8 Hour CA-DFPI SAFE Comprehensive: Compliance for 2024

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Date of Course Content: 6/01/24
Date of Course Approval:

Provider ID: 140003

Module 1 Federal Laws

In the following sections, "CFR" stands for "Code of Federal Regulations" and "USC" stands for "United States Code". Once Congress passes a law it is recorded in the United States Code (USC) books. The Code of Federal Regulations (CFR) are regulations issued by the various agencies which congress assigned to enforce the various laws (code) it adopted. The agencies explain their interpretation of those laws assigned to them and how it intends to implement it.

Other abbreviations include:

"MMC" – Multi-State Mortgage Committee

"CSBS" – Conference of State Bank Supervisors

"AARMR" – American Association of Residential Mortgage Regulators

"CFPB" – Consumer Financial Protection Bureau

"MME" – Multi-State Mortgage Entities

"NMLS" – Nationwide Mortgage Licensing System

"SAFE Act" - Secure and Fair Enforcement for Mortgage Licensing Act

Federal Laws Course Objective

This lesson will provide the student with an understanding of the most common issues found with MMC examinations. The course discusses the purpose of the MMC examination, and the required topics for the most repeated or outrageous non-compliance violations discovered during examinations. Students will review the examination deficiencies and the regulations to understand how to properly comply with the regulations. The federal law sections covered include ECOA appraisal timing, FCRA & ECOA adverse action letters, TILA Right to Rescission, TILA loan fee tolerance, and TILA timing requirements.

Multi-state Mortgage Committee

Mortgage lenders that have multiple locations in several states face challenges to ensure their company's originations meet all federal and state law regulations. In the past, large lenders, termed Multi-state Mortgage Entities (MMEs), struggled as some of their procedures would meet the regulations in one state only to have different state find fault with their compliance. Some federal agencies that oversaw mortgage laws would also conflict on what was considered regulation compliance. MME compliance was near impossible which left many putting complete compliance as a low priority, and managed as best they could and paid the fines when they came.

With the passing of the Dodd Frank Wallstreet Reform and Consumer Protection Act (Dodd-Frank Act), the industry was given structure, and path to uniform compliance on a national level, along with a watch dog compliance enforcer. The Consumer Finance Protection Bureau was established to provide uniform interpretation and compliance enforcement of federal mortgage lending regulations. The Consumer Financial Protection Bureau (CFPB) was given authority to examine loan files of state licensees and monitor consumer complaints regarding proposed violations. When the CFPB receives a sufficient number of complaints, it has the authority to further investigate the issue, however its main focus is on multi-state large, licensed entities (MMEs).

To assist CFPB in overseeing multi-state compliance for MMEs, a Multi-State Mortgage Committee (MMC) was established. The Committee is comprised of ten appointed State Regulator members and one Conference of State Bank Supervisors (CSBS) member. Their role is to implement cooperative protocols between state agencies and the mortgage industry. The committee issued a CSBS-AARMR MMC Exam Manual to provide guidance for compliance. [1]

With the invaluable information found in examining these large MMEs, NMLS is provided with the compliance topics to cover for annual licensee education requirements. This allows the mortgage industry to self-correct potential inaccurate handling of federal law compliance. The examinations of the MMEs provide guidance for CFPB to understand the problem compliance areas. To improve these deficits, the MMC provides examination reports quarterly that outline the current compliance issues identified by the examinations. This course covers the required CE topics for 2024 ranked by the Multi-State Mortgage Committee (MMC) and was derived from the 2021 third quarter examination reports.

Licensees complying with the regulations save money and time in state examinations. Violations found during examinations may require written letters of explanation, corrective action plans, refunds, and assessed penalties. Examination fees are paid by the licensee under examination and can be expensive when non-compliance is identified or suspected.

[1] https://www.csbs.org/system/files/2019-05/MMC%20Mortgage%20Examination%20Manual%20v2%20-%20May%202019.pdf

State Regulator

The state regulators manage the licensing and supervising of state-chartered banks and non-bank entities that include mortgage lenders, mortgage bankers, and mortgage brokers. It is their responsibility to ensure licensees in their state comply with all regulations and operate their business in a safe and sound manner so as to help their communities. The CFPB may also examine non-bank entities as a joint effort with state regulators.

State Regulators during their examination determine if the non-bank entity is operating in compliance, properly educating their employees, and are properly licensed for the lending provided. The examination will include a review of the financial institutions' loans and corporate records to decide whether the entities are effectively meeting the requirement to operate, monitor, and control risks associated with loan origination activities. Proper record retention is important to prove compliance.

Mortgage Loan Originators

An Individual Mortgage Loan Originator (MLO) may be held accountable by State Regulators for violations found during examinations. It is then their responsibility to comply with the regulations, and pay any fines, penalties, or hearing expense required.

MLOs that lead a team need to be sure their unlicensed assistants are not using their license number to handle licensed activities on their behalf. Their actions may cause a licensee to lose their license and livelihood. It is not the unlicensed person's career they are ruining.

Federal Law Compliance Matters

ECOA Adverse Action Compliance

"Unknown Reason" for Loan Denial

The MMC examinations of the top MMEs found the need to give out Citations for violations of ECOA by stating "Unknown Reason" and not providing the principal reason for denying an application. The ECOA Notice of Adverse Action is required to satisfy the disclosure requirements for ECOA and FCRA and includes a statement of specific reason for the credit denial.[2]

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[2] 12 CFR § 1002.9(b)(2)-9

In the official interpretation of Regulation B, the Equal Credit Opportunity Act (ECOA) requires disclosure of the principal reasons for denying or taking adverse action on an application for an extension of credit. The lender is encouraged to provide all reasons used to deny the credit request.

ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided they have the capacity to enter a binding contract), receipt of public assistance income, or because the applicant exercised in good faith any Consumer Credit Protection Act.

In addition, the Fair Credit Reporting Act (FCRA) requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or its own files. Disclosing that a credit report was obtained and used in the denial of the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons for denial.

FCRA example - If the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy the regulation the creditor must disclose the application was denied because of the applicant's delinquent credit obligations.[3] This notice of the credit reports use will accompany how the consumer may obtain a free copy of the credit report used to deny their credit request.

A consumer should be allowed to know the reason they were denied credit. The statement of reasons for adverse action required must be specific and indicate the principal reason(s) for the adverse action. Statements that the adverse action was based on the creditor's internal standards or policies or that the applicant, joint applicant, or similar party failed to achieve a qualifying score on the creditor's credit scoring system are insufficient. The regulation does not mandate that a specific number of reasons be disclosed, but disclosure of more than four reasons is not likely to be helpful to the applicant.

ECOA example – If the consumer receives an adverse action notice with a statement of denial, due to the credit being unable to verify his employment and no other reason is provided, the average consumer may assume he would have gotten approved if his employment were verified. A reasonable

[3] ECOA - 12 C.F.R. §1002.9(b)(2-9)

assumption for a consumer might be that if he is able to provide the verification, he should be approved for the requested loan.

To be accurate, the statement of denial should have included all applicable reasons for denial, such as unable to verify qualifying income, income unstable, and debt to income ratio exceeds allowable threshold for the loan program. This statement provides the consumer direction on the issues he will need to overcome to be creditworthy. These statement of reason in the adverse action letter require the information to the consumer to be clear and concise.

The specific reasons disclosed must relate to and accurately describe the factors actually considered or scored by a creditor. A creditor need not describe how or why a factor adversely affected an applicant.

ECOA example - the notice may say "length of residence" rather than "too short a period of residence."

If a creditor bases the denial or other adverse action on a credit scoring system, the reasons disclosed must relate only to those factors actually scored in the system. Moreover, no factor that was a principal reason for adverse action may be excluded from the disclosure. The creditor must disclose the actual reasons for denial even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.

For example - "credit score too low," yet how high does it need to be is not provided.

FCRA regulation does not require that any one method be used for selecting reasons for a credit denial or other adverse action that is based on a credit scoring system. Various methods will meet the requirements of the regulation.

1. One method is to identify the factors for which the applicant's score fell below the average score for each factor achieved by the applicants whose total score was at or slightly above the minimum passing score.
2. Another method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by all applicants. These average scores could be calculated during the development or use of the system.
3. Any other method that produces results substantially similar to either of these methods is also acceptable under the regulation.

However, if a creditor uses a judgmental system (manual underwrite), the reasons for the denial or other adverse action must relate to those factors in the applicant's record reviewed by the person making the decision.

Combined Credit Scoring and Judgmental System

An underwriter for a mortgage lender makes a credit decision after they review many factors. This is termed a judgmental system. If a creditor denies an application based on a credit evaluation system that employs both credit scoring and judgmental components, the reasons for the denial must come from the component of the system that the applicant failed.

For example - If a creditor initially credit scores an application and denies the credit request as a result of that scoring, the reasons disclosed to the applicant must relate to the credit factors that scored in the system.

If the application passes the credit scoring stage but the creditor then denies the credit request based on a judgmental assessment of the applicant's record, the reasons disclosed must relate to the factors reviewed judgmentally, even if the factors were also considered in the credit scoring component.

For example – denied due to 'stability of income.' The consumer's contract type of employment has shown unstable income, or the underwriter cannot determine exactly how much the borrower earns. The consumer's credit score may have been considered for a non-QM loan but that was not the reason for denial.

If the application is not approved or denied as a result of the credit scoring, but falls into a gray area, and the creditor performs a judgmental assessment and denies the credit after that assessment, the reasons disclosed must come from both components of the system. The same result applies where a judgmental assessment is the first component of the combined system. The primary reason for denial should be listed first in the statements of denial.

Automatic denial

Some credit decision methods contain features that call for automatic denial because of one or more negative factors in the applicant's record. **For example** - the applicant's previous poor credit history with that creditor, the applicant's declaration of bankruptcy was too recent to application date, or the fact that the applicant is a minor. When a creditor denies the credit request because of an automatic-denial factor, the creditor must disclose that specific factor.

Combined ECOA-FCRA disclosures

Both federal regulations govern the creditors method of providing a consumer with a notice of credit denial. ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The Fair Credit Reporting Act (FCRA) requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or its own files. This Adverse Action Notice combines the requirements so one Notice may be provided to satisfy both regulations.

Disclosing the key factors that adversely affected the consumer's credit score should not be confused with the ECOA requirement to disclose specific reasons for denying or taking adverse action on an application or extension of credit.[4]

Additional Statement of Specific Reasons Requirements

When a consumer’s adverse action in whole or in part is related to their credit score, the regulations require that the lender disclose the credit score used. The MMC examiners found some mortgage lenders failed to disclose the credit score it used in taking adverse action along with related information, including up to four key factors that adversely affected the consumer's credit score.[5]

Statements that the adverse action was based on the creditor's internal standards or policies or that the applicant, joint applicant, or similar party failed to achieve a qualifying score on the creditor's credit scoring system are insufficient.[6]

A notification given to an applicant when adverse action is taken must be in writing and contain a statement of the action taken. The required information includes the name and address of the creditor, a statement of the provisions, the name and address of the Federal agency that administers compliance with respect to the creditor, and either:[7]

- A statement of specific reasons for the action taken; or
- A disclosure of the applicant's right to a statement of specific reasons within 30 days if the statement is requested within 60 days of the creditor's notification.

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[4] https://www.consumerfinance.gov/rules-policy/regulations/1002/9/#9-b-2-Interp-9
[5] ECOA - 12 C.F.R. §1002.9(b)(2)
[6] interpretation of Paragraph 9(b)(2). in Supplement I
[7] https://www.consumerfinance.gov/rules-policy/regulations/1002/9/#a-2

Fair Credit Reporting Act Fee Compliance

The Fair Credit Reporting Act (FCRA) provides regulations for the fees allowed to be collected for a credit report when used to make a credit decision. The MMC examiners found in the MMEs audits that the credit report fees charged to the borrowers appeared to contain prohibited fees for rapid recheck or expedited rescore.[8] The Fair Credit Reporting Act prohibits a mortgage company from charging the borrower a fee for a "rapid recheck or expedited rescore." Citation violations to lenders were for charging credit report fees to the borrowers that included prohibited fees for rapid recheck or expedited rescore.[9]

Credit reports are important for consumers and can affect their ability to obtain credit, employment, and housing. The credit bureaus are a for profit company. The regulations have been established to determine how a consumer may obtain free review of their credit report, without charge.

The regulations do not allow the consumer to be charged when disputing information on their credit report. A consumer has a right to dispute the accuracy of their credit report and request an investigation of disputed information. If the Credit Bureau finds a reinvestigation is required, there are rules they must follow on managing the dispute.

If the completeness or accuracy of any item of information contained in a consumer's file at a consumer reporting agency is disputed by the consumer and the consumer notifies the agency directly of such dispute, the agency must reinvestigate **free of charge** and record the current status of the disputed information or delete the item from the file in accordance with the regulations. This review must be completed before the end of the 30-day period beginning on the date on which the agency received the notice of the dispute from the consumer.

When a Mortgage Loan Originator decides to order a rapid rescore or other method to expedite the process of correcting credit report errors or updates, the mortgage lender must directly absorb these fees as their expense and may not pass the costs to the individual consumer needing the rescore. The lender may indirectly charge consumers these fees as an aggregate amount for the creditor's overall credit report cost, provided the aggregate amount is reasonable and customary for a credit report.

[8] FCRA - 15 U.S.C. §1681i(a)(1)(A)
[9] 15 U.S.C. § 1681i(a)(1)(A)

Free Credit Report Under Some Circumstances

Upon the request of the consumer, a consumer reporting agency shall make all required credit disclosures once during any 12-month period without charge to that consumer if the consumer certifies in writing that the consumer -

(1) is unemployed and intends to apply for employment in the 60-day period beginning on the date on which the certification is made
(2) is a recipient of public welfare assistance; or
(3) has reason to believe that the file on the consumer at the agency contains inaccurate information due to fraud.[10]

Equal Credit Opportunity Act (ECOA) Appraisal Requirement

For decades consumers have had the right to a copy of the appraisal report for the property they used as security for their home mortgage loan. The Equal Credit Opportunity Act (ECOA) states the timing for this requirement and requires the borrower to receive an application disclosure notifying them of their appraisal rights.

