon by an uninformed borrower.

Complaint #2751 Joseph and Jeanie Luna continued

The borrowers originally held a 7.5% first mortgage with their prior lender. It is apparent that the borrowers were refinanced into a 12.693% first mortgage with $12,409.52 in discount points (7.25% of the loan amount), and a second mortgage home equity line of credit with an interest rate of 24.90%. The borrowers were later refinanced into a new first mortgage at 11.964% with another $13,04.73 in discount points (again 7.25% of the loan amount), just over six months later. In this six month period alone HFC made over $25,000 in discount points from these borrowers while replacing a low interest loan with a high interest loan.

The HFC sales pitch on the 6.99% rate appears to revolve around a series of very confusing schedules identified as Amortization Schedule Summary E-Z Pay Plus with Pay Right Rewards. Alarming in these schedules are the disclosure of rates and APRs that hold little significance for the loan. The borrowers claim that these schedules were used to convince them that the loan would be made at a 6.99% rate. Similar disclosures were used for the solicitation of a second mortgage. In reviewing these disclosures it is easy to understand how a borrower would be confused, especially lacking any other relevant disclosures that would provide clarification of the loan actually given. In its response, HFC stated, "In explaining the potential savings, amortization schedules were employed to show the comparison by illustrating the difference in, and potential savings of, an 18-year loan at 12.690% over a 30-year loan at 6.99%. This was done for demonstration purposes only, and was not intended to imply or establish that the interest rate on the loan Mr. and Mrs. Luna were considering purchasing was 6.99%."

To this statement the Department must ask what the intentions of the schedules were if not to lead the borrower toward an understanding of a 6.99% rate. Although HFC claims that the schedules were for "demonstration purposes only" the only statement close to this appears on the page containing the true interest rate of 12.69%, and this statement does not even make it clear that the rates are not being offered. The actual statement, "This information is for illustration purposes only and is not intended to be a binding commitment," is not even clear to the Department. Regardless, the pages containing the 6.99% rate carry no statement to this effect whatsoever. Further, the Department does not understand the purpose of making a comparison between an 18-year loan at the real rate and a 30 year loan at a "pretend" rate. The real rate was apparently not available as an 18-year loan and the pretend rate was apparently not available whatsoever. The Department believes the sole purpose of this schedule was for simple deception of the consumer. Regulation Z to the Truth in Lending Act would appear to hold similar concerns as is discussed below:

Pursuant to §226.17(a) of Regulation Z, Form of disclosures:

(1)The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. **The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures required under §226.18.**

The Department believes that HFC has intentionally violated this section by mixing disclosure information required under §226.18 on the Amortization Schedule Summary with information not directly related to the disclosures, for the purpose of confusing the borrower about the interest rate, APR, term of the loan and payment amount on the loan.

In both first mortgages the TIL disclosure is dated well after the date of consummation indicating that the borrowers did not have this information as required in order to make an informed decision.

Complaint #2751 Joseph and Jeanie Luna continued

Apparent Violations

RCW 31.04.135 Advertisements or promotions: Misleading borrower about interest rate.
RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to provide disclosures as required pursuant to TILA and Regulation Z.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.
RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(7) Violations of chapter: Engage in bait and switch advertising.
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

Complaint #2797 Mark and Cheryl Nelson (Federal Way, WA branch)
Loan date: October 2000Complaint date: November 2001

The borrowers claim that they have discovered that the terms of their loans with HFC are far different than what they were led to believe. Specifically, the borrowers state that they were promised a 15 year first mortgage that would be paid in eight and a half years through a twice a month payment plan. They state that there was to be no prepayment penalty and that adjustments to the program could be easily made to accommodate any payment hardships. The borrowers also state that they were provided with a second mortgage to cover debts that would not be paid with the first and indicate that they were surprised by the cost of loans.

Analysis

HFC responded nearly two months after the Department's request for information. HFC did not include a GFE with its response requiring the Department to issue a subpoena to obtain this disclosure. In the response HFC explains that the borrowers were originally solicited for a 15 year mortgage with bi-weekly payments that would have paid the loan in approximately eight years. However, the company explains, the borrowers did not qualify for a 15 year mortgage and subsequently chose a 30 year mortgage with bi-monthly rather than bi-weekly payments. The response states the borrowers, "may be confusing what may have initially been discussed . . .."

The response further addresses the borrowers' claim of a prepayment penalty promise by reciting the prepayment penalty sections from the note and the TIL. HFC addresses the other borrower concerns by making statements of fact concerning the documentation rather than addressing the borrowers' actual

Complaint #2797 Mark and Cheryl Nelson continued

complaint, which was that they were "promised" specific things that ultimately were not true.

This transaction involves a first lien mortgage made by HRC and a second lien home equity line of credit made by HFC. The GFE provided by HFC shows loan discount points for the HRC first disclosed at $13,412.00 on October 9, 2000. The HUD1 settlement statement dated October 23, 2000, shows that the borrowers paid $15,535.71 (or 7.25% of the loan amount) in discount points at closing, and increase of over $2,000 from the initial disclosure. The borrowers were provided with the HFC home equity line of credit at the same time in an amount of $15,626.00, or just enough to cover the discount points charged on the first mortgage.

Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required. The only disclosures produced for the Department in this transaction were the disclosures dated the day of signing closing papers, October 23, 2000, although it is apparent, based on the GFE date that the application was taken no later than October 9.

Complaint #2872 Arthur and Gay Pemberton (Silverdale, WA branch)
Loan date: November 2000Complaint date: January 2002

This complaint concerns a series of loans made by HFC/HRC to the borrowers. Following payment problems in 2000 the borrowers obtained a refinance loan through HRC. The borrowers complaint is primarily that the refinance loan was not made as promised or contained terms that they were not made aware of. HFC responded to the complaint with a letter and documentation for a debt consolidation loan in May 2000 and the most recent refinance in November 2000. The Department interviewed Gay Pemberton following HFC's response and found that the borrower disagreed with many of the claims made by HFC. Specifically, Ms. Pemberton stated the following:

1. No GFE was received until the date of signing. The borrower claims that she has saved all of her paperwork and there is no indication that the GFE she holds had ever been folded and placed in an envelope (the Department has found it to be HFC's practice to use #10 size envelopes for disclosures mailed to borrowers).
2. The borrowers were never informed that their loan would be made with HRC. At all times they believed they were dealing only with HFC.
3. The loan officer "witnessed" on all of the documents was not present at the closing. Ms. Pemberton claims that they were hastily brought into a room by an unknown man and asked to sign documents very quickly without a chance to review them. The man stated that the documents contained whatever the loan officer had told them they would contain. Ms. Pemberton remembers the man only showing parts of documents with signature lines and skipping past every document not requiring a signature, including the TIL.
4. The borrowers did not want the credit life insurance, which was financed into the loan and had it removed months later when they detected it. Ms. Pemberton is unsure about the signatures on the optional insurance disclosures now, but is clear that she would not have seen the informational part

Complaint #2872 Arthur and Gay Pemberton continued

of the three-page disclosure as they were only exposed to the signature page of each document.
5. Despite the borrower's Notice of Confirmation which was apparently signed five days after closing (November 25), Ms. Pemberton states that neither borrower ever returned to the HFC office to sign more documents.
6. Ms. Pemberton claims that the second mortgage loan contained a prepayment when paid off by the November 2000 refinance. Contained within the agreement is the following: "No prepayment penalty will be imposed if this loan is paid off with the proceeds from another loan with us." The borrowers further claim that they were adamant with HFC that the new loan not have a prepayment penalty, yet it did.

Analysis

In light of other similar complaints the Department finds the borrowers claims above to be credible. The Department believes that HFC likely failed to provide disclosures as required, including the GFE and the TIL disclosures; hurried the borrowers through signing to avoid discussing or revealing loan terms; required insurance in violation of the Act; provided false witness signatures on the documents; foreclosed the borrowers' opportunity to rescind by having them sign a pre-dated confirmation notice; charged a prepayment penalty on the payoff of the second mortgage in violation of the agreement, and provided false assurances about the prepayment penalty on the most recent loan.

The fact that insurance premiums were included in the loan amount without the borrowers' knowledge or consent means that the insurance was effectively required. Not only is requiring credit life insurance a violation of the Act, if insurance is required it must be disclosed in the TIL. HFC did not, however, disclose the credit life premium in the TIL and therefore material disclosures were not made to the borrowers. Failure to make material disclosures provides the borrower with additional rescission rights for three years following consummation of the loan.

The Department's review of file documents for the first mortgage shows that the borrower were disclosed discount points (line 802 of the GFE) ranging from $5,429.04 to $6,232.59. While this is a more narrow range of discount points than in other complaints, it appears that the borrowers were unaware of any of the charges to be imposed until after closing. At closing, the borrower paid $6,416.26. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrower's interest rate, there is no evidence that the discount points were used in this way for the Pembertons, especially since it appears that the borrowers never even saw a range or the actual discount points at closing (again, Ms. Pemberton claims that at signing the only parts of documents that they were shown were the signature blocks). The assumption put forth by HFC is that the borrowers would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, since the borrowers appear to have had no disclosure of the discount points at any time, the Department is unable to see any "buy-down" correlation between the rate received and the discount points paid.

Complaint #2872 Arthur and Gay Pemberton continued

Apparent Violations

RCW 31.04.125(4) Lender may not require credit life insurance.
RCW 31.04.145 Investigation authority.
WAC 208-620-050(1) License required: Household Realty Corp. and HFC corporate do not hold a license.
WAC 208-620-120(1) Contents of disclosure statement to borrower: Failure to comply with RESPA and Regulation X in the provision of GFE, disclosure of discount points and the existence of an AfBA relationship. Failure to provide disclosures as required pursuant to TILA and Regulation Z.
WAC 208-620-210 Business only under licensed name. HFC doing business as HRC.

Amended Act

RCW 31.04.027(1)-(3) Violations of chapter: Scheme, device, or artifice to defraud or mislead. Unfair or deceptive practice. Obtain property by fraud or misrepresentation.
RCW 31.04.027(5) Violations of chapter: Solicitation for terms of loan not actually available.

RCW 31.04.027(6) Violations of chapter: Fail to make disclosures as required under federal law (RESPA and/or TILA).
RCW 31.04.027(10) Violations of chapter: Fail to comply with federal law (RESPA and/or TILA).
RCW 31.04.102 Disclosure of fees and costs to borrower: Discount points (RESPA), other disclosures (TILA).

IDENTIFIED PATTERNS IN RECENT COMPLAINT HISTORY

The complaints filed with the Department reflect transactions originated in several branch locations from varying locales of Washington. While most of the complaints show similar patterns of consumer abuse, the Bellingham branch stands out with over 30% of the complaints (6 of 19) discussed in detail in this report. Additionally, the Department is aware of private actions taking place relative to loans originated from the Bellingham office. While the Department has formed no opinion about the higher level of activity occurring in the Bellingham office, HFC corporate has been repeatedly notified that the Bellingham office is a branch with problems.

The Department has identified seven patterns prevalent in the 19 recent complaints discussed in this report. These seven patterns are discussed below:

1. Misrepresentations and failed promises. Consumers repeatedly complained that they had relied on certain representations or promises by HFC representatives that proved to be misrepresentations, deceptions or false promises. These misrepresentation claims ranged widely, including dishonest statements about rates and fees, prepayment penalties, monthly payment amount, insurance or other loan terms. However, it is not necessarily the specific misrepresentation that causes the Department concern, but rather the fact that misrepresentations were apparently made in a significant number of complaint transactions.