The MMC examiners found in the MMEs examinations, they failure to provide the ECOA required copy of the appraisal and applicable valuation disclosures within three business days of application. The violation cited failure to deliver a right to copy of appraisal notice in writing, and files did not have compliant proof of appraisal delivery to the borrower.

ECOA Appraisal Disclosure Notice

In the event an appraisal is required on a loan, the lender is required to provide the "Notice of Right to Receive a Copy of Appraisal." This notice advises the consumer they will receive a copy of the appraisal upon completion, and in any event, no less than three business days prior to consummation. The disclosure also gives the borrower the information they have the right to waive receipt of the appraisal three business days prior to closing.[11]

Multiple Versions of Appraisal Compliance

Often a mortgage lender will request more than one property evaluation completed on a file as a second opinion or a quality control review.

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[10] https://www.govinfo.gov/content/pkg/USCODE-2022-title15/pdf/USCODE-2022-title15-chap41-subchapIII-sec1681j.pdf
[11] ECOA - 12 C.F.R. §1002.14(a)(1

For example - When an automated valuation is completed for internal checks and reviews, the borrower is entitled to receive these additional evaluations as well as the full appraisal report completed by an appraiser. The loan file must retain proof that all valuations obtained and used in determining a loan decision secured by a dwelling were provided. The loan file must document this for compliance.

Proof of Appraisal Receipt

Loan files must contain proof the appraisal was delivered to the borrower in compliance with the timing required. The MMC examination discovered MME loan files did not indicate the borrowers were provided with a copy of the appraisal report or other valuation. The loan files are required to document when the applicant was provided a copy of all appraisals and other written valuations developed in connection with an application as required by this regulation.[12]

Complying with ECOA requires a creditor to provide an applicant with a copy of **all appraisals** and other written valuations developed in connection with an application for credit that is to be secured by a first lien on a dwelling. The Bureau of Consumer Financial Protection's (CFPB's) enforces Regulation B that requires a creditor to mail the appraisal report to the applicant, not later than the third business day after receipt.[13]

CFPB official interpretation requires the lender to handle multiple versions of appraisals or valuations to comply with the "all" reference does not refer to all versions of the same appraisal or other valuation. If a creditor has received multiple versions of an appraisal or other written valuation, the creditor is required to provide only a copy of the latest version received.

If, however, a creditor already has provided a copy of one version of an appraisal or other written valuation to an applicant, and the creditor later receives a revision of that appraisal or other written valuation, then the creditor also must provide the applicant with a copy of the revision to comply with the regulations. If a creditor receives only one version of an appraisal or other valuation that is developed in connection with the applicant's application, then that version must be provided to the applicant to comply with the regulations.[14]

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[12] ECOA - 12 C.F.R. §1002.14(a)(1)
[13] Regulation B, 12 C.F.R. 1002.14(a)(1)
[14] https://www.consumerfinance.gov/rules-policy/regulations/1002/14/#14-a-1-Interp-7

CFPB Appraisal Requirement Official Interpretation

The CFPB has official interpretations on their website providing information for how to comply with this section of ECOA. This is a review of their statements for ECOA appraisal compliance.

A creditor must provide an applicant with a copy of all appraisals and other written valuations developed in connection with an application for credit that is to be secured by a first lien on a dwelling. A creditor shall provide a copy of **each such appraisal or other written valuation promptly upon completion, or three business days prior to consummation of the transaction** (for closed-end credit) **or account opening** (for open-end credit), whichever is earlier. Lenders must comply with Electronic Consent and Signing Act (E-Sign Act) regulations to send by an appraisal to the consumer by email.[15]

For ECOA federal regulations, the term "dwelling" means a residential structure that contains one to four units whether or not that structure is attached to real property. The term includes, but is not limited to, an individual condominium or cooperative unit, and a mobile or other manufactured home.[16]

Motor vehicles are not covered in this definition of dwelling. This ECOA appraisal requirement covers applications for credit to be secured by a first lien on a dwelling whether the credit is for a business purpose (**for example**, a loan to start a business) or a consumer purpose (**for example**, a loan to purchase a home).

For ECOA, an "appraisal or other written valuation" includes, without limitation, an appraisal or other valuation received or developed by the creditor in paper form (hard copy); electronically, such as CD or email; or by any other similar media.

Appraisal Timing Requirement

For ECOA, compliant timing requires that the creditor "provide" copies of appraisals and other written valuations to the applicant "promptly upon completion," or no later than three business days before consummation (for closed-end credit) or account opening (for open-end credit), whichever is

[15] Regulation B, 12 C.F.R.§1002.14(a)(5)
[16] https://www.consumerfinance.gov/rules-policy/regulations/1002/14/#b-2

earlier.[17] For purposes of this timing requirement, "provide" means "deliver." Delivery to or actual receipt by the applicant by electronic means must comply with the E-Sign Act.

Some lenders have struggled with proper notation in the files to prove the appraisals were sent in a timely manner and in compliance with the regulations. In addition, they struggle to understand the regulations as interpreted.

Question - Should the lender send the appraisal when initially received from the appraiser, or after the underwriter has reviewed, requested revisions, and appraisal report corrections are updated?

According to CFPB interpretation, the application and meaning of the "promptly upon completion" standard depends upon the facts and circumstances, including but not limited to when the creditor receives the appraisal or other written valuation, and the extent of any review or revision after the creditor receives it. "Completion" of the appraisal occurs when the last version is received by the creditor, or when the **creditor has reviewed and accepted the appraisal** or other written valuation to include any changes or corrections required, whichever is later.

Answer - The lender should send the appraisal after the underwriter has accepted the last version of the appraisal which is considered completion by CFPB.

In a transaction that is being consummated (for closed-end credit) or in which the account is being opened (for open-end credit), if an appraisal or other written valuation has been developed but is not yet complete, the three business days before consummation or account opening still applies, unless the applicant waives that deadline as provided. If an applicant waives their right to copy the appraisal report before closing, a copy of the appraisal must be provided at or before consummation or account opening.

Waiver Requirements

ECOA regulation B permits the applicant to waive the receipt of the appraisal timing requirement if the creditor provides appraisal copies at or before consummation or account opening, except where otherwise prohibited by law. Understand state laws governing the property that may not allow waiving of this right.

[17] Regulation B, 12 C.F.R Section §1002.14(a)(1)

An allowable waiver must be obtained at least three business days prior to consummation or account opening unless the waiver pertains solely to the applicant's receipt of a copy of an appraisal or other written valuation that contains only clerical changes from a previous version of the appraisal or other written valuation provided to the applicant.

CFPB provided their official interpretation on waiving of the appraisal compliance. Except where otherwise prohibited by law, an applicant's waiver is effective under either of the following two situations:

1. If no later than three business days prior to consummation or account opening, the applicant provides the creditor an affirmative oral or written statement waiving the timing requirement: or
2. If, within three business days of consummation or account opening, the applicant provides the creditor an affirmative oral or written statement waiving the timing requirement and the waiver pertains solely to the applicant's receipt of a copy of an appraisal or other written valuation that contains only clerical changes from a previous version of the appraisal already provided to the applicant three or more business days prior to consummation or account opening. For the purpose of this second type of waiver, revisions will only be considered to be clerical in nature if they have no impact on the estimated value and have no impact on the calculation or methodology used to derive the estimate. In addition, the applicant still must receive the copy of the appraisal revision at or prior to consummation or account opening.[18]

In the past, mortgage lenders were fined for using the appraisal waiver as a standard application disclosure. This standard procedure to have all applicants waive their rights is not allowed, as the mortgage lender is taking the consumer’s rights away as part of their daily business procedures. A waiver of the time frame required should be used sparingly and only when the borrower has a hardship if they are required to wait three business days before consummation. The benefit must be to the consumer and not the mortgage lender.

[18] ECOA 12 C.F.R. Section §1002.14(a)(1)

No Transaction Closed Requirement

Even if the transaction will not be consummated (for closed-end credit) or the account will not be opened (for open-end credit), the copy must be provided "promptly upon completion" unless waived as provided. In this case, the copy must be provided to the applicant no later than 30 days after the creditor determines the transaction will not be consummated or the account will not be opened. For compliance, loan files must be documented as to when the appraisal was provided to the consumer.

Compliant and Noncompliant Scenario Examples -

1. On day fifteen after receipt of the application, the creditor's underwriting department reviews an appraisal and determines it is acceptable. One week later, the creditor sends a copy of the appraisal to the applicant. The applicant actually receives the copy more than three business days before the date of consummation (or account opening). The creditor has provided the copy of the appraisal promptly upon completion. This is an example of sending a copy of an appraisal within a week of completion with sufficient time before consummation (or account opening for open-end credit).
2. An appraisal is being revised, and the creditor does not receive the revised appraisal until day forty-five after the application, when the creditor immediately determines the revised appraisal is acceptable. A week later, the creditor sends a copy of the revised appraisal to the applicant and does not send a copy of the initial appraisal to the applicant. The applicant actually receives the copy of the revised appraisal three business days before the date of consummation (or account opening). The creditor has provided the appraisal copy promptly upon completion. This is an example of sending a copy of a revised appraisal within a week after completion and with sufficient time before consummation (or account opening for open-end credit).
3. The creditor receives an automated valuation model (AVM) appraisal report on day five after receipt of the application and treats the AVM report as complete when it is received. On day twelve after receipt of the application, the creditor sends the applicant a copy of the valuation. The applicant actually receives the valuation more than three business days before the date of consummation (or account opening). The creditor has provided the copy of the AVM report promptly upon completion. This is an example of sending a copy of an AVM report within a week after its receipt and with sufficient time before consummation (or account opening for open-end credit).

4. On day twelve after receipt of the application, the creditor's underwriting department reviews an appraisal and determines it is acceptable. Although the creditor has determined the appraisal is complete, the creditor waits to provide a copy to the applicant until day forty-two, when the creditor schedules the consummation (or account opening) to occur on day fifty. The creditor has not provided the copy of the appraisal promptly upon completion. This is an example of a violation of an unacceptable delay in sending an appraisal.
5. The creditor receives an AVM report on day five after application and completes its review of the AVM report the day it is received. The creditor also has ordered a full written appraisal report, but the initial version of the full appraisal received by the creditor is found to be deficient and is sent for review. The creditor waits 30 days to provide a copy of the completed AVM report, until the full appraisal is revised on day thirty-five. The creditor then provides the applicant with copies of the AVM report and the revised full appraisal. While the full appraisal report was provided promptly upon completion, the AVM report was not. This is an example of a violation for unacceptable delay in sending an AVM report while waiting for completion of a second valuation.

Truth-in-Lending (TILA) Right of Recission Compliance

The Truth-in-Lending (TILA) Regulation Z governs owner occupied home loans secured by primary dwellings. When a homeowner obtains a mortgage secured by their primary residence, additional rights are provided by Regulation Z. The MMC examiners found in their examinations, MMEs were not properly providing borrowers with their Regulation Z required notice of the right to rescind.

Regulations require a lender to provide two copies of the notice of the right to rescind to each consumer entitled to rescind which must clearly and conspicuously disclose the date the rescission period expires. The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice, or delivery of all material disclosures, whichever occurs last.

Consumer's Right to Rescind Notice

All borrowers with an interest in the property have a right to receive two copies of the Notice of Right to Rescind, but it only takes one borrower with rights to the property to sign the notice to rescind the entire loan transaction. One copy to each entitled consumer is acceptable when the notice is delivered in electronic form in accordance with the consumer’s consent and the E-Sign Act. Rescinding the loan transaction, voids the entire transaction.

The loan files must contain proof the lender complied by providing the borrower the notice. If the required notice or material disclosures are not delivered, the right to rescind then expires three years after consummation, 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 may be extended in accordance with Regulations.[19]

For this regulation the term “material disclosures” means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations allowed.[20]

CFPB Regulation Z Right of Rescission Interpretation

CFPB is the regulator for TILA and has provided official interpretations for how to comply with TILA Regulation Z’s right of recission. The rescission period within which the consumer may exercise the right to rescind runs for three business days from the last of three events:[21]

1. Consummation of the transaction
2. Delivery of all material disclosures
3. Delivery to the consumer of the required rescission notice

For example –

1. If a transaction is consummated on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31, the rescission period will expire at midnight of the third business day after June 1 - that is, Tuesday, June 5.
2. If the disclosures are given and the transaction consummated on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4 - that is, Thursday, June 7.

To rescind, the consumer must place the rescission notice in the mail, email it, or deliver it to the creditor's place of business within the waiting period in order to exercise the right. Generally, a lender

[19] TILA- section 125(f) of the Act
[20] 12 C.F.R §1026.32(c) and (d) and §1026.43(g)
[21] https://www.consumerfinance.gov/rules-policy/regulations/1026/23/#23-a-3-Interp-3-ii

will accept any notice to void the transaction, even after the waiting period as the penalty for non-compliance is steep.

Material disclosures must be provided before the rescission timing period can begin to run. Failure to provide information regarding the annual percentage rate (APR) also includes failure to inform the consumer of the existence of a variable rate feature. Failure to give the other required disclosures does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions.[22]

Unexpired Right of Rescission

As provided, the three-year limit may be extended by an administrative proceeding to enforce the provisions of this section. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

When the creditor has failed to take the action necessary to start the three-business day rescission period running, the right to rescind automatically lapses on the occurrence of the earliest of the following three events:

1. The expiration of three years after consummation of the transaction.
2. Transfer of all the consumer's interest in the property.
3. Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back a purchase money note and mortgage or retains legal title through a device such as an installment sale contract.