HFC has frequently offered explanations that the borrowers "misunderstood" the transaction. While the Department agrees that the borrowers misunderstood their transaction, the important question is "why" the borrowers misunderstood the transaction. Consumers also reported to the Department that HFC

representatives made certain promises or assurances concerning their loan transaction that were not born out. After reviewing the complaints, HFC's responses to the complaints and the documents relative to the complaints, the Department believes that HFC representatives have employed sales tactics intended to mislead, misdirect or confuse the borrower. As discussed below, this belief is supported by the Department's own test originations of loans at three different HFC branches in Washington.

While the misrepresentations appear to have occurred at the HFC branch locations, the Department has been extremely disappointed with corporate responses to the allegations. In virtually every case, HFC responded with a very aggressive and "factual" defense of its branch representatives. In early complaint filings the Department gave HFC the benefit of doubt in consumer claims and relied on HFC's adamant claims that no deception or misrepresentation had occurred. HFC's frequent claim was that borrowers were mistaken and had not availed themselves of the information and disclosures provided during the transaction process. These claims of no harm and no foul, however, began to ring hollow as more and more consumers continued to complain of the same practices. It is important to note that these complaints are documented from varied locations including other states. The sameness of complaint allegations coupled with the wide diversity of complaint locales has made it evident to the Department that misrepresentations, as well as the other five areas discussed below, are not relegated to specific transactions or loan officers, but rather to the HFC organization as a whole, including its affiliate Beneficial, which has had a similar number and type of complaints filed against it.

2. Confusion over rates, points and fees. Consumers complain that they were somehow confused or misled about the rates, points or fees offered by HFC. Some consumers apparently believed that their rate would either be lower than what it was, or that somehow the "effective" rate would be lower due to

payment structure. Other consumers were alarmed at the amount of fees they were required to pay in the transaction, indicating that they must have somehow been confused about the fees they would pay.

State and federal disclosure regulations are intended to provide the borrower with sufficient information to make an educated financial decision. With adequate disclosure there should be no borrower confusion about rates, points or fees. A sub-pattern of this pattern of confusion has been identified by the Department in HFC's misuse of the good faith estimate (GFE) and what appears to be intentional confusion about discount points charged on certain loans. This sub-pattern of confusion has been identified by the Department in over half of the recent complaints and is discussed in greater depth below.

Another sub-pattern of this pattern is the belief that a high rate loan actually carried a lower rate. Most often identified by borrowers was the belief that an approximate 14% rate loan was actually an approximate 7% loan.[4] This sub-pattern seems to have most often occurred in conjunction with the offer of specific payment plans offered by HFC (discussed below).

3. Timely Disclosures. A few consumers complained that they did not receive disclosures in a timely manner. The Department believes that an interview of individual consumers will likely result in more claims of this nature as borrowers are frequently unaware of when disclosures are required to be made, and therefore do not know to complain about the matter. Some consumers claim to have not received any paperwork until after closing. The Department was able to identify instances in which borrowers

were not provided GFEs within three days of application as required, as well as failures to provide the TIL disclosure as required, sometimes not until after closing when the disclosure is useless to the borrower. As discussed in the section above, disclosures are intended to keep consumers from being confused or uninformed about the loan they are transacting for. Failure to make disclosures in time obviously aids in any intended confusion desired by HFC representatives, and unnecessarily increases confusion even where not specifically intended to harm.

Significant in this identification are the following:

#2374 Jones complaint: In this transaction the Department found that the complainant never received the information required under Regulation Z to the Truth in Lending Act. HFC itself noted that a printer malfunction caused a lack of disclosure to the borrower. Such lack of disclosure cannot be rectified once the borrower has entered the transaction except through an extended right of rescission.

#2505 Cabral complaint: In this complaint the borrowers claim that they did not receive the material disclosures until several days after signing when they returned to pick up the proceeds check. The Department found in its review that the TIL disclosure was dated four days after the date of signing closing papers.

#2530 Brooks complaint: The borrowers were able to show the Department that the GFE provided by HFC in response to the complaint was not the same GFE provided to them during the transaction. The GFE provided to the Department by HFC carried a larger range of discount points thereby purportedly supporting that the discount points charged to the borrower had been previously disclosed. HFC did not produce the disclosure that the borrowers produced, although both disclosures carried the same date (July 14, 1999) and neither disclosure appeared to have been altered. The Department can only assume that either HFC is utilizing "shadow" disclosures to confuse the borrower or that the GFE produced by HFC for the Department was manufactured sometime after July 14. Either situation is considered a serious violation.

#2460 Fenton complaint: In this transaction the Department found that HFC provided the GFE 11 days after the required date, and provided the TIL five days after the required date.

[4] The borrower claims generally ranged from 6.9% to 7.25%.

Credit Life transactions: The Department believes that in some of the transactions carrying credit life or other types of insurance, the material disclosures required under the Truth in Lending Act were not provided to the borrowers. This issue is discussed in depth below.
Open End Home Equity Lines of Credit: As discussed below under the section "SPURIOUS" HOME EQUITY LINES OF CREDIT, the Department believes that some, if not all, of the home equity lines of credit made by HFC are in reality closed end credit disguised as open end credit. Such a situation means that HFC is in serious violation of the material disclosure requirements of closed end credit under Regulation Z, as well as the disclosure requirements under Section 32 of Regulation Z (HOEPA).
DFI examiner originations: In the three originations conducted by the Department's examiners (discussed below), HFC either failed to provide GFE disclosures altogether, or were seriously delinquent in the provision of the disclosures.

4. Monthly payment amount. Two consumers felt that the monthly payments they were required to make were not what they believed they would be making. While this pattern may be more appropriately carried under pattern number 1 (confusion), it is discussed here as a separate element because of the large potential for harm to consumers. When a borrower believes that their payment will be lower than it actually is they are harmed directly by the difference in expected cash outflow (a serious problem for most consumers). Indirectly, borrowers believing that they will have a lower payment may be less

skeptical of other deceptions or misinformation provided to them. For example, a misstatement of a lower rate is much more plausible when accompanied by a misstatement of lower payment.

Further, several consumers complained that they had been deceived by the payment plans offered by HFC representatives. HFC offers two payment plans to their borrowers. A bi-weekly plan in which payments are made every other week, and a bi-monthly plan where half monthly payments are made twice a month. These payment plans are contracted through a document known as the Easy Payment Plus. Due to the faster amortization of the loan under the bi-weekly program consumers can expect to pay back the principal on their loan in a shorter period of time, thereby saving a considerable amount in interest. However, it appears that HFC representatives have sold the benefits of the bi-weekly payment program to borrowers while signing them up for the bi-monthly program. It is obvious that a result of this practice is increased interest earnings to HFC.

The Department has also identified three additional concerns resulting from borrower confusion over the bi-weekly and bi-monthly program:
i) borrowers have been told that by accepting the bi-weekly payment program they can effectively reduce the interest rate on their loan from approximately 14%, down to 7%. The Department has encountered reference to this 14% to 7% statement a number of times and addressed the problem directly with HFC management in mid-2001. HFC informed the Department that the "practice" was isolated to a single branch in Washington and that the matter was not a corporate practice. However, the Department has identified the practice to other branches in Washington and has even received reports from regulators in other states concerning the practice. Contrary to HFC's claims, the Department does not believe the practice is isolated.

While an interest savings will be achieved through the bi-weekly payment program, for HFC to claim that the interest rate can be reduced through use of the program is a false and misleading statement designed to convince borrowers to accept a loan rate in the neighborhood of 14%, disguised as a loan rate of 7%. Further, although apparently sold as a "novel" concept of rapid principal and significant interest deduction by the HFC representatives, there is nothing novel about the payment plan whatsoever.

Bi-weekly programs have been available to consumers for years and instruction can easily be given to a borrower that will achieve the same result without the establishment of a bi-weekly program. While the Department sees certain benefit from a program of quicker principal reduction it is the sales deception employed by HFC that causes concern. When an HFC representative makes an obvious truthful statement ("the bi-weekly payment will reduce the amount of interest you pay") with the intent of selling

a false promise ("therefore your interest rate will be only 7%"), the representative has lied with the truth and caused harm to the consumer.

ii) In some of the complaints reviewed by the Department it was noted that HFC had apparently violated the Easy Pay Plus contract with the borrowers. The agreement signed by the borrowers for the payment program only allows the borrowers themselves to alter terms by contacting the servicing entity, Fort Knox Bank. However, HFC has apparently contacted the Fort Knox Bank and induced it to alter the terms in violation of this contract. In some cases, the result has been direct financial harm to the consumer while resulting in direct financial gain to HFC.

IDENTIFIED PATTERNS IN RECENT COMPLAINT HISTORY continued

iii) The Department has identified in certain complaints that the Easy Pay Plus agreement has been used to confuse borrowers about the monthly amount of payment due. In one complaint, #2489 Lundquist, the borrowers were shown a monthly payment on the Easy Pay Plus agreement that was half of the actual monthly payment. HFC argued that this was a mistake and that regardless of the mistake, the borrowers agreed to pay a larger payment. However, the borrowers make a credible argument that they relied on this "disclosure" of monthly payment in agreeing to accept the loan terms. In the Smart complaint (#2477), the terms of payment on the document were altered after the borrower signed.

5. Prepayment penalty. Consumers complained that they were either unaware of a prepayment penalty or that they were told they did not have a prepayment penalty. However, their loans did contain a prepayment penalty. In the case of Ms. Smart, complaint #2477, the borrower clearly informed the HFC representative that she would not accept a loan with a prepayment penalty, yet the loan closed without her realizing that a prepayment penalty had been included. The Department does not see how such a major element of a loan transaction could be misunderstood by a consumer and believes that it is far more likely that the borrowers were either not told of a prepayment penalty or that they were intentionally misled about the prepayment penalty. Again, the Department's own testing of HFC origination practices appears to support this belief. Specifically, one of the Department's Examiners reported that the loan officer was very smooth in covering parts of certain disclosures while pointing to other information. Practices of this type are not uncommon in the mortgage industry and are used to effectively steer the borrower's attention away from certain sections that would alert them to unwanted terms and conditions.

Even absent any direct deception about the prepayment penalty the disclosure process described by some consumers would result in them being unaware of a prepayment penalty. borrowers have recounted that the signing of documents was a hurried process in which very little if anything contained within the documents was pointed out to them. HFC has repeatedly responded to the Department when questioned about prepayment penalty disclosure that both the TIL and the note clearly disclose the existence of the prepayment penalty. HFC does not, however, state that the borrowers were specifically "told" about the existence of a prepayment penalty. HFC is surely aware that borrowers rely heavily on the "professional" advice of their loan officer rather than comb through the details of dozens of pages of closing documents. Even for borrowers wary enough to do such, identifying a few words among thousands of words is akin to finding a needle in a haystack. While the TIL contains a statement that the loan "may" contain a prepayment penalty a borrower would have to carefully read the document from top to bottom to identify the sentence. Even then, it is not at all clear that the loan "will" contain a prepayment, offering the HFC representative every opportunity to confuse the borrower.