Transfer of all the consumers' interests includes such transfers as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind.[23]

For example - a foreclosure sale would terminate an unexpired right to rescind. As provided, the three-year limit may be extended by an administrative proceeding to enforce the provisions of this section. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

[22] TILA 12 C.F.R Section §1026.23(a)(3)(ii)
[23] TILA 12 C.F.R Section §1026.23(b)

Failure to Properly Provide Rescission Notice

The MMC examiners found MMEs failed to not only provide two copies of the notice but failed to provide the notice of right to rescission to all applicants with an interest in the property. Providing notice to the primary borrower only is not acceptable. Regulation Z requires that in a transaction subject to rescission, a creditor must deliver two copies of the notice of the right to rescind to each consumer entitled to rescind, based on ownership interest in the property.

The notice must identify the transaction or occurrence and clearly and conspicuously disclose the following:[24]

- The retention or acquisition of a security interest in the consumer's principal dwelling.
- The consumer's right to rescind the transaction.
- How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.
- The effects of rescission.
- The date the rescission period expires.

The notice must include all the above information and the transaction identified by providing the date of the transaction.[25] The CFPB provides model forms for lenders to use in whole or in part provided it meets the regulation minimum requirements and a clear manner.

Unless a consumer waives the right of rescission, no money must be disbursed other than in escrow, no services shall be performed, and no materials delivered until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded.[26]

TILA Disclosure Zero Tolerance Compliance

TILA requires lenders to disclose all loan transaction fees in a Loan Estimate (LE) with lender origination fees having zero tolerance for change. The MMC examination discovered MME loan files disclosed fees charged to the borrower on the final Closing Disclosure (CD) exceeded the allowable

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[24] Regulation Z, 12 C.F.R Section §1026.23(b)
[25] TILA 12 C.F.R Section §1026.23(b)
[26] https://www.consumerfinance.gov/rules-policy/regulations/1026/23/#b-2

tolerances. The loan files did not support any change of circumstance that would have validated the additional charge.[27]

An estimated closing cost disclosed on the Closing Disclosure is not in good faith if the charge paid by or imposed on the consumer exceeds the amount originally disclosed in accordance with the regulations.[28] In a closed-end consumer credit transaction secured by real property or a cooperative unit, other than a reverse mortgage, the creditor must provide the consumer with good faith estimate of the fees for the transaction.[29] For this purpose, the Loan Estimate is used at time of application and the Closing Disclosure is provided at closing.

CFPB Mortgage Broker Compliance

If a mortgage broker receives a consumer's application, either the creditor or the mortgage broker must provide a consumer with the TILA disclosures. If the mortgage broker provides the required disclosures, then mortgage broker must comply with all relevant requirements of TILA. The creditor funding the loan must ensure that such Broker supplied the required disclosures in accordance with the regulations. Disclosures provided by a mortgage broker satisfy the creditor's obligation, but the funding lender is held accountable for TILA compliance.[30]

An estimated closing cost disclosure is in good faith if the charge paid by or imposed on the consumer does not exceed the amount originally disclosed, except as otherwise provided in the regulations.

TILA Good Faith Determination

TILA provides the general rule that an estimated closing cost disclosed is not in good faith if the charge paid by or imposed on the consumer for origination expenses exceeds the amount originally disclosed. Although the regulations allow for some exceptions to the general rule, the charges that may not change after initial disclosure on the Loan Estimate generally include, but are not limited to, the following:

1. Fees paid to the creditor.

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[27] TILA 12 C.F.R. Section §1026.19(e)
[28] TILA 12 C.F.R. Section §1026.19(e)
[29] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#g-2-iv
[30] TILA 12 C.F.R. Section §1026.37

2. Fees paid to a mortgage broker.
3. Fees paid to an affiliate of the creditor or a mortgage broker.
4. Fees paid to an unaffiliated third party if the creditor did not permit the consumer to shop for a third-party service provider for a settlement service.
5. Transfer taxes.[31]

Charges "paid by or imposed on the consumer" refers to the final amount for the charge paid by or imposed on the consumer at consummation or settlement, whichever is later.

"Consummation" is defined by governing state law, but when a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; Regulation Z does not make this determination.

For example - A contractual commitment agreement that under applicable law binds the consumer to the credit terms would be consummation. Consummation, however, does not occur merely because the consumer has made some financial investment in the transaction (**for example**, by paying a nonrefundable fee) unless, of course, applicable law holds otherwise.[32]

Credit v. sale further defines that consummation does not occur when the consumer becomes contractually committed to a sale transaction unless the consumer also becomes legally obligated to accept a particular credit arrangement.

For example - When a consumer pays a nonrefundable deposit to purchase an automobile, a purchase contract may be created, but consummation for purposes of the regulation does not occur unless the consumer also contracts for financing at that time.

"Settlement" is defined in Regulation Z to means the process of executing legally binding documents regarding a lien on property that is subject to a federally related mortgage loan. This process may also be called "closing" or "escrow" in different jurisdictions.[33]

For example - At consummation, the consumer pays the creditor $100 for recording fees. Settlement of the transaction concludes five days after consummation, and the actual recording fees

[31] TILA 12 CFR Section §1026.19(e)(3)(i)
[32] https://www.consumerfinance.gov/rules-policy/regulations/1026/2/#a-12
[33] Regulation X, 12 CFR Section §1024.2(b)

are $70. The creditor refunds the consumer $30 immediately after recording. The recording fee paid by the consumer is $70.

When fees are "paid to" a person, a fee is not considered "paid to" a person if the person does not retain the fee.

For example - if a consumer pays the creditor transfer taxes and recording fees at the real estate closing and the creditor subsequently uses those funds to pay the county that imposed these charges, then the transfer taxes and recording fees are not considered "paid to" the creditor. There is a difference between transfer taxes and recording fees for this discussion.

Similarly, if a consumer pays the creditor an appraisal fee in advance of the real estate closing and the creditor subsequently uses those funds to pay another party for an appraisal, then the appraisal fee is not "paid to" the creditor for the TILA regulation purposes. A fee is also not considered "paid to" a person if the person retains the fee as reimbursement for an amount it has already paid to another party. If a creditor pays for an appraisal in advance of the real estate closing and the consumer pays the creditor an appraisal fee at the real estate closing, then the fee is not "paid to" the creditor, even though the creditor retains the fee, because the payment is a reimbursement for an amount already paid by the lender.[34]

CFPB Lender Credit Compliance

The disclosure of "lender credits" represents the sum of non-specific lender credits and specific lender credits. Non-specific lender credits are generalized payments from the creditor to the consumer that do not pay for a particular fee on the disclosures provided. Specific lender credits are specific payments, such as a credit, rebate, or reimbursement, from a creditor to the consumer to pay for a specific fee. Non-specific lender credits and specific lender credits are negative charges to the consumer. The actual total amount of lender credits, whether specific or non-specific, provided by the creditor that is less than the estimated "lender credits" identified in the disclosure is an increased charge to the consumer for purposes of determining good faith.

For example - If the creditor discloses a $750 estimate for "lender credits", but only $500 of lender credits is actually provided to the consumer, the creditor has not complied with the regulations

[34] TILA 12 CFR Section §1026.19(e

because the actual amount of lender credits provided is less than the estimated "lender credits" disclosed. This change increases the charge to the consumer for purposes of determining good faith.

However, if the creditor discloses a $750 estimate for "lender credits" to cover the cost of a $750 appraisal fee, and the appraisal fee subsequently increases the appraisal fee by $150, and the creditor increases the amount of the lender credit by $150 to pay for the increase, the credit is not being revised in a way that violates the requirements. Although the credit increased from the amount disclosed, the amount paid by the consumer did not.

However, if the creditor discloses a $750 estimate for "lender credits" to cover the cost of a $750 appraisal fee, but subsequently reduces the credit by $50 because the appraisal fee decreased by $50 to $700, then the requirements have been violated because, although the amount of the appraisal fee decreased, the amount of the lender credit decreased. The reduced appraisal fee cost should be a benefit to the borrower, not the lender.[35]

For purposes of conducting the good faith analysis required by the regulation for lender credits, the total amount of lender credits, whether specific or non-specific, provided to the consumer is compared to the amount of the "lender credits" identified in the regulations. The total amount of lender credits provided to the consumer is determined by aggregating the amount of the "lender credits" identified with the amounts paid by the creditor that are attributable to a specific loan cost or other cost disclosed.

CFPB TILA 10% Tolerance Charges

As allowed in TILA, the lender is allowed to increase some allowable charges within limits. An estimate of a charge for a third-party service or a recording fee is in good faith if:

1. The aggregate amount of charges for third-party services and recording fees paid by the consumer does not exceed the aggregate amount of such charges disclosed that allow limited increases of not more than ten percent.
2. The charge for the third-party service is not paid to the creditor or an affiliate of the creditor; and

[35] TILA 12 CFR Section §1026.37(g)(6)(ii)

3. The creditor permits the consumer to shop for the third-party service as permitted in the regulation.[36]

TILA Regulations provides that certain estimated charges are in good faith if the sum of all such charges paid by or imposed on the consumer does not exceed the sum of all such charges disclosed by more than ten percent. This section of fees on the Loan Estimate permits limited increases for only the following items:

- Fees paid to an unaffiliated third party if the creditor permitted the consumer to shop for the third-party service, consistent with the regulations.
- Recording fees.

Whether an individual estimated charge is in good faith depends on whether the sum of all charges in this section increases by more than ten percent, regardless of whether a particular charge increases by more than ten percent. This is true even if an individual charge was omitted from the estimate provided and then imposed at consummation.

The following examples illustrate the determination of good faith for charges for this section:[37]

- Assume that, in the disclosures provided, the creditor includes a $300 estimated fee for a settlement agent, the settlement agent fee is included in the category of charges, and the sum of all charges in this section (including the settlement agent fee) equals $1,000. In this case, the creditor does not violate TILA if the actual settlement agent fee exceeds the estimated settlement agent fee by more than ten percent (i.e., the fee exceeds $330), provided that the sum of all such actual charges does not exceed the sum of all such estimated charges by more than ten percent (i.e., the sum of all such charges does not exceed $1,100).
- Assume that, in the disclosures provided in this section, the sum of all estimated charges subject to the ten percent rule equals $1,000. If the creditor does not include an estimated charge for a notary fee but a $10 notary fee is charged to the consumer, and the notary fee is subject to the ten percent rule, then the creditor does not violate TILA if the sum of all

[36] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#e-3-i
[37] TILA 12 CFR Section §1026.19(e)(3)(ii)(A)

amounts charged to the consumer does not exceed $1,100, even though an individual notary fee was not included in the estimated disclosures provided.[38]

To calculate the aggregate amount of estimated charges to be in good faith, the aggregate amount of estimated charges must reflect charges for services that are actually performed.

For example - Assume that the creditor included a $100 estimated fee for a pest inspection in the disclosures provided and the fee is included in the category of charges allowing a variance, but a pest inspection was not obtained in connection with the transaction. Then for purposes of the good faith analysis required by TILA Regulation Z, the sum of all aggregate allowable charges paid by or imposed on the consumer is compared to the sum of all such charges disclosed, minus the $100 estimated pest inspection fee.[39] The pest inspection fee was not actually performed, so may not be included in determining compliance to the ten percent variation.

TILA No Tolerance Restrictions

Restrictions on Loan Estimate fees do not apply when a consumer is allowed to shop for the service. Services for which the consumer may but does not select a settlement service provider have different requirements for limitations. Good faith is not determined by the ten percent rule when the creditor permits the consumer to shop for a settlement service provider. When the consumer chooses on their own the settlement service provider that is required by the creditor for the mortgage loan transaction, there are no restrictions on the fee changing. If the consumer selects a settlement service provider identified by the creditor on their list, then good faith is determined in the 10% aggregate as allowed in TILA.[40]

For example - If, in the disclosures provided, a creditor discloses an estimated fee for an unaffiliated settlement agent and permits the consumer to shop for that service, but the consumer either does not choose a provider, or chooses a provider identified by the creditor on the written list provided, then the estimated settlement agent fee is included with the fees that may, in aggregate, increase by no more than ten percent for the purposes allowable change of circumstances.

[38] TILA 12 CFR Section §1026.19(e)(3)
[39] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#e-3-ii-C
[40] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#e-3-ii

If, however, the consumer chooses a provider that is not on the written list, then good faith is determined in accordance with TILA may increase. Regardless of whether the amount paid by the consumer exceeds the amount disclosed, the creditor 'in good faith' provided the best information reasonably available when they provided the disclosure.

The determination of compliance here is whether the creditor allows the consumer to shop. If the creditor is providing a list of providers, that creditor should understand what the settlement service provider will charge within a ten percent variance. Yet if the consumer shops for a settlement service provider, the creditor is not held to have known in advance when quoting the loan fees what this unknown to the creditor third party would charge.

Bona Fide Charges

In covered transactions, TILA requires the creditor to provide the consumer with good faith estimates in the Loan Estimate disclosures. TILA provides that an estimate of the charges is in good faith if it is consistent with the best information reasonably available to the creditor at the time the disclosure is provided and that good faith is determined even if such charges are paid to the creditor or affiliates of the creditor, so long as the charges are bona fide. For determining good faith, to be bona fide, charges must be lawful and for services that are actually performed.[41]

When the settlement service provider does not provide the creditor with their fees, the creditor is obligated to provide the disclosure in the timing required by TILA. The creditor can then use a best guess estimate of what the settlement service provider will charge. When the settlement fees are provided, after disclosure, the creditor may document their file of the issue and provide a change of circumstances revised Loan Estimate.

CFPB Recording Fees Compliance

TILA Regulation Z provides that an estimate of a charge for a third-party service or recording fees is in good faith if the conditions specified are satisfied. Recording fees are not charges for third-party services because recording fees are paid to the applicable government entity where the documents related to the mortgage transaction are recorded. The condition that the creditor permits the consumer to shop for the third-party service is inapplicable. Therefore, estimates of recording fees

[41] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-3-iii-Interp-4

need only satisfy the condition specified in TILA that requires the name of the entity the fees were paid to, and the recording fees for the deed for title ownership transfer are separated from the recording fees for the mortgage or deed of trust.[42]

CFPB Allowable Changes in Fees

TILA Regulation Z does allow some variations for certain charges on the Loan Estimate. An estimate of any of the charges specified is in good faith if it is consistent with the best information reasonably available to the creditor at the time it is disclosed, regardless of whether the amount paid by the consumer exceeds the amount disclosed. Loan fees that the creditor has no control over are not limited by TILA restrictions. For purposes of this part of TILA rules, good faith is determined under this section even if such charges are paid to the creditor or affiliates of the creditor, so long as the charges are bona fide:

1. Prepaid interest
2. Property insurance premiums
3. Amounts placed into an escrow, impound, reserve, or similar account
4. Charges paid to third-party service providers selected by the consumer that are not on the list provided in compliance by the creditor
5. Property taxes and other charges paid for third-party services not required by the creditor[43]

According to CFPB, the good faith requirement for prepaid interest, property insurance premiums, and escrowed amounts have unlimited tolerances although the estimates of these fees and premiums placed into an escrow, impound, reserve or similar account must be consistent with the best information reasonably available to the creditor at the time the disclosures are provided. Differences between the amounts of such charges disclosed and the amounts of such charges paid by or imposed on the consumer do not constitute a lack of good faith, so long as the original estimated charge, or lack of an estimated charge for a particular service, was based on the best information reasonably available to the creditor at the time the disclosure was provided.

This means that the fee/cost estimate disclosed in compliance with TILA Regulation Z was obtained by the creditor through due diligence, acting in good faith.

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[42] TILA 12 CFR Section §1026.19(e)(3)(ii)
[43] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#e-3-iii-D

For example - If the creditor requires homeowner's insurance but fails to include a homeowner's insurance premium on the estimates provided, then the creditor's failure to disclose does not comply with TILA Regulation Z.

However, if the creditor does not require flood insurance and the subject property is located in an area where floods frequently occur, but not specifically located in a zone where flood insurance is required, failure to include flood insurance on the original estimates provided does not constitute a lack of good faith.

Or, if the creditor knows that the loan must close on the 15th of the month but estimates prepaid interest to be paid from the 30th of that month, then the under-disclosure does not comply with TILA Regulation Z.

If however, the creditor estimates consistent with the best information reasonably available that the loan will close on the 30th of the month and bases the estimate of prepaid interest accordingly, but the loan actually closed on the 1st of the next month instead, the creditor complies with TILA Regulation Z.[44] Most creditors will disclose thirty days of interest on initial TILA disclosures, regardless of when the estimated close of escrow is, so they error on the side of caution with an overestimate.

Differences between the amounts of such Loan Estimate charges disclosed and the amounts of such charges paid by or imposed on the consumer do not constitute a lack of good faith, so long as the original estimated charge, or lack of an estimated charge for a particular service, was based on the best information reasonably available to the creditor at the time the disclosure was provided.

For example- If the consumer informs the creditor that the consumer will choose a settlement agent not identified by the creditor on the written list provided, and the creditor discloses an unreasonably low estimated settlement agent fee of $20 when the average prices for settlement agent fees in that area are $150, then the under-disclosure does not comply with TILA Regulation Z and good faith.

For example - If the consumer informs the creditor that the consumer will obtain a type of inspection not required by the creditor, the creditor must include the charge for that item in the Loan

[44] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-3-iii-Interp-4

Estimate disclosures. The actual amount of the inspection fee need not be compared to the original estimate for the inspection fee to perform the good faith analysis. The original estimated charge, or lack of an estimated charge for a particular service, complies with TILA Regulation Z if it is made based on the best information reasonably available to the creditor at the time that the estimate was provided.

But, for example - If the subject property is located in a jurisdiction where consumers are customarily represented at closing by their own attorney, even though it is not a requirement, and the creditor fails to include a fee for the consumer's attorney, or includes an unreasonably low estimate for such fee, on the original estimates provided, then the creditor's failure to disclose, or unreasonably low estimation, does not comply with TILA Regulation Z good faith requirement.

Similarly, the amount disclosed for property taxes must be based on the best information reasonably available to the creditor at the time the disclosure was provided.

For example - If the creditor fails to include a charge for property taxes, or includes an unreasonably low estimate for that charge, on the original estimates provided, then the creditor's failure to disclose, or unreasonably low estimation, does not comply with TILA Regulation Z and the charge for property tax would be subject to the good faith determination. [45]

Revised Estimate Change of Circumstances

Changed circumstances cause the estimated charges on the Loan estimate provided to increase or, in the case of estimated charges that allow a variance, cause the aggregate amount of such charges to increase by more than ten percent.

The creditor may issue a revised loan estimate in good faith, and may use the revised estimate of a charge instead of the estimate originally disclosed if the revision is due to any of the following allowable change circumstance reasons:

1. An extraordinary event beyond the control of any interested party or other unexpected event specific to the consumer or transaction.

[45] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-3-iii-Interp-4

2. Information specific to the consumer or transaction that the creditor relied upon when providing the disclosures required was inaccurate or changed after the disclosures were provided, or
3. New information specific to the consumer or transaction that the creditor did not rely on when providing the original disclosures required.

A changed circumstance may be an extraordinary event beyond the control of any interested party.

For example - A war or a natural disaster would be an extraordinary event beyond the control of an interested party.

A changed circumstance may also be an unexpected event specific to the consumer or the transaction.

For example - If the creditor provided an estimate of title insurance on the disclosures required, but the title insurer goes out of business during underwriting, then this unexpected event specific to the transaction is a changed circumstance.

A changed circumstance may also be information specific to the consumer or transaction that the creditor relied upon when providing the disclosures required and that was inaccurate or changed after the disclosures were provided.

For example - If the creditor relied on the consumer's income when providing the disclosures required, and the consumer represented to the creditor that the consumer had an annual income of $90,000, but underwriting determines that the consumer's annual income is only $80,000, then this inaccuracy in information relied upon is a changed circumstance.

A changed circumstance may also be the discovery of new information specific to the consumer or transaction that the creditor did not rely on when providing the original disclosures required.

For example - If the creditor relied upon the value of the property in providing the disclosures required, but during underwriting a neighbor of the seller, upon learning of the impending sale of the property, files a claim contesting the boundary of the property to be sold, then this new information specific to the transaction is a changed circumstance.

CFPB Examples of Allowable Change of Circumstances

<u>Charges subject to the zero percent tolerance category.</u>

Assume a creditor provides a $200 estimated appraisal fee, which will be paid to an affiliated appraiser and therefore may not increase for purposes of determining good faith, except as provided in the regulations. The estimate was based on information provided by the consumer at application, which included information indicating that the subject property was a single-family dwelling. Upon arrival at the subject property, the appraiser discovers that the property is actually a single-family dwelling located on a farm. A different schedule of appraisal fees applies to residences located on farms. A changed circumstance has occurred (i.e., information provided by the consumer is found to be inaccurate after the disclosures required were provided), which caused an increase in the cost of the appraisal. Therefore, if the creditor issues a change of circumstances revised disclosure with the corrected appraisal fee, the actual appraisal fee of $400 paid at the real estate closing by the consumer will be compared to the revised appraisal fee of $400 to determine if the actual fee has increased above the estimated fee.

However, if the creditor failed to provide revised disclosures within the three-business day period after discovery of the change of circumstance, then the actual appraisal fee of $400 must be compared to the originally disclosed estimated appraisal fee of $200.[46] In this instance, the creditor would only be able to charge the consumer $200 appraisal fee at closing, and not the actual fee of $400.

Charges are subject to the ten percent tolerance category.

Assume a creditor provides a $400 estimate of title fees, which are included in the category of fees which may not increase by more than ten percent for the purposes of determining good faith, except as provided in the Regulations. During processing, an unreleased lien is discovered, and the title company must perform additional work to release the lien. However, the additional costs amount to only a five percent increase over the sum of all fees included in the category of fees which may not increase by more than ten percent. A changed circumstance has occurred (i.e., new information), but the sum of all costs subject to the ten percent tolerance category has not increased by more than ten percent tolerance.

TILA Regulation Z does not prohibit the creditor from issuing revised disclosures, but if the creditor issues revised disclosures in this scenario, when the closing disclosures required before closing are

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[46] [46] TILA 12 CFR Section §1026.19(e)(1)(i)

delivered, the actual title fees of $500 may not be compared to the revised title fees of $500; they must be compared to the originally estimated title fees of $400 because the changed circumstance did not cause the sum of all costs subject in this category to increase by more than ten percent.[47]

Six pieces of information presumed collected, but not required.

TILA Regulation Z requires creditors to deliver the disclosures no later than the third business day after the creditor receives the consumer's application, which consists of the six key pieces of information. A creditor is not required to collect any of the six pieces of information such as the consumer's name, monthly income, social security number to obtain a credit report, the property address, an estimate of the value of the property, or the mortgage loan amount sought.[48]

However, for purposes of determining whether an estimate is provided in good faith, a creditor is presumed to have collected these six pieces of information.

For example - If a creditor provides the disclosures required TILA Regulation Z prior to receiving the property address from the consumer, the creditor cannot subsequently claim that the receipt of the property address is a changed circumstance.[49]

TILA Loan Estimate Not Delivered in Timely Manner by Broker

The MMC examiners found the MMEs were not ensuring the consumer received the initial application disclosures required by TILA Regulation Z in a timely manner after application. As we discussed earlier, when a creditor accepts the mortgage broker handling of the initial disclosure, they accept the disclosures were provided within compliance to the timing requirements of TILA.[50] If any required disclosures are not provided to the consumer in person, the consumer is considered to have received the disclosures three business days after they are delivered or placed in the mail.

The creditors were given a violation for their brokered loan, where the initial Loan Estimate was not provided in a timely manner. In addition, the initial Loan Estimate must be provided no later than the third business day after the receipt of the consumer’s application even though a company is the

[47] [47] TILA 12 CFR Section §1026.19(e)(3)(iv)
[48] TILA Regulation Z Section §1026.19(e)(1)(iii)
[49] CFPB Official interpretation of 19(e)(3)(iv)(A)
[50] TILA 12 C.F.R. Section §1026.19(e)(1)

broker and might have established disclosure agreements with the wholesale lender. The responsibility falls on the originators (funding lender).[51]

The creditor is responsible for delivering or placing in the mail the Loan Estimate no later than the third business day after the creditor receives the consumer's application. Federal Regulation states in part that an application consists of the submission of the consumer's name, the consumer's income, the consumer's social security number to obtain a credit report, the property address, an estimate of the value of the property, and the mortgage loan amount sought.[52] Once this information is received by the broker or the creditor, the initial disclosure timing requirement starts.

Except as allowed by the regulations, the creditor must deliver or place in the mail the loan estimate disclosures required no later than the seventh business day before consummation of the transaction.

Waiver of Seven Day Timing Requirement

If the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency, the consumer may modify or waive the TILA seven-business-day waiting period for early disclosures, after receiving the disclosures required. To modify or waive the waiting period, the consumer must give the creditor a dated written statement that describes the emergency, specifically modifies, or waives the waiting period, and bears the signature of all the consumers who are primarily liable on the legal obligation. Printed forms for this purpose are prohibited.[53]

Whether a bona fide emergency exists is determined by the circumstances of the individual situation. The imminent sale of the consumer's home at foreclosure, where the foreclosure sale will proceed unless loan proceeds are made available to the consumer during the waiting period, is one example of a bona fide personal financial emergency. Each consumer who is primarily liable on the legal obligation must sign the written statement for the waiver to be effective.[54]

Delayed Construction Loan Settlement

In transactions involving new construction, where the creditor reasonably expects that settlement will occur more than sixty days after the initial disclosures required are provided, the creditor may

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[51] Topic 7: TILA 12 CFR Section §1026.19(e)(1)
[52] Federal Regulation Section §1026.2(a (3)(ii)
[53] Official interpretation of 19(e)(1)(v)
[54] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-1-v-Interp-1

provide revised disclosures to the consumer if the original disclosures state clearly and conspicuously that at any time prior to sixty days before consummation, the creditor may issue revised disclosures. If no such statement is provided, the creditor may not issue revised disclosures, except as allowable change of circumstances.

However, if a use and occupancy permit has been issued for the home prior to the issuance of the disclosures required, then the home is not considered to be under construction and the transaction would not be a construction loan to build a home for the purposes of this rule.[55]

If a creditor uses a revised estimate for the purpose of determining good faith, the creditor shall provide a revised version of the disclosures required including any corrected disclosures reflecting the revised estimate within three business days of receiving information sufficient to establish that one of the reasons for revision has occurred.

For example - The following examples illustrate these requirements:

- Assume a creditor requires a pest inspection. The unaffiliated pest inspection company informs the creditor on Monday that the subject property contains evidence of termite damage, requiring a further inspection, the cost of which will cause an increase in estimated settlement charges by more than ten percent. The creditor must provide revised disclosures by Thursday to comply with TILA Regulation Z.[56]
- Assume a creditor receives information on Monday that, because of a changed circumstance, the title fees will increase by an amount totaling six percent of the originally estimated settlement charges subject to the ten percent tolerance. The creditor had received information three weeks before that, because of a changed circumstance, the pest inspection fees increased by an amount totaling five percent of the originally estimated settlement charges. Thus, on Monday, the creditor has received sufficient information to establish a valid reason for revision and must provide revised disclosures reflecting the eleven percent increase by Thursday to comply with TILA Regulation Z tolerances.[57]
- Assume a creditor requires an appraisal. The creditor receives the appraisal report, which indicates that the value of the home is significantly lower than expected. However, the creditor

[55] CFPB interpretation of 19(e)(3)(iv)(F)
[56] TILA 12 CFR Section §1026.19(e)(4)(i)
[57] TILA 12 CFR Section §1026.19(e)(4)(i)

has reason to doubt the validity of the appraisal report. A reason for revision has not been established because the creditor reasonably believes that the appraisal report is incorrect. The creditor then chooses to send a different appraiser for a second opinion, but the second appraiser returns a similar report. At this point, the creditor has received information sufficient to establish that a reason for revision has, in fact, occurred, and must provide corrected disclosures within three business days of receiving the second appraisal report.