Even less obvious than the TIL disclosure of prepayment penalty is the contractual terms of the prepayment penalty. Here, in the note, the prepayment penalty notice is buried in the middle of several paragraphs of other contractual information. It is preposterous to put forth that the borrowers have ample opportunity, much less the knowledge, to search through a stack of documents looking for this "disclosure," during a hurried and controlled document signing meeting. Just as preposterous is HFC's repeated explanation to the Department that the borrowers could have found the prepayment penalty in the documents and rescinded the transaction within three days following closing. If a borrower has been told that there is no prepayment penalty, or even if the loan officer has simply remained silent about the

existence of the prepayment penalty, there is no reason for the borrower to undertake a search of documents looking for lies or unsaid terms of the loan. It is clear to the Department that HFC has

IDENTIFIED PATTERNS IN RECENT COMPLAINT HISTORY continued

continually relied on the likelihood that a borrower will not undertake such a search, affording the company the opportunity to sneak the prepayment penalty past the point of rescission.

6. Insurance packing: HFC routinely sells insurance products to consumers in conjunction with the loan. Included are credit life, unemployment, disability and accident and health insurance. Insurance packing is discussed in greater depth below, however, the Department notes that several consumers were either unaware that they had insurance products associated with their loans or that they believed that the insurance was "required" in order to obtain the loan. One factor that may be used in determining whether a company has employed aggressive or deceptive insurance sales practices or has required insurance on a loan is the company's rate of insurance penetration (the percent of loans closed with insurance). The Department analyzed HFC's insurance penetration report by branch for Washington loans at the mid-point in 2001 and found that some branches had penetration rates as high as 92% to 100%. As stated under specific complaints analyzed in this report, the Department believes that some of this penetration may have been achieved through actual forgery of borrower signatures on insurance acceptance documents. These insurance products are so costly that is inconceivable that such a high percentage of borrowers would willingly agree to the terms.

7. Upselling loans: The Department found that HFC attempts to provide both a first and second mortgage to borrowers regardless of the borrower's desire or need for two loans. Several complainants claimed that they wanted only a second mortgage, but were talked into a new loan that replaced their existing low cost first mortgage as well as a high cost second mortgage (generally 24.9%). Other borrowers only wanted to refinance a first mortgage, but claim to have been "forced" to accept both the first and the high cost second.

Accompanying the sale of two loans to borrowers was the consistent pattern of convincing the borrowers that the first would be carried at a very low rate (7%) while actually being made at a fairly high rate (11-14%). Most of these first mortgages also carried a significant amount of discount points (generally more than 7 points). Often, the financed discount points alone ate up so much loan principal that the borrowers were forced into the high rate second in order to achieve the financing they sought.

Some borrowers complained that the value of their homes came in far too low. The Department believes that HFC may intentionally direct the appraiser to undervalue the property in order to use up the LTV on the first mortgage, thereby forcing a high rate second of up to 25%.

HFC has consistently responded to these complaint allegations by stating that the borrowers received significant value from the two loans by a restructuring of their existing debt. HFC cites replacement of various high cost debt with HFC debt that delivered benefit to the consumers. The Department has observed or reviewed some of the sales approaches used by HFC representatives to convince borrowers of the benefit derived. The Department is not convinced, however, that HFC representatives hold the expertise or training to be able to make such decisions for borrowers. One technique used by HFC representatives is to identify an existing "blended" rate of debt held by borrowers, which will be replaced by the HFC debt. However, it appears that these representatives conduct an incredibly simplistic analysis of borrower debt structure (a sort of weighted average approach) without considering such factors as term to maturity for individual debts or the borrower's ability to obtain a reasonable closed end second mortgage without replacing their low rate first mortgage.

IDENTIFIED PATTERNS IN RECENT COMPLAINT HISTORY continued

Another argument proffered by HFC is that of monthly cash flow benefit to the borrower. However, better cash flow, which may only be the result of extending maturities, is not necessarily the most beneficial decision for the borrower. Despite HFC's claims of finding benefit for the borrower, the

Department has not seen a single situation in which the borrowers felt that they had any participation in the decision process (Not even the Department's examiner attempting to originate a loan with the Lakewood branch office felt that he had the opportunity to participate in the decisions made for him.) Regardless of whether HFC believes that they have ultimately delivered a better package of products to the borrower, there is no excuse for misleading, deceiving or failing to adequately inform a borrower about their transaction.

HFC's ORIGINATION PRACTICES

Department's Understanding of HFC's Policy and Practice

During the 2001 examination, Department staff inquired of the practices used by HFC to inform borrowers obtaining residential mortgage loans of the rate and expected cost on those loans. HFC explained that after pulling a credit report on the borrower, a Credit Guide Score is developed and the loan is reviewed. The Credit Guide Score determines the rate of interest to be offered to the borrowers. Next the branch representative utilizes a matrix that provides the borrower with a range of discount points that correlate to a range of interest rates. The exact range of points and rates offered are driven by various factors including the Credit Guide Score and the loan to value ratio. The Department understands that the borrowers are never actually shown the matrix of rates and points. HFC claims that borrowers are informed of the lowest and highest possible rates and of a range of points that can be paid to "buydown" or "buyup" the rate. The higher the points paid, the lower the rate obtained. The lower the points paid, the higher the rate obtained.

An example from one of the HFC matrices shows an 80% LTV loan with a start (highest) rate of 14.09% and a discount point range of 0.00% to 7.5%. On a $100,000 loan this discount point range would be $0.00 to $7,500.00. An illustration of the rates that a borrower could buy down given payment of the correlated discount points is:

RATE	POINTS IN $	DISCOUNT AS A % OF LOAN
14.09%	$0	0.0%
13.69%	$1,000	1.0%
13.29%	$2,000	2.0%
12.89%	$3,000	3.0%
12.69%	$3,500	3.5%
12.49%	$4,000	4.0%
12.09%	$5,000	5.0%
11.69%	$6,000	6.0%
11.29%	$7,000	7.0%
11.09%	$7,500	7.5%

HFC claims its practice is to give the borrower verbal information of the highest rate and then provide the borrower with a range of points on a GFE that can be accessed in order to buy down that rate. However, the Department's experience was that little or no information was provided. As discussed below, Department examiners originated loans based on this type of program at two different

Department's Understanding of HFC's Policy and Practice continued

Washington branches of HFC. In neither case were the examiners shown a matrix like the one described above. Nor were the examiner's questions about the program adequately answered, nor were they provided with any documentation or information that would aid them in understanding the buydown options on the offered loan. Only when posing a direct question were they informed of a loan amount or rate and in neither case were they informed that the range of discount fees quoted would be optionally available to buy down the rate. In fact, both examiners left the sales presentation with little or no understanding of the program being offered or the potential rates or cost associated with the program being offered.

The Department has questioned several complaining consumers about whether they knew that their loan could be adjusted by paying discount points. All of the borrowers questioned stated that not only did they not know that the points they were paying were used to buy down the rate, they were never offered the option or informed that the discount points paid at closing would be as high as they were. When the Department referred the borrowers to the initial GFE containing a range of discount points, the answers ranged from statements that the GFE was not received until they were given the package of closing document copies to having been told by the HFC representative to ignore the GFE.

It is clear to the Department that consumer borrowers filing complaints are confused about the loan terms being offered. Rather than informed borrowers offered a choice of programs and costs, HFC appears to intentionally create misinformed borrowers with no real ability to make a choice about the programs and costs. The following two complaint examples aid the Department in making its point:

Complaint #2077, Connell (Note: part of this analysis is restated from above for ease of reading)

The borrowers allege that HFC overcharged them on "points" and when they asked about the points being charged they were told that the amount was the "normal rate charged." The borrowers claim that they were required to take out a second mortgage line of credit in order to cover the costs charged on the first mortgage.

The Department's review of file documents shows that the borrowers were disclosed discount points (line 802 of the GFE) ranging from $6,600.00 to $13,200.00. At closing, the borrowers paid $12,381.53. This amount (equal to 7.25% of the loan amount) was financed by HRC, thereby increasing the loan amount significantly, and apparently requiring the addition of a second mortgage line of credit in the amount of $10,426.00. Although HFC has explained to the Department that the discount points are used to "buy-down" the borrowers' interest rate, there is no evidence that the discount points were used in this way for the Connells. The GFE delivered to the borrowers is dated July 20, 1999. The assumption put forth by HFC is that the borrower would have been offered a specific rate at a specific cost and that the rate could be lowered by increasing the dollar amount of the discount points. However, a review of file documents (application and underwriting review) provided to the Department shows that as late as July 21, 1999, (one day before closing), HFC had identified a rate of 9.29% in the offer of this loan program. The rate given the borrowers at closing, however, was 9.388%. A rate increase, accompanied by discount points closer to the top of the range than the bottom of the range calls into question any correlation between points and rate in this transaction and does not support a claim that discount points were used to buy-down the rate.

Department's Understanding of HFC's Policy and Practice continued

Tom Schneider of HFC provided a written response to the Department on May 18, 2000. In his letter he stated, "Under the provisions of this section [1735f-7a, Title 12, USC], we are allowed to charge points of 7.5%. The points charged on this loan were clearly disclosed on her good

faith estimate, loan agreement, truth in lending disclosure and settlement statement." The Department takes exception with this misstatement by Mr. Schneider. The points charged on this loan were not clearly disclosed on the borrowers' GFE. The borrowers' GFE disclosed discount points over a $6,600.00 range. There is nothing clear about this whatsoever. Further, Mr. Schneider makes reference to a percentage charge of 7.5%. First, no percent format is given to the borrowers on the GFE. Second, no loan amount is disclosed to the borrowers at the time of the GFE. Therefore, it is impossible for the borrowers to even derive an answer of what percent of the loan amount is made up in fees that are disclosed only as dollars.

At closing (two days after the GFE date) the loan amount was $170,779.75. The upper end of the points disclosed on the GFE were equal to 7.73% of the loan amount, not 7.5%. The Department believes that "talking" percentages and "showing" dollars, or in the reverse, "talking" dollars and "showing" percentages, is intentionally confusing to the borrower. There is no evidence in the documents provided

by HFC that the range of discount points disclosed and marketed by the HFC representative were not discussed over a larger loan amount. For example, if the HFC representative had verbally discussed a $181,205 loan amount (the actual amount of loan to the borrowers once the second mortgage is factored in), then the borrowers would believe that the upper range of discount points was 7.28%, not the 7.5% that Schneider argues. The fact that the loan ultimately carried only a 7.25% charge in discount points is no defense for confusing the borrowers at the outset of the transaction. Just as easily, the borrowers could have been left with the impression that their discount points would be only 3.64% based upon the lowest amount of discount points disclosed on the GFE. Again, despite the claims of clarity, the disclosures in this transaction were anything but clear.

A second mortgage line of credit in the amount of $10,426.00 was taken out by the borrowers with HFC at the same time the first mortgage was made by HRC. HFC failed to provide the Department with any information relative to this loan despite requests made by the Department on May 11, 2000 (complaint #2077) and May 17, 2000 (complaint #2092). The Department reiterated its request for this information by subpoena on February 22, 2002. To date, HFC has provided no response relative to the second mortgage. Pursuant to Regulation Z, §226.5b: Requirements for Home Equity Plans, a specific disclosure must be provided to the borrower at the time an application is provided to the borrower. HFC's origination practices do not include providing an application to the borrower, rather they take application information for all loans at a single point in time, and this point in time should be considered the triggering date for the disclosures required under this section. There is no evidence that HFC provided the borrowers the disclosure as required.

In an attempt to determine how this loan could have been made to the borrowers, the Department looked to the application form dated July 19, 1999. Here the contemplated loan amount is shown as $165,000. The HUD1 reflects that the borrowers needed approximately $158,008 to satisfy the purpose of the refinance. Were the borrowers charged the lower range of disclosed discount points ($6,600), plus the third-party costs in the transaction, the loan amount would have been $164,981, only $19 different than that shown on the application. However, the borrowers do not appear to have been given the option of paying lower discount points resulting in a lower loan amount. Further, had the borrowers been given the option of no discount points (based on HFC's description of the program this should have been an option), it appears that they would not have needed the higher rate second mortgage they were required

to take out in order to pay off underlying liens and other debts. The borrowers were so disgruntled at the idea of acquiring a second mortgage (whose only purpose appears to be to pay fees) that it would be ridiculous to argue that the borrowers "chose" this discount point structure.

It is the intentionally confusing disclosure process that so concerns the Department. Simple and clear disclosure could easily be made to borrowers at the time of the initial GFE. If HFC believes that it will likely charge 7.25% in discount points at closing, it should show 7.25% on the GFE (and while not required under Regulation X, provide the borrower with a disclosed loan amount corresponding to the percentage as well). HFC's argument that it is more accurate to disclose the possible range is disingenuous. A review of loan files reflects that nearly all of the borrowers ultimately paid 7.25% in discount points at closing (the upper end of the range). Obviously HFC has sufficient history and knowledge of its own pricing to be clear and direct on the initial GFE.

HFC has created a situation in which they can completely mislead and confuse the borrower, while later providing a plausible explanation of their actions to the Department or other regulatory agencies. However, the purpose of initial disclosures is not so that the lender can provide justification for the amounts ultimately charged. The purpose of initial disclosures is to clearly provide the consumer with meaningful information from which they can make an informed decision. As evidenced by repeated borrower claims of misrepresentation and confusion, HFC practices reflect a pattern of intentional deception while laying the foundation for a later defense.

Complaint #2224, Dodge

The borrowers complain that rather than receiving the single loan that was originally offered to them, they received a first and second mortgage which has left them paying one and half times the amount of

monthly payments they previously were making. The borrowers also complain that they were unaware of the high fees paid on the first mortgage or the existence of a prepayment penalty. In its complaint resolution the Department challenged HFC's compliance with the Real Estate Settlement Procedures Act in providing the GFE. Tom Schneider of HFC responded in a letter to the Department on November 22, 2000, stating, "In response to your RESPA claims regarding the Good Faith Estimate (GFE), RESPA allows a lender to provide a range of fees. The range is meaningful in that depending on the rate the customer desires, they may pay from 0 to 7 _ discount points, which equates to a certain dollar amount. However, often customers decide they want a lower rate (i.e. increased points) or more money, which will change the amount charged. The safe harbor GFE as provided in Reg. X specifically disclosed that 'fees are estimates and actual charges may be more or less.' Our form clearly discloses the same language that fees are estimates and the actual charge may be more or less dependent upon the transaction, and that the HUD-1 or HUD –1A settlement statement will show the actual costs of the items paid at settlement. Therefore, our GFE is in full compliance with requirements of RESPA and Regulation X."

Department's Understanding of HFC's Policy and Practice continued

The pertinent sections under Regulation X to RESPA referenced by Mr. Schneider are:

§3500.7: Good Faith Estimate (04/01/97)

> (a)Lender to provide. Except as provided in this paragraph (a) or paragraph (f) of this section, the lender shall provide all applicants for a federally related mortgage loan with a good faith estimate of the amount of or range of charges for the specific settlement services the borrower is likely to incur in connection with the settlement. The lender shall provide the good faith estimate required under this section (a suggested format is set forth in Appendix C of this part) either by delivering the good faith estimate or by placing it in the mail to the loan applicant, not later than three business days after the application is received or prepared.
>
> (c)Content of good faith estimate. A good faith estimate consists of an estimate, as a dollar amount or range, of each charge which:
>
> > (1)Will be listed in section L of the HUD-1 or HUD-1A in accordance with the instructions set forth in Appendix A to this part; and
> > (2)That the borrower will normally pay or incur at or before settlement based upon common practice in the locality of the mortgaged property. Each such estimate must be made in good faith and bear a reasonable relationship to the charge a borrower is likely to be required to pay at settlement, and must be based upon experience in the locality of the mortgaged property. As to each charge with respect to which the lender requires a particular settlement service provider to be used, the lender shall make its estimate based upon the lender's knowledge of the amounts charged by such provider.

The Department takes exception with Mr. Schneider's statement as follows:

1. "RESPA allows a lender to provide a range of fees." While the regulation does refer to a "range" being used it clearly was not contemplated under the regulation that a range would be used in an abusive manner. §3500.7(c) clarifies that the range is the "estimate" of the cost to be incurred. Used in this manner, an "estimate" means "to form an approximate judgment or opinion regarding the value"[5] of the settlement service. However, the regulation first instructs "a dollar amount" of each charge and follows with "or range." Lacking any further clarification, and understanding the purpose and construct of the

[5] Random House College Dictionary

GFE, the Department firmly believes that whenever known, the lender should use the actual charge contemplated. The Department further believes that a "range" is acceptable only when the cost is not known by the lender (e.g. independent third-party charges), and that when a range is used, it is more appropriate to simply disclose the upper end of the range rather than a spread between two points.

2. "The range is meaningful in that depending on the rate the customer desires, they may pay from 0 to 7 _ discount points, which equates to a certain dollar amount." The Department counters that a range has the potential to be meaningful, however, used as HFC does, it is meaningless. For example, the lender knows that appraisals within a given area are priced at a low of $400 and a high of $550. It would be quite appropriate and meaningful for the lender to disclose to the borrower that the appraisal could "range" up to $550. Likewise, if the lender charges points between 0% and 7.5%, it is appropriate and more meaningful to inform the borrower that the fee "ranges" up to 7.5% and/or the corresponding dollar amount.[6]

Department's Understanding of HFC's Policy and Practice continued

In the case of HFC, however, the lender has knowledge of what it intends to charge. To disclose anything else is nothing more than a pretense. As discussed, the Department's review shows that HFC consistently charges 7.25% or more in discount points. This consistency is born out in a review of complaint transactions filed with the Department; however, the Department conducted further analysis of discount points charged Washington borrowers in 259 loans made in the month of May 2001.[7] The results of this analysis are as follows:

Discount Points Charged	# of Loans	% of Total Loans
1% or less	11	5%
6% or less	5	1%
7% or less	16	6%
> 7%	225	88%

(Note 127 loans at 7.25% and 97 loans at 7.4%)

To argue that a "range" should be disclosed in the rare event that a lower amount of points may occur, is a mendacious use of its control over the disclosure process. The most meaningful information that can be provided to a borrower is the most accurate. Further, in all lending transactions, the borrower needs to know the highest cost they can expect to pay, not the lowest. There is a general concept in regulatory disclosure that a borrower is not harmed by "over-disclosure." The danger clearly lies in under-disclosure, especially of costs in a financial transaction.

Supporting the Department's position is that, "Each such estimate must be made in good faith and bear a reasonable relationship to the charge a borrower is likely to be required to pay at settlement," and this good faith disclosure is made based upon the lenders "experience" and "knowledge." If the lender "knows" what they are likely to charge the borrower (i.e., 7.25% or higher in discount points), and has actual "experience" of charging this, then disclosing anything else cannot be an act of good faith. Further, a range of $0 - $10,000 for example does not "bear a reasonable relationship to the charge a borrower is likely to be required to pay at settlement," especially when the borrower consistently ends up paying $10,000 at settlement.

3. "[O]ften customers decide they want a lower rate (i.e. increased points) or more money which will change the amount charged." The Department has not reviewed a single complaint filed against HFC where the borrower was aware that a trade-off was available between rates and points. Neither was this fact made known to the Department's examiners who originated loans at HFC branch offices. Consistently, borrowers complain that they did not understand why the points were so high on their loan. If borrowers were actually making the choice Mr. Schneider claims, it is unlikely they would be surprised and so hotly contest the charge that they themselves chose. It is more realistic to assume that

[6] As discussed previously, the percent disclosure is only meaningful to the borrower if they are also informed at the same time of the proposed loan amount against which the percent will be applied.

[7] Loan terms for the month of May 2001 were selected and provided to the Department by HFC during the 2001 examination.

the borrowers' confusion lies in the fact that they have been shown the lowest end of the discount points along with the highest, without any explanation of how the range might work for or against them. Even more likely is the possibility that a loan officer, with financial incentive to sell the largest loan possible, will stress the availability of the lower end of the cost to deceive the borrower while submitting the loan to headquarters with the borrower's "choice" being the highest cost. Still another plausible explanation is that the borrower never even sees a GFE and knows nothing of costs except what is charged at closing (note that this possibility actual existed in some complaint files).

Department's Understanding of HFC's Policy and Practice continued

The second half of Mr. Schneider's statement, "or more money which will change the amount charged," also appears disingenuous. The Department's review of loan files does not show an increase in loan amount by borrower choice. As explained in this complaint and the Connell complaint above, the increase in the loan amount (or addition of a second mortgage) appears to be entirely out of the control of the borrower. Increased loan amounts appear to be more often a function of HFC financing the upper end of the discount points disclosed. This determination is born out by HFC's own analysis provided to the Department on three complaint files:

Borrower	Loan Applied For	Amount of Loan	Amount w/o Disc. Points
Brown	$130,000	$144,689	$134,199
Connell	$165,000	$170,780	$158,398
Johnston	$169,000	$182,485	$169,255

In the case of the Browns, the loan amount increased "benefiting" the borrowers by $4,000; however, the bulk of the nearly $15,000 increase was discount points to HFC. In the case of the Connells, the loan amount they needed was actually only $158,398; however, over $12,000 in discount points to HFC is what drove the loan amount up. In the case of the Johnstons, the loan amount increased "benefiting" the borrowers by only $255; however over $13,000 in discount points to HFC dramatically increased the amount they borrowed.

4. "The safe harbor GFE as provided in Reg. X specifically disclosed that 'fees are estimates and actual charges maybe more or less.' Our form clearly discloses the same language that fees are estimates and the actual charge may be more or less dependent upon the transaction, and that the HUD-1 or HUD-1A settlement statement will show the actual costs of the items paid at settlement. Therefore, our GFE is in full compliance with requirements of RESPA and Regulation X." The Department is unaware of any identification of a GFE "safe harbor" made by HUD. In fact, the regulation simply states "a suggested format is set forth in Appendix C of this part." The use of a suggested form does not in itself provide a safe harbor, especially if the form is used in an abusive manner. Making such an argument is akin to saying that as long as a suggested blank disclosure form is utilized, the lender is not responsible for what they put into that disclosure form.

The Department challenged HFC's "safe harbor" argument in early 2001. At that time the Department was told that HFC had obtained its safe harbor exemption directly from the Office of Housing and Urban Development (HUD). The Department queried HUD about any such exemption and found that none had been given to any lender. The Department then asked HFC to produce a copy of the safe harbor exemption and was told that it was their staff of attorneys that had researched the issue and determined that the safe harbor existed. When the Department insisted on seeing the staff attorneys' legal research and written opinion on this, the Department was told by HFC that in reality, one attorney had made such a determination and there in fact was no written documentation to support the claim. Still, Mr. Schneider and other officers from his staff continue to claim that such a safe harbor exists.