- In this example, in order to comply with the regulations, the creditor must maintain records documenting the creditor's doubts regarding the validity of the appraisal to demonstrate that the reason for revision did not occur upon receipt of the first appraisal report.[58]

Relationship Between Loan Estimates and Closing Disclosures

The creditor may not provide a revised version of the loan estimate disclosures required on or after the date on which the creditor provides the required closing disclosures. The consumer must receive any revised version of the initial TILA disclosures no later than four business days prior to consummation. If the revised version of the disclosures required is not provided to the consumer in person, the consumer is considered to have received such version three business days after the creditor delivers or places such version in the mail. If the consumer consents to the E-Sign Act, delivery is considered the same as if it were mailed unless other method is used to identify the consumer has received the email sooner than the 3-business day requirement for mail.

A revised Loan Estimate may not be delivered to the applicant at the same time as the Closing Disclosure. TILA Regulation Z requires that the consumer must receive any revised version of the loan estimate disclosures no later than four business days prior to consummation. However, if a creditor uses a revised estimate for the purpose of determining good faith and permits the creditor to provide the revision in the closing disclosure the creditor may still meet the four-day requirement.

For example -

1. If the creditor is scheduled to meet with the consumer and provide the closing disclosure required on Wednesday, June 3, and the APR becomes inaccurate on Tuesday, June 2, the

[58] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-4-i-Interp-1-iii

creditor complies with the requirements by providing the disclosures reflecting the revised APR on Wednesday, June 3. However, the creditor does not comply with the requirements if it provides both a revised version of the loan estimate disclosure reflecting the revised APR on Wednesday, June 3, and also provides the closing disclosures on Wednesday, June 3.

2. If the creditor is scheduled to email the loan estimate disclosures required to the consumer on Wednesday, June 3, and the consumer requests a change to the loan that would result in revised disclosures on Tuesday, June 2, the creditor complies with the requirements by providing the disclosures required reflecting the consumer-requested changes on Wednesday, June 3. However, the creditor does not comply with the requirements if it provides disclosures reflecting the consumer-requested changes using both the revised version of the loan estimate disclosures on Wednesday, June 3, and also the closing disclosures on Wednesday, June 3.
3. Consummation is scheduled for Thursday, June 4. The creditor hand delivers the disclosures required on Monday, June 1, and, on Tuesday, June 2, the consumer requests a change to the loan that would result in revised disclosures but would not require a new waiting period. The creditor is required to provide corrected disclosures reflecting any changed terms to the consumer so that the consumer receives the corrected disclosures at or before consummation. The creditor complies with the requirements by hand delivering or emailing the disclosures reflecting the consumer-requested changes on Thursday, June 4.
4. Consummation was originally scheduled for Wednesday, June 10. The creditor hand delivers or emails the disclosures required on Friday, June 5. On Monday, June 8, the consumer reschedules consummation for Wednesday, June 17. Also on Monday, June 8, the consumer requests a rate lock extension that would result in revised disclosures but would not require a new waiting period. The creditor complies with the requirements by delivering or placing in the mail the disclosures required reflecting the consumer-requested changes on Thursday, June 11. The creditor is required to provide corrected disclosures reflecting any changed terms to the consumer so that the consumer receives the corrected disclosures at or before consummation. The creditor complies with by hand delivering or emailing the disclosures on Thursday, June 11.
    a. Alternatively, the creditor complies by providing the disclosures to the consumer by mail, including by electronic mail, on Thursday, June 11, because the consumer is considered to have received the corrected disclosures on Monday, June 15 (unless the

creditor relies on evidence that the consumer received the corrected disclosures earlier).

5. Consummation was originally scheduled for Wednesday, June 10. The creditor hand delivers the disclosures required on Friday, June 5, and the APR becomes inaccurate on Monday, June 8, such that the creditor is required to delay consummation and provide corrected closing disclosures, including any other changed terms, so that the consumer receives them at least three business days before consummation. Consummation is rescheduled for Friday, June 12. The creditor complies with the requirements by hand delivering or emailing the disclosures reflecting the revised APR and any other changed terms to the consumer on Tuesday, June 9.[59]

CFPB Delivery Timing for Closing Disclosure

Except as provided in the regulations, the creditor must ensure that the consumer receives the closing disclosures required by TILA Regulation Z no later than three business days before consummation. If any required closing disclosure is not provided to the consumer in person, the consumer is considered to have received the disclosures three business days after they are delivered or placed in the mail.[60]

Mail Delivery

TILA Regulation Z provides that, if any disclosures required are not provided to the consumer in person, the consumer is considered to have received the disclosures three business days after they are delivered or placed in the mail. If the creditor delivers the closing disclosures required in person, consummation may occur at any time on the third business day following delivery.

Other Forms of Delivery

Creditors that use electronic mail or a courier other than the United States Postal Service may follow the timing requirements for disclosures provided by mail services.

For example - If a creditor sends a required disclosure via email on Monday, the consumer is considered to have received the disclosure on Thursday, three business days later. The creditor may,

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[59] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-4-ii-Interp-1-v
[60] CFPB Official interpretation of 19(f)(1)(ii) Timing

alternatively, rely on evidence that the consumer received the emailed disclosures earlier after delivery. The creditor may, alternatively, rely on evidence that the consumer received the disclosures earlier than three business days after mailing, such as by overnight delivery with signature required.[61]

Creditors using electronic delivery methods, such as email, must also comply with TILA timing requirements for when the consumer is thought to have received the disclosures.

For example - If a creditor delivers the required disclosures to a consumer via email, but the creditor did not obtain the consumer's consent to receive disclosures via email prior to delivering the disclosures, then the creditor does not comply with TILA or E-Sign Act.[62]

No fee may be imposed on any person, as a part of settlement costs or otherwise, by a creditor or by a servicer for the preparation or delivery of the closing disclosures required.

Post-Closing Disclosure (CD) Compliance

The MMC examiners found some MMEs were not providing the borrower with post-closing disclosure when there was a change for third party charges. The MMEs were cited for the violation. TILA requires creditors to provide the Post Closing Disclosure with any corrected Title fee so the amount of fees on the Closing Disclosure matches with the final settlement statement.[63]

If during the 30-day period following consummation, an event in connection with the settlement of the transaction occurs that causes the closing disclosures to become inaccurate, and such inaccuracy results in a change to an amount actually paid by the consumer from that amount disclosed, the creditor is required to deliver or place in the mail corrected disclosures not later than 30 days after receiving information sufficient to establish that such event has occurred.[64] The borrower has a right to have in their possession the final closing disclosure of all fees incurred for the transaction.

For example -

1. Assume consummation occurs on a Monday and the security instrument is recorded on Tuesday, the day after consummation. If the creditor learns on Tuesday that the fee charged by the recorder's office differs from that previously disclosed, and the changed fee results in a

[61] TILA 12 CFR Section §1026.19(f)(1)(ii)(A)
[62] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-f-1-iii-Interp-2
[63] TILA 12 CFR Section §1026.19(f)(2)(iii)
[64] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#f-2-ii-B

change in the amount actually paid by the consumer, the creditor complies with TILA Regulation Z by revising the disclosures accordingly and delivering or placing them in the mail no later than 30 days after Tuesday.

2. Assume consummation occurs on a Tuesday, October 1 and the security instrument is not recorded until 15 days after October 1 on Thursday, October 16. The creditor learns on Monday, November 4 that the transfer taxes owed to the State differ from those previously disclosed, resulting in an increase in the amount actually paid by the consumer. The creditor complies by revising the disclosures accordingly and delivering or placing them in the mail no later than 30 days after Monday, November 4.
    a. Assume further that the increase in transfer taxes paid by the consumer also exceeds the amount originally disclosed on the loan estimate making the fee change above the tolerance limitations allowed. The creditor does not violate TILA Regulation Z if the creditor refunds the excess to the consumer no later than 60 days after consummation, and the creditor delivers corrected closing disclosures to reflect the refund of such excess no later than 60 days after consummation. The creditor satisfies these requirements if it revises the disclosures accordingly and delivers or places them in the mail by November 30.
3. Assume consummation occurs on a Monday and the security instrument is recorded on Tuesday, the day after consummation. During the recording process on Tuesday the settlement agent and the creditor discover that the property is subject to an unpaid $500 nuisance abatement assessment, which was not disclosed, and learns that pursuant to an agreement with the seller, the seller will pay the $500 assessment rather than the consumer. Because the $500 assessment does not result in a change to an amount actually paid by the consumer, the creditor is not required to provide a corrected disclosure.
    a. However, the assessment will result in a change to an amount actually paid by the seller from the amount disclosed. The settlement agent must deliver or place in the mail corrected disclosures to the seller no later than 30 days after Tuesday and provide a copy to the creditor as required.
4. Assume consummation occurs on a Monday and the security instrument is recorded on Tuesday, the day after consummation. Assume further that ten days after consummation the municipality in which the property is located raises property tax rates effective after the date on which settlement concludes. TILA Regulation Z does not require the creditor to provide the

consumer with corrected disclosures because the increase in property tax rates is not in connection with the settlement of the transaction.[65]

If during the 30-day period following consummation, an event in connection with the settlement of the transaction occurs that causes the disclosures to become inaccurate, and such inaccuracy results in a change to an amount actually paid by the consumer from that amount disclosed, the creditor must provide the consumer corrected disclosures.

A creditor is not required to provide corrected disclosures if the only changes that would be required to be disclosed in the corrected disclosure are changes to per-diem interest and any disclosures affected by the change in per-diem interest, even if the amount of per-diem interest actually paid by the consumer differs from the amount disclosed. Nonetheless, if a creditor is providing a corrected disclosure for reasons other than changes in per-diem interest and the per-diem interest has changed as well, the creditor must disclose in the corrected disclosures the correct amount of the per-diem interest and provide corrected disclosures for any disclosures that are affected by the change in per-diem interest.[66]

[65] TILA Regulation Z, 12 CFR Section §1026.19(f)(2)(iii)
[66] https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#f-2-iii

Module 2 - Ethics

Ethics Lesson Objective:

The student will learn some of the regulations that govern ethical behavior in the mortgage industry. Some of these laws include the Telephone Consumer Protection Act, Whistleblower Regulations, ECOA, Unfair Deceptive Acts and Practices, the Fair Housing Act, and Housing Financial Discrimination Act. The student will have a strong understanding of what actions are prohibited after a review of these federal regulations. The course also reviews with the students current fraud schemes to prepare students to mitigate fraud in the mortgage industry.

Introduction

Ethics is a required topic for annual licensing, and an important part of professional mortgage lending. With the Dodd-Frank Act, Regulators believed licensing mortgage loan originators (MLOs) would achieve success to ensure that responsible, affordable mortgage credit remains available to consumers. Regulators understand reducing uncertainty facilitates compliance and that is why CFPB provides so many examples which we use in our courses.

Most licensed mortgage loan officers (MLOs), manage their business in an ethical manner. A few MLOs do not understand ethics, and the laws that govern their bad behavior. An MLO may believe they are managing their business in an ethical manner but may not be in compliance with some ethics focused federal regulations. All licensees, including individual MLOs, are responsible for performing their daily activities in an ethical and compliant manner.

CFPB Update

To improve the mortgage industry, the Consumer Financial Protection Bureau (CFPB) has increased their capacity for industry education and enforcement actions in 2023. For the first time a team of technologists dedicated to enforcement matters joined the CFPB. This cross-disciplinary team of technology experts has increased the Bureau’s capacity to enforce the law when emerging technologies harm consumers.

The CFPB recently announced they are significantly expanding their enforcement capacity in 2024 to build on their achievements so far. These positions include enforcement attorneys as well as non-attorney positions, including analysts, paralegals, e-litigation support specialists, economists, and more. These roles are located in the Washington, D.C. headquarters, and for many, in the regional offices in San Francisco, New York, Chicago, and Atlanta.[67]

Telephone Consumer Protection Act

The Telephone Consumer Protection Act (TCPA) was enacted in 1991 to impose restrictions on the use of automatic telephone auto dialing systems (Do Not Call Provision), artificial or pre-recorded voice messages, and fax machines that sent unsolicited advertisements. The Federal Communication Commission (FCC) adopted rules and regulations implementing the TCPA. Different rules and regulations apply on calls placed to homes rather than calls placed to businesses.

For the mortgage industry, CFPB regulates providing consumers the opportunity to opt out of telemarketing and information sharing.[68] The TCPA includes a Telemarketing Sales Rule with a Do Not Call Provision. The Telemarketing Sales Rule prohibits calling a consumer at home who had asked not to be called again.

Telemarketing Sales Rule

The Telemarketing Sales Rule (TSR) gives the consumers a choice about whether they want to receive telemarketing calls and makes it illegal for specified telemarketers to call consumers. This Act expressly prohibits outbound telemarketing calls that deliver a prerecorded message unless the seller has obtained the call recipient's prior signed and written agreement to receive such calls from that seller. To call or solicit a consumer listed on the Do Not Call Registry is a violation.

Some nonprofit organizations, political organizations, telephone surveyors, and charities are exempt from this regulation. The website with detailed information is at https://www.donotcall.gov/, and https://www.ftc.gov/business-guidance .

TCPA Violations and Fines

According to the Federal Trade Commission (FTC), failure to provide any of the required information truthfully and in a "clear and conspicuous" manner, before the consumer pays for the goods or

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[67] https://www.consumerfinance.gov/about-us/blog/the-cfpbs-enforcement-work-in-2023-and-what-lies-ahead/
[68] https://www.consumerfinance.gov/rules-policy/regulations/1022/24/

services offered, is a deceptive telemarketing act or practice that violates the TSR and subjects a seller or telemarketer to a civil penalty of $51,744 for each violation.[69]

CFPB Law Enforcement

Under the Consumer Financial Protection Act (CFPA), the CFPB has the authority to take action against institutions that violate consumer financial laws, including the use of unfair acts or practices, misleading or abusive acts, and against those that violate the Telemarketing Sales Regulations.