The GFE form used by HFC includes the statement, "These fees are estimates; the actual charges may be more or less." HFC frequently discloses its discount point range beginning with zero. There is absolutely little meaningful information in disclosing zero or any other amount when there is no intent to

charge that amount. Even so, stating that "the actual charges may be . . . less" than zero (or a low amount that is never charged) has zero meaning to the borrower. In fact, it is simply a false statement altogether, and the Department cannot fathom a false statement, especially on a government suggested form, providing a "safe harbor."

Department's Understanding of HFC's Policy and Practice continued

Finally, the regulation at §3500.7(c) directs the lender to follow the instructions for completing the HUD-1 under Appendix A, when completing the GFE. Appendix A advises, "Line 802 is used to record the loan discount or 'points' charged by the Lender, and, if it is computed as a percentage of the loan amount, enter the percentage in the blank indicated." HFC has explained that the dollar amounts disclosed on the GFE, line 802, are to be considered percentages corresponding to loan amount and a specific buydown matrix. If so, then the instructions under Appendix A should be followed and HFC should tell borrowers what percent they will pay. However, the Department has not seen a single GFE in which HFC has referenced line 802 in a percentage format, and without disclosure of a loan amount there is no way for the borrower to derive a percentage to be charged. Again, HFC's "percent" argument appears to be an after the fact justification rather than a means of disclosure to the borrower.

Department's Experience With HFC Branches in Washington

In August 2001, the Department directed three financial examiners to originate residential real estate loans with HFC representatives. The purpose of this testing of HFC's origination practices at its branches was: i) To determine whether HFC representatives intentionally misrepresented or withheld loan information from the borrower, ii) To determine whether HFC was in compliance with laws and regulations, and iii) To determine if the corporate policy and practices explained to the Department during the examination were followed at the branch level.

In all three tests the Department found that HFC representatives misrepresented or withheld information, failed to comply with state and federal law and regulations, and did not follow the policy and practice that HFC corporate claimed. The examiner experience is discussed for each branch:

Bellingham Branch

Loan originated on August 10, 2001. No disclosures were received until August 23, 2001. Although disclosures were backdated to August 16, it is apparent to the Department (based upon the 8/21 postmark) that the disclosure documents were not placed in the mail until at least ten days after the date of the application.

The GFE contained a range of discount points from $5,200 to $8,400. At no time did the three HFC representatives serving the examiner offer any explanation of the range, or that discount points could be used to raise or lower the rate. On August 22, 2001, the examiner directly inquired about the rate that would be offered, which to this time had not been addressed by any representative. The examiner was told that rate information should be contained in the disclosures (yet to be received). When pressed, the representative stated a rate that was identified as the "lowest" rate available on first mortgages, but the representative was careful not to address a rate that would be offered to this borrower. When asked about the costs, the examiner was told "the amount is determined by loan amount and value so we have to quote a range." The examiner was not told what the actual range would be or what costs would be given as a range. The disclosures subsequently received did not contain any information regarding the rate or the loan amount proposed. In a fourth contact, the examiner was informed that the only way to provide financing was to add a second mortgage onto the first. At no time did the examiner request, apply for or consent to a second mortgage. A second packet of disclosures arrived containing a GFE with a discount point range from $500 to $2,500. In neither loan was a loan amount disclosed to the examiner, making it impossible, other than through guesswork, which disclosure applied to which loan.

Department's Experience With HFC Branches in Washington continued

Of additional note in this transaction is that the examiner solicited business from the Bellingham branch office of Household Finance Corporation III. The examiner saw only signage relative to Household

Finance Corporation. No mention was made to the examiner by any of the branch representatives that at any time he would be dealing with any company other than Household Finance Corporation III. The first set of disclosures, however, identified Household Realty Corporation as the lender. The disclosure envelope identified the address as the branch, but did not identify a company name. These disclosures contained a list of required service providers, but did not contain an Affiliated Business Arrangement Disclosure between Household Finance Corporation III and Household Realty Corporation. The second set of disclosures identified the lender as Household Finance Corporation III. Again, these disclosures did not contain an Affiliated Business Arrangement Disclosure. At all times, the HFC personnel represented themselves as HFC. It is apparent to the Department that a referral from Household Finance Corporation III to Household Realty Corporation and/or vice versa, took place in these transactions.

Approximately two weeks later the examiner received two credit denial notices from the Bellingham branch. Neither disclosure provided information that would allow the examiner to determine which loan was being referenced on which document. Both notices identified the lender as "HOUSEHOLD FINANCE AND SUBIDIARIES A Household International Company." This was yet a third company for which there had been no discussion, identification or Affiliated Business Arrangement Disclosure.

Lakewood Branch

Loan originated on August 28, 2001. No disclosures were received until September 5, 2001. Although disclosures were backdated to August 29, it is apparent to the Department (based upon the 9/4 postmark) that the disclosure documents were not placed in the mail until at least seven days after the date of the application.

The GFE received on September 5 contained a range of discount points from $0 to $4,000, but did not contain a loan amount. The amount of loan the examiner applied for was $40,000. Based on this amount, the $4,000 discount points would equate to 10% if paid out of pocket and 9% if financed into the loan. To date, HFC has identified the upper end of its discount point range at 7.5%, which would equate to $3,000 in fees. If the fees disclosed were calculated upon a 7.5% basis, then the loan amount would equate to $53,333. Not only is this an odd loan amount, it bears no resemblance to any figure contemplated by the examiner.

On September 13, the examiner met with a Lakewood branch loan officer to discuss financing. The examiner reports that at this meeting he was presented with terms for a $100,000 loan with over $8,000 in discount points. The loan officer proceeded to discuss the benefits of the loan with the examiner by using a document formatted like a HUD-1 closing statement. The examiner reports, however, that the loan officer carefully kept another piece of paper over the cost side of the disclosure document while directing his attention to the items the proceeds would be used for.

The examiner stressed to the loan officer that he was not interested in a $100,000 loan and the loan officer switched the sales presentation to a previously prepared $50,000 loan. Again, the loan officer placed a sheet of paper over the cost side of the disclosure and directed the examiner's attention to the items to be paid with the loan proceeds. At this point the examiner noted a payment for insurance for over $4,000, and challenged the loan officer on this item. The loan officer informed the examiner that insurance was included in the loan for his protection. The examiner stated that he had not requested insurance and the loan officer told him that it was optional and could be removed. The examiner states

that he is confident that the loan officer had no intention of pointing out the insurance and had the examiner not asked, it would have simply been included in the loan amount.

The loan officer informed the examiner that the loan would be paid off in 17 years. The examiner asked if the loan was on a 17 year amortization and at this point the loan officer informed the examiner that he could sign up for a bi-weekly program that would accelerate the amortization to 17 years.

At no time did the HFC representative offer any explanation of the range shown on the GFE, or that discount points could be used to raise or lower the rate. The examiner reports that he asked the loan officer why the cost he was shown on the GFE was different than the costs he would pay on this loan.

The loan officer responded, "Those papers are just garbage. Those are just a bunch of RESPA papers that the federal government requires us to send you but they don't mean anything." The examiner states that he had to press the loan officer to determine what rates were even being discussed. When the examiner was told the rate he was not provided with a corresponding annual percentage rate (APR). The examiner asked if he might see the credit documentation upon which his financial decisions were being based. The loan officer responded that the examiner was not allowed to see his credit report. The examiner informed the loan officer that he would have to discuss the offered terms with his wife and requested that he be provided with copies of the disclosure documents they had been reviewing. The loan officer informed the examiner that he was not allowed to have copies of the documents they had been reviewing; but that he could bring his wife back and the loan officer would explain them again.

As noted in the Bellingham transaction above, the examiner applied for the loan at a Household Finance Corporation III branch office. However, the disclosures received in the transaction came only from Household Realty Corporation. It is apparent to the Department that the examiner's loan transaction was referred from Household Finance Corporation III to Household Realty Corporation. No Affiliated Business Arrangement disclosure was provided for this referral of business.

Olympia Branch

Loan originated on August 23, 2001. No disclosures were ever received.

Clear, Conspicuous and Segregated Disclosures

Several borrowers raised the issue of being confused about the interest rate. As discussed in the Bley complaint, HFC intentionally presents the borrower with disclosure information that is neither clear nor conspicuous and certainly not "segregated." This situation occurs in conjunction with the sale of the E-Z Pay Plus program and attempts by HFC representatives to convince borrowers that they will have a loan with an effective rate of 7.0%, rather than the actual contract rate to be offered. By showing the "Amount Financed" as the "Loan Amount" on the disclosure the borrower is led to believe that the Amount Financed is the Loan Amount. Such a practice holds the ability to deceive the borrower about the amount of loan they are transacting for. In fact, inclusion of certain material TIL disclosures on the E-Z Pay Plus disclosure is a deceptive practice in violation of Regulation Z.

In the Luna complaint, #2751, the Department reviewed an Amortization Schedule Summary E-Z Pay Plus with Pay Right Rewards, and found that the schedule presented rates and APRs that hold no significance for the loan to be given. The borrowers claim that these schedules were used to convince them that the loan would be made at a 6.99% rate. In its response, HFC stated, "In explaining the potential savings, amortization schedules were employed to show the comparison by illustrating the

Clear, Conspicuous and Segregated Disclosures continued

difference in, and potential savings of, an 18-year loan at 12.690% over a 30-year loan at 6.99%. This was done for demonstration purposes only, and was not intended to imply or establish that the interest rate on the loan Mr. and Mrs. Luna were considering purchasing was 6.99%."

Regardless of what HFC was demonstrating or not implying, one thing is obvious; HFC did not provide either of these borrowers with clear and conspicuous disclosures that were segregated as required under Regulation Z.

> Pursuant to Regulation Z, §226.17(a)(1), The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. **The disclosures shall be grouped together, shall be segregated from everything else, and shall**

not contain any information not directly related to the disclosures required under §226.18. [Emphasis added]

The Official Staff Interpretations at Supplement I, §226.17, makes this requirement unambiguous:
Paragraph 17(a)(1).
1.Clear and conspicuous. This standard requires that disclosures be in a reasonably understandable form. For example, while the regulation requires no mathematical progression or format, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other. In addition, although no minimum type size is mandated, the disclosures must be legible, whether typewritten, handwritten, or printed by computer.
2.Segregation of disclosures. The disclosures may be grouped together and segregated from other information in a variety of ways. For example, the disclosures may appear on a separate sheet of paper or may be set off from other information on the contract or other documents:

- By outlining them in a box
- By bold print dividing lines
- By a different color background
- By a different type style

In the documents reviewed by the Department, there was no attempt to make certain TIL information clear and conspicuous, or to segregate the disclosures as required above. As discussed throughout this report, the Department has received several complaints and other information alleging that HFC representatives inform borrowers that their loan will carry a 7% rate when it actually carries a much higher rate. HFC has provided various responses to the Department ranging from statements that the borrowers were mistaken to claims that the practice is isolated to a single branch in Washington. The Department believes these responses to be disingenuous, however.

As the Bley and Luna complaints show, HFC used less than clear and conspicuous and unsegregated disclosures from two branches quite remote from each other (Spokane and Bellingham). The 7% "equivalent rate" scenario has been alleged to occur in several branches in Washington and multiple locations in the country. It is inconceivable that borrowers from remotely different locations could all be confused about exactly the same thing in the same way, or that HFC could somehow believe that the occurrence was isolated to a single branch location. The Department believes that the "equivalent rate" sham proffered by HFC representatives is known and likely fostered by the corporation itself or at the least, by corporate officers overseeing large segments of the country. This belief appears to be supported by HFC headquarters' knowledge of the disclosures and sales practices when responding to complaints.

Clear, Conspicuous and Segregated Disclosures continued

In his response letter to the Johnston complaint (#2382), Mr. Schneider clearly indicates that HFC is aware of representatives disclosing an "equivalent rate" of 7%. Yet this complaint, filed in December 2000, was neither the first nor the last complaint concerning the 7% rate scenario that HFC responded to.

Disclosures for Lines of Credit Under TILA

Specific disclosures are required to be made in conjunction with open-end home equity plans secured by the consumer's dwelling (see Regulation Z §226.5). The disclosure requirements are applicable to HFC's second mortgage home equity lines of credit made to Washington borrowers.[8] While the Department has not identified deficiencies in the content of the disclosures made by HFC, it does find that HFC is in apparent violation of Regulation Z §226.5b(2)(b), Time of Disclosures. Pursuant to this section, the disclosures and brochure required by paragraphs (d) and (e) of this section shall be provided at the time an application is provided to the consumer. Footnote 10a to this section explains, The

[8] Complicating this issue is whether HFC's home equity lines of credit are truly open end loans or whether they are closed end loans disguised as open end loans. This matter is discussed in greater depth under the "SPURIOUS" HOME EQUITY LINES OF CREDIT section of this report below.

disclosures and the brochure may be delivered or placed in the mail not later than three business days following receipt of a consumer's application in the case of applications contained in magazines or other publications, or when the application is received by telephone or through an intermediary agent or broker.

In complaints filed with the Department, HFC was requested to produce all disclosures provided to the borrower. HFC's production fails to show that many of the borrowers were provided with the disclosure documents under this section. Other response productions show that the disclosures were provided, but not until the time of closing or signing of the loan. In many instances, the Department was able to identify that HFC had taken application information well before the date of signing. While HFC's application procedures do not include an application that is "provided" to the consumer, the only logical interpretation of this section is that the disclosure requirement is triggered at least when HFC is in receipt of an application from a borrower.

Pursuant to Regulation X §3500.2(b), "application" means, the submission of a borrower's financial information in anticipation of a credit decision, whether written or computer-generated, relating to a federally related mortgage loan. If the submission does not state or identify a specific property, the submission is an application for a prequalification and not an application for a federally related mortgage loan under this part. The subsequent addition of an identified property to the submission converts the submission to an application for a federally related mortgage loan.

It is apparent to the Department that HFC has a practice of failing to make the material disclosures as required pursuant to §226.5b. Pursuant to §226.15, if the required notice and material disclosures are not delivered, the right to rescind shall expire three years after the occurrence giving rise to the right of rescission, or upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first.

"Spurious" Home Equity Lines of Credit

Regulation Z and the Staff Commentary to TILA define open-end credit as consumer credit extended by a creditor under a plan in which:

1. The creditor reasonably contemplates repeated transactions;
2. The creditor may impose a finance charge from time to time on an unpaid balance; and
3. The amount of credit that may be extended to the consumer during the term of the plan is generally made available to the extent that any outstanding balance is repaid.

All three of these characteristics are criteria that must by present for the loan to be considered open-end.

"Reasonably contemplates" repeat transactions means that the creditor must expect there to be repeat business against the line of credit. A single use of the credit line, with no contemplation of repeated transactions is not open-end credit. For example, a large amount of credit for a single use or purchase (e.g. one time pay down of debt, or funds to improve a home) is not a contemplation of repeated transactions.

The plan must allow for the imposition of a finance charge from time to time. There is no requirement, however, that the finance charge be actually imposed. Rather, the contract must allow for the imposition. If the finance charge is precomputed at the inception of the transaction, it is not an open-end credit transaction.

The third criteria is that the open-end credit be a reusable line without specific approval at each reuse. In other words, the line must be self-replenishing.

The Department is concerned that HFC's home equity lines of credit may actually be "spurious" or sham lines of credit, labeled as open end to avoid disclosure requirements and certain prohibitions under the Home Ownership and Equity Protection Act (HOEPA), the TIL disclosure for closed-end credit, and the early disclosure requirements under RESPA. Again, open-end credit must meet all three of the criteria listed above. In reviewing the home equity lines of credit in each of the complaint files in which this type of loan was present, the Department found:

1. That the loans were generally made for a single purpose. Primarily, this purpose was to fulfill the borrowers' desired financing needs where the first mortgage fell short. As discussed previously in this report, the shortfall in the first loan was frequently the result of large fees financed into the loan thereby eating up the available credit or an artificially low appraised value on the home.

2. The loans were usually funded at or even above the full amount of credit insuring that the lines were effectively unusable after the first disbursement. An example of this is provided below. The table shown is an excerpt of an amortization schedule produced by a mathematician for an HFC home equity line of credit for $10,000. The higher principal balance reflects financed fees and the amortization includes the addition of a $50.00 annual fee for the use of the line of credit. The table shows that normal payment reduction of the loan moves so slowly that the loan could not be used as a line of credit as intended.

"Spurious" Home Equity Lines of Credit continued

Principal balance of $10,434.00 (balances include annual credit line fee)

YEAR	AMORTIZATION
2001	$10,340.48
2002	10,297.35
2003	10,254.61
2004	10,212.25
2005	10,170.27
2006	10,128.67
2007	10,087.44
2008	10,046.58
2009	10,006.08
2010	9,965.95
2011	9,886.76
2012	9,847.70
2013	9,808.99
2015	9,770.62

After 15 years, the balance on this loan has only decrease by $569.86, making the loan's use as a line of credit impossible without significant additional principal reductions. Although not shown in the table above, the cost to the borrower for the one time use of this $10,000 line of credit over the 15 years is $48,904.37.

Pursuant to Regulation Z, §226.34(b) Prohibited acts or practices for dwelling-secured loans; open-end credit. In connection with credit secured by the consumer's dwelling that does not meet the definition in §226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of §226.32.

Pursuant to §3500.7(f) Open-end lines of credit (home equity plans) under Truth in Lending Act. In the case of a federally related mortgage loan involving an open-end line of credit (home equity plan) covered under the Truth in Lending Act and Regulation Z, a lender or mortgage broker that provides the borrower with the disclosures required by 12 CFR 226.5b of Regulation

Z at the time the borrower applies for such loan shall be deemed to satisfy the requirements of this section. In other words, no GFE is required on loans that meet the definition of open-end lines of credit. In most cases, the home equity line of credit loans made by HFC were made to borrowers without the provision of a GFE detailing the actual costs to be incurred. Instead, the borrowers were provided with the Regulation Z disclosures under §226.5b at or about the time of closing when it was too late for the disclosures to offer much useful information. Many of the complainants claim that they were completely unaware of the inclusion of a home equity line of credit in their financings until the time of closing. By making a closed-end loan appear as if it were an open-end loan, HFC avoids this very important early disclosure.

Insurance Packing

The Complaint History section of this report details borrower complaints concerning inclusion of insurance that they did not desire. As discussed in the Dodge (#2224), Brooks (#2530), and Cabral (#2505) complaints, the Department believes that HFC representatives may have actually forged borrower signatures making it appear as if the borrowers had requested insurance when they had not. In complaint #2715, Ms. Byington states that she believed the insurance she was taking out was a "required" part of the transaction. Further, in the Cabral (#2505) and Pemberton (#2872) complaints, the borrowers clearly did not want the insurance products, but unknowingly closed on loans that contained insurance.

Again, it is apparent to the Department that HFC consistently attempts to "require" insurance on their products by "slipping" the insurance past the borrower whenever possible. The Department believes that HFC's employee compensation program provides incentive for its representatives to include insurance on a borrower's loan, despite a borrower's wish or need, and avoid the borrower learning of the inclusion.

Federal Regulation

Pursuant to Regulation Z §226.4(b)(7), premiums or other charges for credit life, accident, health, or loss-of-income insurance, written in connection with a credit transaction, must be included in the finance charge. However, Pursuant to §226.4(d)(1), voluntary credit insurance premiums: Premiums for credit life, accident, health or loss-of-income insurance may be excluded from the finance charge if the following conditions are met:

(i)The insurance coverage is not required by the creditor, and this fact is disclosed in writing.

(ii)The premium for the initial term of insurance coverage is disclosed. If the term of insurance is less than the term of the transaction, the term of insurance also shall be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under §226.17(g), and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

(iii)The consumer signs or initials an affirmative written request for the insurance after receiving the disclosures specified in this paragraph. Any consumer in the transaction may sign or initial the request.

While the HFC disclosures contain the requirements listed above, the regulation clearly assumes that the borrowers saw the disclosures so that they would either be aware of the inclusion, and/or request the inclusion. However, it is apparent that in some complaints, the borrowers made it clear that they did not want insurance and still had it "slipped" passed them.

Providing clarification of optional versus required insurance is Part 226, Supplement I: Official Staff Interpretations at §226.4(d)5, required credit life insurance. This section states that credit life, accident, health, or loss-of-income insurance must be voluntary in order for the premium or charges to be

excluded from the finance charge. **Whether the insurance is in fact required or optional is a factual question. If the insurance is required, the premiums must be included in the finance charge.** [emphasis added]

Insurance Packing continued

Two issues and concerns have been raised by the Department here:

1. Borrower signatures forged on an "affirmative written request for insurance."

2. Borrowers led to believe that insurance was required to obtain the loan. The Department does not see how a borrower would come to such an understanding on their own. This "belief" by the borrower transcends any written disclosure by HFC that the insurance was optional.

In situation 1 above, borrowers are effectively "required" to transact for insurance by never having the option to decline the insurance. In situation 2 above, borrowers are effectively "required" to transact for insurance by being led to believe that they have no choice or option to refuse insurance. As stated in the Official Staff Interpretation to §226.4(d), "Whether the insurance is in fact required or optional is a factual question." Whether or not the borrower accepted insurance through an unknown forged document or accepted it because they were led to believe that they had no choice, the fact is that the insurance was effectively "required."

In either of these situations, if insurance is required, the premiums must be included in the finance charge. However, HFC does not include the insurance premium in the finance charge in any of its transactions. The effects of a failure to make material disclosures for either open-end (§226.15) or closed-end (§226.23) loans is an extended right of rescission expiring three years after the occurrence of the event giving rise to the right, or the date of consummation, respectively.

<u>State Law</u>

The discussion of insurance packing above revolves around the requirements under federal regulation. However, Washington law clearly disallows any requirement of credit life insurance in the making of a loan. Pursuant to RCW 31.04.125(4), the lender may not require any credit life insurance.