The CFPB had previously sued these companies to stop their illegal conduct and demand reparations and other compensation. In March 2023, the district court ruled that the defendants violated the advance fee provision of the Telemarketing Sales Rule. This regulation provides a series of protections to consumers related to telemarketing and establishes restrictions on payment for certain goods and services. It also requires credit repair companies to wait up to six months after providing the consumer with documentation that the promised results have been achieved before requesting or receiving payment from the consumer.

CFPB may ban violators from telemarketing or the financial industry for a period of time, or lifetime. They can prohibit other companies from doing business with certain affiliate marketers. These prohibitions will apply even after bankruptcy proceedings are completed.

CFPB required notifications to all remaining customers who were still enrolled using telemarketing. The notice must give the consumer the right to cancel their services, and the process for canceling them.

The CFPB may determine when its victim relief fund can be used to pay those harmed by perpetrators. Many laws allow for civil penalties as well as imposing civil monetary penalties.

Unlawful Junk Fees for Credit Repair Settlements

In August 2023, the CFPB entered into a settlement with a ring of corporate entities operating some of the largest credit repair brands in the country, including Lexington Law and CreditRepair.com. The settlement follows a federal court ruling that the companies violated federal law by collecting billions of dollars in illegal advance fees for credit repair services for many years.[70]

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[69] https://www.ftc.gov/business-guidance/resources/complying-telemarketing-sales-rule
[70] https://www.consumerfinance.gov/about-us/newsroom/cfpb-acuerda-con-conglomerado-de-reparacion-de-credito/

During the time period relevant to the lawsuit, the companies operated throughout the country and had more than four million customers who were subjected to telemarketing practices. As of 2022, the defendants had combined annual revenues of approximately $388 million. The settlement came after a court ruled that the companies charged illegal upfront fees for credit repair services using telemarketing, violating federal law. If approved, the resolution would impose a judgment of $2.7 billion on these companies. The order would also prohibit these companies from telemarketing credit repair services for ten years.

"*People looking to improve their credit scores across the country have turned to companies like CreditRepair.com and Lexington Law. These credit repair industry giants used bogus real estate and rent-to-own opportunities to illegally lure people in and line their pockets with billions of dollars in fees*," said CFPB Director Rohit Chopra. "*This scam is another sign that we need to work harder to fix the credit scoring and reporting system in our country*."

Following the district court ruling, the companies filed for Chapter 11 bankruptcy protection. The companies stated that they had closed about 80% of their business, including their call centers, and had laid off about nine hundred employees in response to the court ruling.

Whistleblower Regulations

The Consumer Financial Protection Bureau (CFPB) provides some protections for federal employees and applicants that are "whistleblower" with the Whistleblower Protection Act. A "whistleblower" provides information he or she reasonably believes have evidence of:

- A violation of any law, rule, or regulation
- Gross mismanagement
- A gross waste of funds
- An abuse of authority
- A substantial and specific danger to public health or safety

This bill requires the CFPB to provide awards to whistleblowers who report information resulting in monetary sanctions. Whistleblowers claiming an award are permitted to have legal representation.[71]

[71] https://www.ftc.gov/office-inspector-general/whistleblower-protection#:~:text=Overview%20of%20the%20WPA%20%2D%20The,supervisors%20who%20retaliate%20against%20Whistleblowers.

This Act protects federal employees or applicants against retaliation for telling authorities about suspected fraudulent activities. It prohibits federal agencies from taking or threatening a personnel action because an employee or applicant made a whistleblower disclosure.

In addition, mortgage industry personnel may not be retaliated against by their employer when the whistleblower reports wrongdoing to a federal, state, or local government authority or law enforcement agency. If the illegal conduct violates any provisions of Title X of the Dodd Frank Act, and it is reported, they will have whistleblower rights. If they have experienced retaliation, they may report it to the U.S. Occupational Safety and Health Administration.

A whistleblower may request that the Office of Inspector General (OIG) keep their identity confidential. An OIG is prohibited from disclosing an employee's identity without the employee's consent unless the OIG determines that disclosure is unavoidable or is compelled by a court order.[72]

Equal Credit Opportunity Act (ECOA), Regulation B

The Equal Credit Opportunity Act (ECOA) is among the oldest laws to provide guidance for ethical behavior. ECOA prohibits creditors from unethical and illegal discrimination against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income was derived from public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Ethics in the mortgage industry is required for consumers to trust their mortgage professional and lender.

ECOA and Fair Housing Act Prohibitions

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the Fair Housing Act (FHAct), it is unlawful for a lender to discriminate on a prohibited basis in a residential real estate related transaction. Under one or both of these laws, a lender may not, because of a prohibited factor:

[72] https://www.ftc.gov/office-inspector-general/whistleblower-protection#:~:text=Overview%20of%20the%20WPA%20%2D%20The,supervisors%20who%20retaliate%20against%20Whistleblowers.

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards.
- Discourage or selectively encourage applicants with respect to inquiries about applications for credit.
- Refuse to extend credit or use different standards in determining whether to extend credit.
- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan.[73]
- Use different standards to evaluate collateral.
- Treat a borrower differently in servicing a loan or invoking default remedies.
- Use different standards for pooling or packaging a loan in the secondary market.

A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis. A violation may still exist even if a lender treated applicants equally.

A lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower.
- A person associated with an applicant, prospective applicant, or borrower (**for example** - a co-applicant, spouse, business partner, or live-in aide).
- The present or prospective occupants of either the property to be financed or the characteristics of the neighborhood or other area where property to be financed is located.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.[74]

[73] https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/documents/4/iv-1-1.pdf
[74] https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/documents/4/iv-1-1.pdf

Discrimination

The Fair Housing Act (FHAct) and the Equal Credit Opportunity Act (ECOA) protect consumers by prohibiting unfair and discriminatory practices. Read the OCC's "Answers About Consumer Loans" and "Answers About Mortgages and Home Loans" for more information.[75]

The FHAct prohibits discrimination in residential real estate–related transactions based on -

- **race or color**
- **national origin**
- **religion**
- **sex**
- familial status
- handicap

ECOA prohibits discrimination in credit transactions based on -

- **race or color**
- **national origin**
- **religion**
- **sex**
- marital status
- age*
- applicant's receipt of income from a public assistance program
- applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act

*Age is a prohibited factor provided the applicant has the capacity to enter into a contract.[76]

Disparate Impact

A lender's policies, even when applied equally to all its credit applicants, may have a negative effect on certain applicants. **For example -** a lender may have a policy of not making single family home loans for less than $60,000. This policy might exclude a high number of applicants who have lower

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[75] https://www.occ.treas.gov/topics/consumers-and-communities/consumer-protection/truth-in-lending/index-truth-in-lending.html
[76] https://www.occ.treas.gov/topics/consumers-and-communities/consumer-protection/fair-lending/index-fair-lending.html

income levels or lower home values than the rest of the applicant pool. That uneven effect of the policy is called disparate impact.

Disparate Treatment

Illegal disparate treatment occurs when a lender bases its lending decision on one or more of the prohibited discriminatory factors covered by the fair lending laws.

For example – An 80-year-old borrower applies for a 30-year fixed mortgage. The creditor's mortgage loan originator pre-approves the loan request but limits the term to 15 years due to his age. The originator reasoned the borrower was a risk to the creditor since he likely would not live long enough to pay back the loan. The decision was not based on the fact the borrower qualified for the 30-year loan. This is 'blatant' age discrimination by the MLO.

The Fair Housing Act

The Fair Housing Act (FHAct) provides guidance for what is considered prohibited for mortgage lenders to consider when requesting financing for a home loan. FHAct prohibits discrimination based on race, color, national origin, religion, sex, familial status, or handicap. Members of a community should not be discouraged or excluded from the lending opportunities available to the masses based purely on a prohibited basis. To do so is considered unethical and predatory mortgage lending. Access to credit is a right for everyone, provided they qualify for the mortgage loan.

For example - A married couple applies for a home loan with the mortgage loan originator. The MLO decides to complete the loan in the wife's name only as she makes the most income. The MLO accepts the loan request and puts it into processing. The next day an unmarried couple comes in for a home loan application with the same loan originator. They both want to be on the loan, but the MLO discourages the couple from making a joint application because they are unmarried. The MLOs personal religion discourages sex outside of marriage, and he feels this would violate his beliefs. The MLO steers the consumers to only apply with one of them explaining it will be better for them to hold title this way since they are not married.

This is discrimination based on familial status, as the MLO treats married couples differently than unmarried couples. It would also be a violation of ECOA based on marital status. By having different requirements, he is limiting the availability of credit to the unmarried couple.

The mortgage loan originator's religious beliefs do not provide him a right to discriminate in residential mortgage lending. The MLO should have the right to have the unmarried couple go to another MLO in his office if he cannot provide unbiased service to avoid his company from having ECOA and FHAct violations.

Predatory Lending

Fair lending laws also contain provisions to address predatory lending practices.

For example -

- Collateral or equity "stripping": The practice of making loans that rely on the liquidation value of the borrower's home or other collateral rather than the borrower's ability to repay.
- Inadequate disclosure: The practice of failing to fully disclose or explain the true costs and risks of loan transactions.
- Risky loan terms and structures: The practice of making loans with terms or structures that make it more difficult or impossible for borrowers to reduce their indebtedness.
- Padding or packing: The practice of charging customers unearned, concealed, or unwarranted fees.
- Flipping: The practice of encouraging customers to frequently refinance mortgage loans solely for the purpose of earning loan-related fees without a net tangible benefit to the borrower.
- Single-premium credit insurance: The requirement to obtain life, disability, or unemployment insurance for which the consumer does not receive a net tangible financial benefit.

Unfair Deceptive Acts and Practices

Multiple government agencies work to fight fraud and protect consumers. Early on the Office of Comptroller of Currency (OCC) took the lead among the federal bank regulatory agencies in developing an approach to address unfair and deceptive marketing practices. These practices are often an element in predatory lending. The OCC has taken a number of enforcement actions against banks that were found to have engaged in abusive practices and, in one landmark case, required a bank to pay over $300 million in restitution to its customers.

The Housing Financial Discrimination Act

The Housing Financial Discrimination Act requires the Fair Lending Notice disclosure be signed by the borrower. The Fair Lending Notice provides information on acts that are illegal and unethical when determining a consumer’s credit worthiness. The combined disclosure encompasses the consumer rights provided in several Acts (RESPA, ECOA, and FHAct). This legislation identifies what is considered unethical to use when making a credit decision. FHAct prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to:

- Making loans to buy, build, repair, or improve a dwelling
- Purchasing real estate loans
- Selling, brokering, or appraising residential real estate, or
- Selling or renting a dwelling

For example - a mortgage lender decides they are going to stop approving loans in a low income ethic neighborhood because they have experienced too high a delinquency on the loans they produced in this neighborhood. This would be a violation of the Housing Discrimination Act due to using race and trends of a neighborhood to make lending policies unless the lender can justify doing loans in the area are unsound business practice. If the lender not providing loans in the area causes a negative impact to borrowers in this area, this would be considered unethical and unfair lending practices.

Lenders are required to look at all transactions on their own merits for making a credit decision, and not on any of the ECOA or Fair Housing Act prohibited factors.

Unlawfully Discriminatory Lending Practices

<u>Redlining</u>

Red-lining is where a particular neighborhood, zip code, or community are excluded from marketing efforts and/or loan approvals due to reasons that are not based on sound business practice but blatant, disparate-treatment or disparate-impact practices. **Redlining is the practice of denying a creditworthy applicant a loan for housing in a certain neighborhood even though the applicant may otherwise be eligible for the loan.** The term referred to the practice of mortgage lenders drawing red-lines around neighborhoods or census tracts on a map to indicate the unwanted areas to originate mortgage loans.[77]

For example - A mortgage banker that office is in a poor neighborhood may assume the borrowers would be unable to make the loan payments, so target advertising to only affluent areas fifty miles outside their immediate neighborhood. If this policy caused a disparate impact to the neighborhood

[77] https://www.federalreserve.gov/boarddocs/supmanual/cch/fair_lend_fhact.pdf

they serve, their policy would be a violation by making it difficult for residents in the neighborhood to obtain home financing.

The prohibition against redlining does not mean that a lending institution is expected to approve all housing loan applications or to make all loans on identical terms. Denying loans or granting loans on more-stringent terms and conditions, however, must be justified on the basis of the borrower creditworthiness and property acceptance; and without regard to the prospective borrower's race, color, religion, national origin, sex, marital status, or **the neighborhood in which the property is located**.

For example - a mortgage lender may consider such economic factors as:

- An applicant's income or credit history - Character
- The condition, use, or design of the proposed security property (or of those nearby properties that clearly affect the value of the proposed security property) – Collateral
- The availability of neighborhood amenities or city services – Collateral
- The need of the lender to hold a balanced real estate loan portfolio, with a reasonable distribution of loans among various neighborhoods, types of property, and loan amounts – Sound business practice.

It would not be sound business practice to be over exposed with a concentration of all business in one neighborhood. Diversified investments in lending may be considered a sound business practice. FHA limits the number of FHA insured condominium loans in a condo project to manage their risk exposure. Each of the factors must be applied without regard to any prohibited factors.

Lowballing

Lowballing is the practice of manipulating property values to obtain an excessively low appraisal in relation to the purchase price on the basis of prohibited considerations which is one form of redlining. Lending more than the appraised value of the collateral is not sound business practice, and lowballing forces a borrower either to cancel the purchase contract, the loan application, or both; or to make a larger down payment on a property in order to make up the difference between the sales price and the low appraised value.

For example - this may allow the lender to have a lower exposure to risk on this home loan since the loan amount was based on the lowballed price and the property is actually valued at a higher amount. If the lender did have to foreclosure, they would be more likely to be able to recoup their foreclosure losses. Benefit to the lender, not the consumer.