Insurance Penetration Rates Support "Requirement" Theory

In determining whether requiring insurance or hiding insurance is a practice, regulators may look to a company's rate of penetration of certain insurance products. The penetration rate is simply the percentage of loans made containing insurance. A review of HFC's penetration rates for the year to date as of July 1, 2001 shows the following for all loans and real estate loans:

Insurance Packing continued

BRANCHPENETRATION RATES AS A PERCENT OF LOANS

All loans/All insuranceRE loans/Credit life only
Kennewick 81%74%
Vancouver 65%60%
Yakima 66%75%
Burien 83%89%
Bellingham 87%92%
Bellevue 54%58%
Everett 52%37%
Federal Way 94%94%
Lynnwood 66%71%
Puyallup 49%61%
Renton 36%61%
Seattle 67%75%
Edmonds 55%53%
Vancouver (McLoughlin)100%100%
Olympia 57%44%
Tacoma 53%74%
Lakewood 64%56%
Vancouver (Parkway) 77% 69%

Of note is the Bellingham office where 87% of all loans contained some insurance and 92% of real estate loans contained credit life insurance. Bellingham customers Fenton (#2460) and Lundquist (#2489) stated that they believed the credit life insurance was required in order to obtain their loans, while the Dodges (#2508) had communicated they did not want the insurance, and the Cabrals (#2505) claim that their signatures were forged on the insurance acceptance disclosure.

While there are no established benchmarks for acceptable penetration rates, it is hard to believe that such a high percentage of consumers would request to have $4,000 to $5,000 in insurance premiums added to their loan, or agree to pay significant monthly premiums for non-financed insurance.

Steering or Controlling Borrowers to Maximize Revenue

Consumers have complained to the Department that their financing needs were to obtain a second mortgage loan. However, HFC representatives proceeded to convince the borrowers to take out a large first mortgage rather than the second mortgage, and in many cases a large first mortgage in addition to a second mortgage. Consumers have also complained that at closing they were "required" to take out a second mortgage in the form of a line of credit in order to obtain the loan for which they were applying.

In the case of complaint #2077, the Connells claimed that they were required to take out a second mortgage line of credit in order to cover the costs charged on the first mortgage. In the case of complaint #2224, the Dodges claimed that rather than receiving the single loan that was originally offered to them, they received a first and second mortgage which has left them paying one and a half times the amount of monthly payments they previously were making. It is apparent to the Department that HFC is concerned more with creating the largest amount of loan possible rather than whether the loan is a sound financing decision for the borrower.

Steering or Controlling Borrowers to Maximize Revenue continued

The Department's belief that HFC attempts to create the largest amount of loan possible regardless of whether the loan is a benefit to the consumer is emphasized by the Department's origination experience with the Lakewood branch where the examiner was solicited for a $100,000 loan, when the examiner was clear that what he wanted was a $40,000 loan. The examiner has related that the HFC representative used a variety of financial arguments to convince him to take the $100,000 loan, which certainly would

not have been to his benefit. Had the examiner been an untrained consumer rather than a mortgage enforcement specialist that understood the intricacies of financial transactions, economics and tax consequences, the result may have been an unfavorable $100,000 transaction with HFC.

It is apparent to the Department that in at least some, if not many, transactions, the borrowers did not "apply" for a second mortgage and did not desire a second mortgage, but at closing were faced with only one financing option: to take out a first and undesired second mortgage. In certain cases it appears that the second mortgage was primarily used to pay for high points being charged by HFC. Further, all of the second mortgages reviewed by the Department carried very high rates of interest (generally in excess of 20%), as well as origination fees at nearly 4%. In situations where the borrowers were required to take out a second mortgage primarily to pay points on the first mortgage, the borrower paid additional points for points, as well as an exorbitant interest charge on the financing of both layers of the points.

Again, the steering of borrowers into larger first mortgages concerns the Department. As discussed above under the Department's Understanding Of HFC Policy And Practice, first mortgages were made even larger by the inclusion of large amounts of discount points. It is apparent that the borrowers' financing decisions are "steered" and "controlled" by HFC representatives, often to the detriment and harm of the consumer and to the significant gain of HFC and the representatives.

The inclusion of unwanted or unneeded insurance products (as discussed throughout this report) by steering methods, misrepresentation or out and out fraud through forgery appears to be part of HFC's practice of obtaining maximum revenue from consumers regardless of any actual benefit to the consumer. HFC encourages its employees to maximize the number of products sold, the dollar amount of loans sold and insurance products sold. A review of HFC's Branch Sales Compensation policy for 2001 shows that account executives, branch managers and sales assistants are paid significant monthly incentives for maximizing borrower transactions in these areas.

Unlicensed Activity

Branch Activity

HFC operates a separate lending company from the same location as its licensed Washington branches. This company is identified as Household Realty Corporation (HRC). The licensee and HRC share the same facilities, resources and employees.[9] To the Department and Washington consumers there is no distinguishable difference between these two companies except that the licensee generally provides settlement services for second mortgages while Household Realty Corporation provides settlement services for first mortgages. However, this is only a general concept as the licensee at times provides settlement services for first mortgages as well. More accurately, borrowers believe that they have only dealt with HFC even when their loan has been made by HRC.

Unlicensed Activity continued

By operating two companies within the same location and using the same representatives and branch management for both companies, the consumer is effectively misled as to which company they have agreed to enter a loan transaction with. As discussed above, the Department found in its own origination attempts at two branches that no mention was made by the loan representatives when HFC's "hat" was removed and replaced by the HRC hat. In at least one consumer loan transaction (Connell, #2077/2092), the settlement services on the borrowers' first mortgage were handled as follows:

Transaction Activity	HFC	HRC
Application	X	
GFE disclosure	X	

[9] HFC states that all branch personnel are employees of Household Payroll Services (HPS) and are authorized to transact business for either HFC or HRC.

TIL disclosure X

Servicing disclosure X X ("HFC, its Affiliates and/or Subsidiaries")

HUD settlement statement X

Right of rescission X

Note (Security Agreement) X

Deed of Trust X

Title policy X

AfBA disclosureNeither party

In a transaction such as this the borrower has no ability to distinguish which company has handled their transaction. In fact, the Connells filed a complaint against the licensee believing that this was the company that made their loan, when in fact it did not. As support of this belief, the borrower submitted their HUD settlement statement showing HFC as the lender on the transaction when in fact HRC was the lender on the transaction.

In a response letter to the Bley complaint (#2378) dated March 26, 2001, Tom Schneider of HFC stated, "Household Realty Corporation makes first mortgage loans through the Spokane location under the Washington Usury Act, which does not require licensing." However, when the licensee transacts business through HRC (as in the transaction described above), a separate license must be held for HRC. The Department believes this holds true even in situations where all of the documentation has been completed in the name of HRC. The Department argues that the physical location, signage and even employees[10] are those of HFC, and that consumers are marketed, solicited and led to believe that they are transacting business with HFC. However, HFC proceeds to transact the business under an unlicensed name.

Pursuant to WAC 208-620-210(2), business only under licensed name, a licensee may transact business or make any loan subject to the act only under the name on the license. The Department does not take the position that separate businesses cannot share a single office, however.

Pursuant to subsection (1) of this same section, a licensee may conduct its business in a licensed location in which other persons or entities engage in business. This is not, however, what is taking place with the licensee. In this situation the licensee is actually conducting business through HRC and HRC is actually conducting business through the licensee. To the extent that HFC would argue that HPS is actually responsible for the business conduct of the branch personnel, the Department would likely argue that HPS is conducting unlicensed activity as well.

Unlicensed Activity continued

Underwriting and Servicing Activity

HFC reported to the Department that underwriting activities are performed through processing centers in Elmhurst, IL, Carmel, IN, and Chesapeake, VA., and that loans are serviced in London, KY, Brandon, FL, Virginia Beach, VA, Pomona, CA, Carmel, IN and Elmhurst, IL. All loan documents and records are stored at 577 Lamont Road, Elmhurst, IL. Underwriting and servicing activities are covered business requiring a license under the Act. However, only the Brandon, Virginia Beach and Pomona locations held licenses to conduct this business with Washington consumers.

Affiliated Business Arrangements (AfBAs)

The Department believes that an affiliated business arrangement pursuant to Regulation X, §3500.15 exists between HFC and HRC. The Department further believes that when a customer seeks a first

[10] Despite the claim that HPS is the employer it is apparent to the Department that the branch personnel take all direction from HFC.

mortgage the customer is "referred" by HRC to HFC for a second mortgage. When a customer seeks a second mortgage the customer is "referred" by HFC to HRC. In practice, the Department believes there is little differentiation between HFC and HRC. However, HFC has gone to lengths to show the Department that there is a difference between the two corporations and that one is not responsible for the business of the other.

If a borrower enters a branch facility identified as HFC, meets with employees identifying themselves as HFC employees, and exits the branch having obtained a loan with HRC, then the borrower has clearly been "referred"[11] to the business products offered by HRC and that referral could only have come from the representatives of HFC. On March 31, 2002, HFC provided the following response to the Department's 2001 examination report:

"An affiliated business relationship under Section 3500.15 of RESPA requires that one company "refer" or "steer" a customer to an affiliate that will perform settlement services. The purpose of the required disclosure is to inform the customer of the relationship and to give the customer a chance to shop for another settlement provider. There is no affiliate business arrangement here since loans are never 'referred' between HFC III and HRC. The employee at the branch has the authority to make loans on behalf of each entity and therefore can offer loan products for each company. When a first mortgage is offered, it is being offered by HRC, and if the customer prefers a second or unsecured loan, it is offered by the employee on behalf of HFC III. Neither HFC III nor HRC can sell the other company's products. Thus, there is no 'referral' of business by the employee to the other company, but, an 'offer' by a representative on behalf of the entity making the loan being offered."

The Department contends that HFC is wrong in its premise. First, does an affiliated business arrangement (AfBA) exist?[12] Pursuant to 12 USC 2602(7), the term "affiliated business arrangement" means an arrangement in which:

(A)a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and

(B)either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.

Affiliated Business Arrangements (AfBAs) continued

The lending services offered by HFC and HRC are settlement services. By virtue of being in the same place at the same time with settlement service products to offer the borrower, these companies are in a "position" to refer business to each other. Regardless of whether it is technically HPS that is making the referral of the settlement service to the borrower, the activity still rises to meet the test of affiliate (see 12 USC 2602(8) for the definition of "associate").

The question then becomes, have any of these entities directly or indirectly referred business or affirmatively influenced the selection of the provider. The Department argues "yes" and can see no other logical view of these arrangements. The borrowers never knew of HRC (or HPS for that matter) when they entered the HFC facility. In fact, all of the borrowers interviewed by the Department never knew of either entity when they left the HFC facility, yet they left with products provided by one or both of the lenders using this facility. It is only logical to assume that the personnel within the facility (the only people even knowing of the arrangement) at the very least influenced the borrowers to obtain a loan with one or the other lending companies.

[11] Referring includes "affirmatively influencing" a borrower to use the service of the provider.
[12] Not as stated by HFC, an affiliated business "relationship."

HFC contends that the branch employees were essentially "independent" representatives of HPS authorized to offer products of HFC or HRC. The Department contends that such an arrangement is simply a sham. HPS is not a lender and holds no independent lending expertise. As a standalone entity it is incapable of offering lending products to Washington consumers. Further, the employees claim to be representatives of HFC not HPS and they take direction for everything they do from HFC. When these employees "sold" a borrower into a loan service, they have clearly "referred" them to that service.

Once the existence of an AfBA has been established, the question becomes whether the regulations were followed under §3500.15 to avoid a violation of section 8 of RESPA. Regulation X at §3500.15(b) states:

(1)The person making each referral has provided to each person whose business is referred a written disclosure, in the format of the Affiliated Business Arrangement Disclosure Statement set forth in Appendix D of this part, of the nature of the relationship (explaining the ownership and financial interest) between the provider of settlement services (or business incident thereto) and the person making the referral and of an estimated charge or range of charges generally made by such provider (which describes the charge using the same terminology, as far as practical, as section L of the HUD-1 settlement statement). The disclosures must be provided on a separate piece of paper no later than the time of each referral or, if the lender requires use of a particular provider, the time of loan application, except that:

(2)No person making a referral has required (as defined in §3500.2, "required use") any person to use any particular provider of settlement services or business incident thereto, except if such person is a lender, for requiring a buyer, borrower or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent the lender's interest in a real estate transaction, or except if such person is an attorney or law firm for arranging for issuance of a title insurance policy for a client, directly as agent or through a separate corporate title insurance agency that may be operated as an adjunct to the law practice of the attorney or law firm, as part of representation of that client in a real estate transaction.

(3)The only thing of value that is received from the arrangement other than payments listed in §3500.14(g) is a return on an ownership interest or franchise relationship.

Affiliated Business Arrangements (AfBAs) continued

The Department found that HFC/HRC/HPS failed to make the required disclosure in any of the loan transactions. The failure to make the disclosure is not sufficient in and of itself, however, in determining a violation. The question becomes, was anything of value received by the referring party? The Department argues yes to this question as follows:

1. HPS employees received value in the form of compensation based directly upon the lenders' acquisition of the loans.
2. HRC received value through the use of a facility owned and operated by HFC. While HFC argues that HRC ultimately carries expenses base upon loan volume[13], there is still value obtained by this arrangement. First, as stated by HFC, HRC does not share the overhead expense of the branch until year-end. Surely there is significant value in not paying overhead expense on a number of fixed locations for a twelve-month period, while those very locations deliver a significant amount of revenue. Second, the

[13] It is interesting to note that this very question was put to HFC accounting personnel at its headquarters by the Department's examiners in 2001, yet HFC was unable to formulate the breakout of expenses as was presented to the Department in March 2002.

expenses that are paid are based upon loans derived. Again there is surely value in the prospect of paying overhead only if income is derived.

An additional test for a violation under section 8 of RESPA is whether the settlement service is required. The regulation defines required use as follows:

Required use means a situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service. However, the offering of a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process.

HFC has made it clear to the Department that HRC provides first lien mortgages exclusively and HFC provides second lien mortgages. If a borrower "desires" either product they can only obtain it from the lender that offers that product. In many cases, borrowers have told the Department that they could only get the product they wanted if they also took the product they did not want. This would clearly be "required use" under the regulation.

The purpose of the disclosure, as stated by HFC itself, is to notify the borrower that an arrangement (that may be disadvantageous to them) exists, thereby giving the borrower an opportunity to shop for a different service. When the disclosure is not given, and especially when the borrower is led to believe that the affiliate's service is required, the borrower is harmed by not having the opportunity to shop. In the case of HFC and HRC we are dealing with very high cost mortgages with terms and conditions that hold significant potential harm to the consumer (e.g. prepayment penalties). Had the borrowers been adequately informed as required they could have shopped for a service with a lower cost or terms that better suited their needs. By failing to give the AfBA disclosure form, and further by not making the relationship between the companies known to the borrower, HFC has precluded the borrower from a basic right in the lending transaction: to make an informed decision.

SUMMARY OF APPARENT VIOLATIONS

The following violations have been cited throughout this report. Most if not all of the violations are recurrent with the HFC branches. While most of the activity reviewed by the Department does not fall within the coverage of the July 2001 amended Act, the Department has reason to believe that loans made by HFC since July 2001 are in violation of the sections cited.

Note: where the language within a citation covers more than the violation identified, the language containing the violation has been set out in bold print.

STATUTE AND REGULATION VIOLATIONS PRIOR TO AMENDED ACT

RCW 31.04.125(4) No licensee may provide credit life or disability insurance in an amount greater than that required to pay off the total balance owing on the date of the borrower's death net of refunds in the case of credit life insurance, or all minimum payments that become due on the loan during the covered period of disability in the case of credit disability insurance. **The lender may not require any such insurance.**

RCW 31.04.135 Advertisements or promotions. No licensee may advertise, print, display, publish, distribute, or broadcast or cause or permit to be advertised, printed, displayed, published, distributed, or broadcast, in any manner whatsoever, any statement or representation with regard to the rates, terms, or conditions for the lending of money that is false, misleading, or deceptive.

RCW 31.04.145 Examinations--Director's duties--Costs. **For the purpose of discovering violations of this chapter or securing information lawfully required under this chapter, the director may at any time, either personally or by a designee, investigate the loans and business and examine, wherever located, the books, accounts, records, and files used in the business of every licensee and of every person who is engaged in the business described in RCW 31.04.035, whether the person acts or claims to act as principal or agent, or under or without the authority of this chapter.** For that purpose the director and designated representative shall have free access to the offices and places of business, books, accounts, papers, records, files, safes, and vaults of all such persons. The director and persons designated by the director may require the attendance of and examine under oath all persons whose testimony may be required about the loans or the business or the subject matter of any investigation, examination, or hearing. The director shall make such an examination of the affairs, business, office, and records of each licensee as determined by rule. The licensee so examined shall pay to the director the actual cost of examining and supervising each licensed place of business.

WAC 208-620-050 Interstate operations. (1) License required. Any person that conducts business under the act with Washington residents must obtain a license for all locations from which such business is conducted, including out-of-state locations. When conducting business with Washington residents pursuant to the act, the out-of-state licensee must comply with all laws and rules governing the activities of licensees in the state.

(3) Servicing loans out-of-state. A licensee may service loans made pursuant to the act at out-of-state locations as long as the locations are licensed. The licensee must agree in writing to provide the director access to the records pursuant to WAC 208-620-180.

STATUTE AND REGULATION VIOLATIONS PRIOR TO AMENDED ACT continued

WAC 208-620-120 Contents of disclosure statement to borrower. (1) The licensee shall comply with all applicable federal laws and regulations, including the Truth in Lending and Real Estate Settlement Procedures Acts.

(2) Each licensee shall maintain in its files sufficient information to show compliance with state and federal law.

WAC 208-620-130(5) Noncredit insurance. A licensee may include the premiums for noncredit insurance in the principal amount of the loan, provided that purchase of the insurance is not required to obtain a loan and that this fact is disclosed to the borrower in writing.

WAC 208-620-210 Other business in same office. (1) Office sharing. A licensee may conduct its business in a licensed location in which other persons or entities engage in business.

(2) Business only under licensed name. A licensee may transact business or make any loan subject to the act only under the name on the license.

(3) Sale of incidental products. A licensee may engage in the sale of incidental products on the premises of the licensed location only after receiving approval from the director. The cost of such products may, at the consumer's option, be paid from the proceeds of the loan and included in the principal balance provided that:

(a) The purchase of the product is not a factor in the approval of credit and this fact is clearly disclosed in writing to the consumer; and

(b) In order to obtain the product the consumer gives specific affirmative written indication of his or her desire to purchase the product after receiving disclosure of the cost.

STATUTE VIOLATIONS SUBSEQUENT TO AMENDED ACT

RCW 31.04.027 Violations of chapter. It is a violation of this chapter for a licensee, its officers, directors, employees, or independent contractors, or any other person subject to this chapter to:

(1) Directly or indirectly employ any scheme, device, or artifice to defraud or mislead any borrower, to defraud or mislead any lender, or to defraud or mislead any person;

(2) Directly or indirectly engage in any unfair or deceptive practice toward any person;

(3) Directly or indirectly obtain property by fraud or misrepresentation;

(5) Solicit, advertise, or enter into a contract for specific interest rates, points, or other financing terms unless the terms are actually available at the time of soliciting, advertising, or contracting;

(6) Fail to make disclosures to loan applicants as required by RCW 31.04.102 and any other applicable state or federal law;

(7) Make, in any manner, any false or deceptive statement or representation with regard to the rates, points, or other financing terms or conditions for a residential mortgage loan or engage in bait and switch advertising;

(10) Advertise any rate of interest without conspicuously disclosing the annual percentage rate implied by that rate of interest or **otherwise fail to comply with any requirement of the truth in lending act, 15 U.S.C. Sec. 1601 and regulation Z, 12 C.F.R. Sec. 226, the real estate settlement procedures act, 12 U.S.C. Sec. 2601 and regulation X, 24 C.F.R. Sec. 3500**, or the equal credit opportunity act, 15 U.S.C. Sec. 1691 and regulation B, Sec. 202.9, 202.11, and 202.12, or any other applicable federal statute, as now or hereafter amended, in any advertising of residential mortgage loans or any other consumer loan company activity.

STATUTE VIOLATIONS SUBSEQUENT TO AMENDED ACT continued

RCW 31.04.102 Licensee--Disclosure of fees and costs to borrower--Three business days. Within three business days following receipt of a loan application, a licensee shall provide to each borrower a written disclosure containing an itemized estimation and explanation of all fees and costs that the borrower is required to pay in connection with obtaining a loan from the licensee. A good faith estimate of a fee or cost shall be provided if the exact amount of the fee or cost is not available when the disclosure is provided. Disclosure in a form which complies with the requirements of the truth in lending act, 15 U.S.C. Sec. 1601 and regulation Z, 12 C.F.R. Sec. 226, the real estate settlement procedures act and regulation X, 24 C.F.R. Sec. 3500, and all other applicable federal laws and regulations, as now or hereafter amended, shall be deemed to constitute compliance with the disclosure requirements of this section when it is provided to the borrower within three days of receipt of a loan application. Each licensee shall comply with all other applicable federal and state laws and regulations.

RCW 31.04.145 Investigations and examinations--Director's duties--Production of information--Costs. (1) For the purpose of discovering violations of this chapter or securing information lawfully required under this chapter, the director may at any time, either personally or by designees, investigate or examine the loans and business and, wherever located, the books, accounts, records, papers, documents, files, and other information used in the business of every licensee and of every person who is engaged in the business making or assisting in the making of loans at interest rates authorized by this chapter, whether the person acts or claims to act as principal or agent, or under or without the authority of this chapter. For these purposes, the director or designated representatives shall have free access to the offices and places of business, books, accounts, papers, documents, other information, records, files, safes, and vaults of all such persons. The director or persons designated by the director may require the attendance of and examine under oath all persons whose testimony may be required about the loans or the business or the subject matter of any investigation, examination, or hearing and **may require such person to produce books, accounts, papers, records, files, and any other information the director or designated persons deem relevant to the inquiry. The director may require the production of original books, accounts, papers, records, files, and other information; may require that such original books, accounts, papers, records, files, and other information be copied; or may make copies himself or herself or by designee of such original books, accounts, papers, records, files, or other information. If a licensee or person does not attend and testify, or does not produce the**

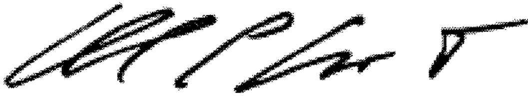
requested books, accounts, papers, records, files, or other information, then the director or designated persons may issue a subpoena or subpoena duces tecum requiring attendance or compelling production of the books, accounts, papers, records, files, or other information.

REQUIREMENTS

1. HFC is required to respond to each apparent violation cited by the Department within this report not later than June 15, 2002.

2. HFC is required to pay the enclosed invoice of $12,526.88 calculated at 187.50 examiner hours at $66.81 per hour.

By order of the Director Department of Financial Institutions



Chuck Cross, Enforcement Chief