Racial Steering

Racial steering is deliberately guiding loan applicants or potential purchasers toward or away from certain types of loans or geographic areas because of race. This is a blatant ECOA violation and is illegal.

Application of Different Standards or Procedures

The application of different standards or procedures in administering foreclosures, late charges, penalties, reinstatements, or other collection procedures is unlawful. Collection practices must be fair to all clients and standards applied evenly to all clients.

Discriminatory Acts Have a Negative Impact

The courts have held that discriminatory acts that have a negative impact on non-minorities, such as white individuals, are illegal and that such individuals have standing to sue.

Excessively Burdensome Qualifications

The use of excessively burdensome qualification standards to deny, or that have the effect of denying, housing to minority applicants is also illegal under the FHAct.

Onerous Rates, Terms, Conditions, or Requirements

The imposition of more-onerous interest rates, or other more-onerous terms, conditions, or requirements, on minority loan applicants is explicitly prohibited. The phrase "terms or conditions" as used in the act covers many types of discriminatory practices.

Use of Racially Exclusive Images

The use of racially exclusive images has repeatedly been found to be illegal even when there was little, or no evidence of a discriminatory policy directed toward any given individual. This practice has been held to violate the Fair Housing Act as well.

For example - a housing lender might exploit an exclusive image by showing only applicants of a particular race in advertisements for home loans.

For example - using only white individuals in advertisements for home equity loans may suggest to viewers that 'only white applicants need apply' or 'only people who look like that could afford to have that type of loan.' How would a reasonable consumer view this advertisement?

Advertising must be inclusionary, as you may have noticed most modern-day ads show couples and families that are mixed race, same sex, single parent, and other combinations to include how people see themselves. To attract today's homebuyers and be in compliance with FHAct, mortgage lenders should reach out to the diverse community it serves.

Mortgage lenders are not expected to make unsound mortgage loans or to render services on more-favorable terms to applicants solely because of the applicant's status as a member of a protected class. However, denying loans or services on a prohibited basis is illegal.

Fraud Trend Evolution

According to Experian, the fraud landscape is constantly evolving, and staying vigilant against the latest trends is critical to safeguarding yourself, your organization, and your consumers. In 2023 these were the top fraud trends and their continued potential impact.[78]

When economic uncertainty reigns, a rise in fraud often follows. To begin with, consumers tend to be financially stressed in such periods and prone to making risky decisions. In addition, fraudsters are keenly aware of the opportunities inherent in unstable times and develop tactics to take advantage of them.

For example - As consumers rein in spending and financial institutions struggle to maintain new account volumes, fraudsters might ramp up their new account and loan activities.

Fraud is becoming more sophisticated.

For example - Thanks to the rapid rise in the availability of artificial intelligence (AI) tools, fraudsters are increasingly able to impersonate companies and individuals with ease, as well as consolidate data from diverse sources and use it more efficiently.

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[78] https://www.experian.com/blogs/insights/biggest-fraud-trends/#:~:text=Fraud%20is%20a%20serious%20concern,of%20concern%20about%20fraud%20risk.

CFPB Fraud Findings

The CFPB safeguards household financial stability by ensuring that consumer financial markets are fair, transparent, and competitive. Their enforcement authority is among the CFPB's most impactful tools for reinforcing compliance with federal consumer financial laws and sending a clear message to entities within their authority and the public that the CFPB remains vigilant on behalf of consumers.

When a financial institution, individual, or other entity subject to the CFPB's authority breaks the law, the CFPB may take enforcement action against them. As previously discussed, under certain cases, the CFPB may partner with other federal, state, or local agencies to investigate the wrongdoing and coordinate the enforcement action.

In 2023, the CFPB filed twenty-nine enforcement actions and resolved through final orders six previously filed lawsuits. Those orders require lawbreakers to pay approximately $3.07 billion to compensate harmed consumers and pay approximately $498 million in civil money penalties.[79]

Their enforcement actions are public knowledge, but we have left out the individual names for privacy. You may look up more information by following the citation link. Some of their enforcement actions included the following:

- Protecting service members from illegal high-interest loans and false advertising. In this action, a home loan company was banned from the mortgage lending industry.
- Action against a bank for illegally charging junk fees, withholding credit card rewards, and opening fake accounts.
- Action to stop loan churning is a refinancing scheme that repeatedly charged fees eat up the equity.
- Stopped unlawful junk advance fees for credit repair services.

CFPB Possible Future Fraud Risks

It is anticipated that markets in both U.S. and foreign financial services sectors will evolve to address different and ever-changing risk factors based on their programs, unique business mixes, and organizational structures. These future external challenges must be monitored, as they will impact

[79] https://www.consumerfinance.gov/about-us/blog/the-cfpbs-enforcement-work-in-2023-and-what-lies-ahead/#:~:text=In%202023%2C%20the%20CFPB%20filed,million%20in%20civil%20money%20penalties.

the work of the CFPB in protecting financial consumers and addressing a continually changing financial environment. It is also anticipated that as CFPB continues to exercise its authorities and regulate the financial services markets, the financial institutions in those markets will continue to contest the CFPB's rules, regulations, and authorities.

In addition, the CFPB's statutory method of funding has been the subject of litigation. On October 3, 2023, the Supreme Court heard oral arguments in CFPB v. Community Financial Services Association of America, in which a three-judge panel of the Fifth Circuit held in October 2022 that the law funding the CFPB's operations through the earnings of the Federal Reserve System violates the Appropriations Clause. To date, all other courts considering this question have upheld the CFPB's statutory funding mechanism, and a decision by the Supreme Court is expected in the first half of calendar year 2024. These contests may also impact the work of the CFPB in the future.[80]

Fraud Motivations

There are two basic motivations for mortgage fraud. Fraud for housing and fraud for profit.

Fraud for Housing

Fraud for Housing primarily consists of illegal actions by borrowers motivated to acquire or maintain ownership of a home. This type of fraud is committed when a borrower materially misrepresents information on a mortgage loan application such as employment, income, or assets in order to obtain a mortgage. The borrower is motivated to acquire ownership of a house.

Some fraud for housing people purchases a home as an owner occupied for a cousin or other close family member, knowing they will not be moving into the property. Creditors have put more conditions on borrowers that are purchasing their second property and retaining their current primary resident because of this fraud issue.[81]

FHA Requirements

If Rental Income is being derived from the Property being vacated by the Borrower, the Borrower must be relocating to an area more than one hundred miles from the Borrower's current Principal

[80] https://files.consumerfinance.gov/f/documents/cfpb_final-financial-report-fy_2023-11.pdf, page 51
[81] https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Fraud-Prevention.aspx

Residence. The Mortgagee must obtain a lease agreement of at least one year's duration after the Mortgage is closed and evidence of the payment of the security deposit or first month's rent.[82]

FNMA Requirements

When the borrower owns mortgaged real estate, the status of the property determines how the existing property's PITI must be considered in qualifying for the new mortgage transaction. If the mortgaged property owned by the borrower is -

- an existing investment property or a current principal residence converting to investment use, the borrower must be qualified in accordance with, but not limited to all FNMA policies regarding rental income use, reserve requirements and limits on financed properties.
- an existing second home or a current principal residence converting to a second home, the PITI of the second home must also be counted as part of the borrower's recurring monthly debt obligations.[83]

Fraud for Profit

This type of fraud is a more complex process involving a group of industry insiders attempting to defraud lenders for profit. Those who commit this type of mortgage fraud use their knowledge or authority to commit or facilitate the fraud.

This collusion by industry insiders may include mortgage loan originators, appraisers, mortgage brokers, attorneys, or other professionals engaged in the industry. Fraud for profit aims not to secure housing, but to misuse the mortgage lending process to steal cash and equity from lenders or homeowners.

Fraud for Profit schemes aim to gain cash or home equity through abuse of the mortgage lending process. This is the type of fraud federal agencies target as it does the most damage to consumers and the mortgage industry.[84]

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[82] https://www.hud.gov/sites/dfiles/OCHCO/documents/4000.1hsgh-011823.pdf
[83] https://selling-guide.fanniemae.com/Selling-Guide/Origination-through-Closing/Subpart-B3-Underwriting-Borrowers/Chapter-B3-6-Liability-Assessment/1032991161/B3-6-06-Qualifying-Impact-of-Other-Real-Estate-Owned-06-30-2015.htm
[84] https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Fraud-Prevention.aspx

Collusion Issues

Mortgage fraud can occur through the actions of borrowers and through the actions of mortgage industry professionals in connection with obtaining a mortgage loan. Common instances of fraud committed by borrowers and mortgage industry professionals include:

- Providing false information regarding employment status, income level, or employer
- Misrepresenting the source of funds for a borrower's down payment
- Falsifying a borrower's credit score and/or outstanding debts and liabilities
- Misrepresenting a borrower's intent to occupy the property
- Providing false information concerning a borrower's identity
- Using inaccurate appraisal figures to misrepresent the true value of a property
- Obtaining multiple loans on a single property based on false information
- Providing false property information to secure or modify a loan
- Misrepresenting income, hardship, or related information to halt foreclosure or influence a short-sale decision[85]

Impactful Fraud Trends of 2023

The fraud trends that emerged in 2023 were diverse, though they all had one thing in common: fraudsters' ability to take advantage of new technologies and opportunities. Businesses are feeling the repercussions, with nearly 70% reporting that fraud losses have increased in recent years.

Here are five trends Experian forecasted in the fraud and identity space that challenged regulators and mortgage professionals this year. Some of your home loan applicants may fall victim to these types of fraud.

Deposit and Checking Account Fraud

With everyone focused on fraud in the on-line channels, it is interesting that financial institutions reported more fraud occurring at brick-and-mortar locations. Preying on the good nature of helpful branch employees, criminals are taking risks by showing up in person to open accounts, pass bad

[85] https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Fraud-Prevention.aspx

deposits and try to work their way into other financial products. The Treasury Department reports complaints doubling YoY, after increasing more than 150% between 2020 and 2021.

Synthetic Identity Fraud

Not quite fake, not quite real, so-called synthetic or "Frankenstein" identities mash up real data with false information to create unique customer profiles that can outsmart retailers' or financial institutions' fraud control systems. With synthetic identity (SID) fraud, real data is often stolen or purchased on the dark web and combined with other information, even Artificial Intelligence (AI), to created faces so that fraudsters can build up a synthetic identity's credit score before taking advantage of them to borrow and spend money that will never be paid back.

Fake Job Postings and Mule Schemes

Well-paying remote work was in high demand, creating opportunities for fraudsters to create fake jobs to harvest data such as Social Security numbers from unsuspecting applicants. Experian predicts a continued rise in "mule" jobs, in which workers unknowingly sign on to do illegal work, such as re-shipping stolen goods.

According to the Better Business Bureau, an estimated fourteen million people get caught in a fake employment fraud yearly. Job seekers can protect themselves by being skeptical of jobs that ask them to do work that appears suspicious, requires money, financial details, or personal information upfront.

Peer-to-peer Payment Fraud

Peer-to-peer payment tools are increasingly popular with consumers and fraudsters, who appreciate that they are both instant and irreversible. Experian expects to continue to see an increase in fraudulent activity on these payment systems, as fraudsters use social engineering techniques to deceive consumers into paying for nonexistent merchandise or even sharing access credentials. Stay safe while using peer-to-peer payment tools by avoiding common scams like requests to return accidental payments, opting for payment protection whenever possible and choosing other transaction methods like paying with a credit card.

Social Media Shopping Fraud

Social media platforms are eager to make in-app shopping fun and friction-free for consumers, and many brands and shoppers are keen to get on board. In fact, approximately 58% of users in the U.S. have purchased a product after seeing it on social media.

Unfortunately, these tools neglect effective identity resolution and fraud prevention, leaving sellers vulnerable to fraudulent purchases. And while buyers have some recourse when a purchase turns out to be a scam, it is wise to be cautious while shopping on social media platforms by researching sellers, only using credit cards and being cognizant of common scams, like when vendors on Facebook Marketplace ask for payment upfront.

Employer Text Fraud

Fraudulent text messages, also known as "smishing," a mash-up of Short Messaging Service (SMS) and phishing continues to rise. In fact, according to data security company Lookout, 2022 was the biggest year ever for such mobile phishing attacks, with more than thirty percent of personal and enterprise mobile phone users exposed every quarter.

Fraud Prevention and Detection Matter

Nearly two-thirds of consumers say they are "very" or "somewhat concerned" with online security, and more than eighty five percent expect businesses to respond to their identity and fraud concerns. Addressing and preventing fraud and communicating these fraud-prevention actions to customers is an essential strategy for businesses that want to maintain customer trust, thereby decreasing churn and maximizing conversions on new leads.

Fraud Strategy

According to Experian, in 2024 fraud management solutions must be even more technically advanced than the fraudulent techniques they are combating. But more than that, they need to be appealing to consumers, who are likely to abandon signup or purchase attempts when they become too onerous. In fact, 37% of consumers have moved their business elsewhere due to a negative account opening experience.

To succeed, effective fraud strategies must be seamless, low friction, data-driven and customer-focused. That means making use of up-to-date technologies that boost security while prioritizing a positive customer experience.

Experian and other providers have creditor tools for fraud prevention and identity verification tools which help creditors detect and combat fraud. If a company is unable to manage with their own staff, outside companies can provide the service to implement a fraud management solution.[86]

Omnichannel Fraud Report

According to Transunion, globally in 2022 fraud returned to something more closely resembling pre-pandemic levels. However, with increased digital transaction volumes, the risk to organizations and individuals was even greater than before.[87]

Transunion's 2023 State of Omnichannel Fraud Report provided insights and recommendations for implementing smarter, more effective fraud prevention strategies that build consumer trust by demonstrating safety in customer experiences.

Global fraud trends highlighted in the report include:

- Growth in digital transactions is driving fraud risk exposure
- 4.6% of global digital transactions were potentially fraudulent in 2022
- 80% increase in digital transactions resulted in 80% growth in suspected digital fraud attempts globally from 2019 to 2022
- Stolen identifiers are being weaponized to commit increasingly sophisticated fraud
- 83% increase in publicly reported data breaches in the US from 2020 to 2022
- $4.6 billion outstanding balances attributed to suspected synthetic identities for US auto loans, credit cards, retail credit cards and unsecured personal loans (highest level ever and a 27% increase since 2020)
- Fraudsters are using every available digital channel to access consumer accounts
- 62% of high-risk phone calls into US call centers were from non-fixed VoIP phone lines in 2022
- 52% of consumers said they were targeted with online, email, phone call or text messaging fraud attempts from Sept. to Dec. 2022

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[86] https://www.experian.com/blogs/insights/biggest-fraud-trends/#:~:text=Fraud%20is%20a%20serious%20concern,of%20concern%20about%20fraud%20risk.
[87] https://www.transunion.com/report/omnichannel-fraud-report

Equifax Consumer Debt Observations

As of January 2024, the total US consumer debt is $17.33 trillion, up 2.3% over a year ago. Mortgage debt, including home equity loans, accounts for $12.58 trillion, a 72.6% share of total debt. Non-mortgage debt totals $4.75 trillion, equating to a 27.4% share.

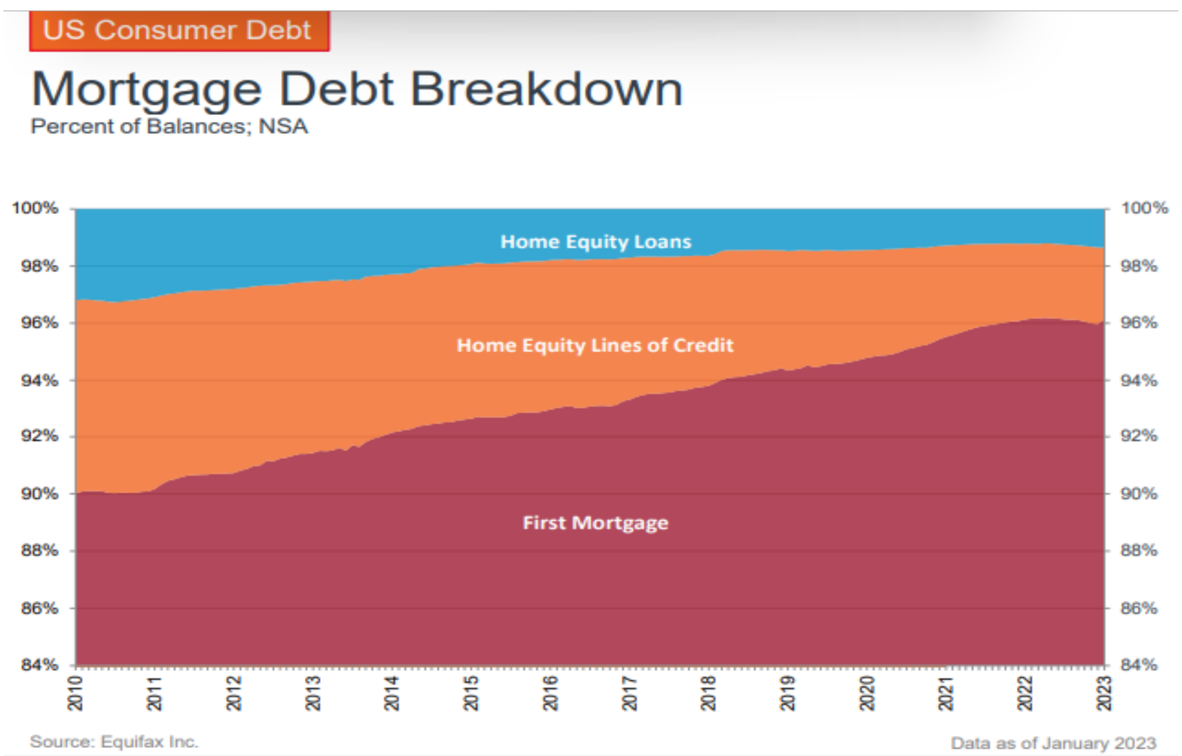
In January 2024, 34.3% of non-mortgage consumer debt is from auto loans and leases, 31.9% is from student loans, and 23% is from credit card balances.

As of January 2024, HELOCs are 2.7% of mortgage debt outstanding and first mortgages account for 95.8%. Total mortgage debt is over 20% below the October 2008 peak level.

In January 2024, non-mortgage consumer debt write-offs came in at $12.98 billion, which is an increase of 41.8% over a year ago.

First Mortgage Trends

The following graph shows the growth of first mortgage debt for consumers over the last 20+ years. [88]



[88] https://assets.equifax.com/marketing/US/assets/EFX_PortfolioCreditTrends_202301.pdf, page 11

First Mortgage Observation

As of January 2023, there were 53.28 million outstanding first mortgage loans, up 2.3% from January 2022.

First mortgage outstanding balances have risen steadily since June 2013 ($7.747 trillion), reaching $11.769 trillion.

The severe delinquency rate (share of balances 90+ Days Past Due, in bankruptcy or foreclosure) is 0.40%. This is up 7 bps from a year ago, when it stood at 0.33%.

Write-offs are at 0.48 bps on balances and 1.06 bps on accounts and are up from 0.38 bps and 0.77 bps from a year ago.

Home Equity Installment Loan Observations

Outstanding balances on home equity installment loans or fixed second mortgages rose 24.9% year-over-year to $166.0 billion.

The total number of outstanding home equity installment loans stands at 5.08 million, which is an increase of 13.1% compared to a year ago.

The severe delinquency rate (share of balances 90+ Days Past Due, in bankruptcy or foreclosure) is 0.73%, comparable with this time last year.

Monthly write-offs are at 14.06 bps as a share of outstanding balances.

This is 9.45 bps higher than the same time last year. HE Loan write-offs peaked in October 2008 at 38.8 bps.

Home Equity Lines of Credit Observations

Outstanding HELOC balances are $306.8 billion. This is a 2.2% increase in total balances from a year ago, and a 54.6% decrease from the May 2009 peak of $676.5 billion.

Outstanding HELOC accounts have similarly fallen over the past year from 7.95 million HELOCs in January 2022 to 8.99 million in January 2023, a 17.7% increase.

Utilization rates continue to trend down, sitting at 37.2% in January 2023 down from 37.3% a year ago. HELOC utilization rates peaked in December 2010 at 54.8%.

The severe delinquency rate (share of 90+ Days Past Due, in bankruptcy or foreclosure) is 0.44% which is a 10 bps decrease from the same month last year. In December 2009, severe delinquencies peaked at 2.86%.

Total aggregate HELOC credit limits continue to slowly trend down.

Senior Consumer Fraud

Seniors have long been targeted by fraudsters using the phone primarily to dupe seniors into sending money or other private information to savvy fraudsters. This segment of the population frequently are victims of violent crime, property crime, and consumer and telemarketing fraud. Scammers target those over fifty years of age with their telephone fraud schemes.

The Federal Trade Commission was authorized to enforce The Telemarketing and Consumer Fraud and Abuse Prevention Act, and target telephone fraud schemes to consumers.

The Act required the Federal Communications Commission (FCC) to promulgate regulations by -

1. defining and prohibiting deceptive telemarketing acts or practices
2. prohibiting telemarketers from engaging in a pattern of unsolicited telephone calls that a reasonable consumer would consider coercive or an invasion of privacy
3. restricting the hours of the day and night when unsolicited telephone calls may be made to consumers
4. requiring disclosure of the nature of the call at the start of an unsolicited call made to sell goods or services.[89]

Organizations including the Administration on Aging provide the elderly education about how to identify a scam, rules to never give out personal information over the phone, and updates on the current fraud scams affecting the elderly. Awareness is important for seniors to be aware of what scammers are doing and recognize when they are being scammed. They are also provided with the information to turn the fraudster in for legal action.

[89] https://www.ftc.gov/legal-library/browse/statutes/telemarketing-consumer-fraud-abuse-prevention-act

The Money Smart for Older Adults Program raises awareness among older adults and their caregivers on how to prevent fraud, scams, and other elder financial exploitation. The curriculum encourages advanced planning and informed financial decision-making.[90]

In the mortgage industry, reverse mortgage fraud has been a problem for seniors. A reverse mortgage is a special type of loan that allows homeowners 62 years of age and older to borrow against the accrued equity in their homes. The loan must be paid back when the borrower dies, moves, or no longer lives in the home. Fraud scams will get seniors to remove their property's equity only to get the funds stolen after loan funding.

For example - one fraud scam includes the homeowner's line of credit gets depleted shortly after closing often without the elderly homeowner's knowledge. Often this is done by an unethical family member, MLO, or fraudster.

Covid-19 pandemic has changed how people interact when managing financial matters with over the phone or electronic transactions, becoming the norm over face-to-face interaction. As a result of the economic uncertainty caused by the COVID-19 pandemic, scammers target older homeowners with home equity through reverse mortgage schemes.

These schemes can include:

- A trusted family member or caregiver coercing an elderly homeowner into applying for a reverse mortgage loan or impersonating their elderly relative during the loan process.
- Using an older homeowner's identity, Social Security number, or other personal information without his or her knowledge to get the equity loan money.
- Tempting reverse mortgage borrowers to use loan money to make a "can't miss" investment or to take out a reverse mortgage to pay for high-cost repairs or improvements to the home.
- Trying to convince the reverse mortgage borrower to sign a power of attorney that gives the scammer sole access to the reverse mortgage loan money.

[90] https://www.fdic.gov/resources/consumers/money-smart/teach-money-smart/money-smart-for-older-adults.html#:~:text=The%20Money%20Smart%20for%20Older,and%20informed%20financial%20decision%2Dmaking.

Many older homeowners do not realize they have been scammed until the loan money and their property equity is gone. Scammers may target older adults through community organizations; investment seminars; and television, radio, billboard, and mailer advertisements.[91]

The CFPB advises seniors that reverse mortgage ads do not always tell the whole story. They recommend they consider these facts when viewing an advertisement:

- A reverse mortgage is a home loan, not a government benefit. Reverse mortgages have fees and compounding interest that must be repaid, just like other home loans.
- A homeowner can lose their home with a reverse mortgage. **For example** - when a reverse mortgage ad says you will retain ownership of your home, or that you can live there as long as you want to, do not take these messages at face value.
- Without a good plan, a homeowner could outlive their loan money. **For example** - after seeing a reverse mortgage ad, a homeowner may think that a reverse mortgage guarantees financial security no matter how long you live.

Equity-rich, cash poor, elderly homeowners are an attractive target for unethical predatory lenders. Many elderly homeowners are on fixed or limited income yet need access to credit to pay for home repairs, medical care, property or municipal taxes, and other expenses. Predatory lenders profit from elders' needs for cash with loans packed with high interest rates, excessive fees and costs, credit insurance, balloon payments and other predatory terms.

Family Fraud Scams

When a family member cannot qualify, another family member will purchase the home in their name. The family member on the loan may not take occupancy of the property. Often, they will state they are going to rent their current home and move into the property they are purchasing. Yet after closing they allow the non-qualifying family member to move into the home, and they continue to occupy their existing home. There are some loan programs that would allow a non-occupying co-borrower to be on the loan and assist the borrower to qualify. Without disclosing the true occupancy of the property, this is considered occupancy fraud for housing.

[91] https://www.consumerfinance.gov/about-us/blog/avoid-reverse-mortgage-shopping-scams/

Additionally, a family member may try to steal the equity of another family member's home. The family member may steal the identity of the family member or push the transaction on the family member without explaining the transaction fully to the unsuspecting homeowner. Then the unethical family member may steal the cash equity with a second mortgage, reverse mortgage line of credit or cash out refinance. The homeowner may or may not be aware of the home loan transaction.

Air Loan Fraud Scheme

The air loan is a loan obtained on a nonexistent property or for a nonexistent borrower putting cash into the hands of the fraudsters. With no property ever bought or sold takes a group of professionals to work together to create a fake borrower, fake chain of title, and get a title and property insurance binder. The fraud chain may include phone banks and mailboxes to create fake employment verifications, home addresses and borrower telephone numbers.

Real Estate Cash Purchases Fraud

For this scheme, criminals use cash purchases to make payments in full for properties to evade the scrutiny on the origin of their funds they would experience by a financial institution. Many cash transactions are routine and legitimate, yet present significant opportunities for exploitation by unethical fraudsters.

Shell Companies Fraud

Criminals launder money to hide the illicit origin of their funds. Shell companies are typically non-publicly traded corporations, limited liability companies, or trusts that have no physical presence except a mailing address. Shell companies can be formed without disclosing the ultimate owners or people in control of them and can be used to conduct financial transactions without disclosing the true beneficial owners' involvement. Criminals abuse this anonymity to mask their identities, involvement in transactions, and origins of their wealth, hindering law enforcement efforts to identify individuals behind illicit activity.

Real Estate Broker Fraud

Real estate agents may be victims of a cash buyer scam that includes a fraudster that never intends to purchase the property. They lull a real estate agent to help them with cashier's check or bogus check and provide it to the broker. The fraudster identifies they have made an error in the amount or the account it was sent from and asks that all or a portion of the money be returned to them out of the broker or escrow account. Unsuspecting, the broker sends the money only to find out the funds received were not legitimate when the cashier's check is processed.

Other Fraud Schemes

The increase in **income fraud** follows the trend of rising home prices with strong demand for homes. Most income fraud cases are fraud-for-housing motivated borrowers trying to qualify to purchase a home. Other income frauds are misrepresentations and may be fraud-for-profit schemes.

This typical fraud scenario includes the borrower having a new job with a significant pay increase or a high paying first job out of college. As it is a new job, the lender is unable to validate the job with the IRS.

Occupancy fraud occurs when mortgage applicants deliberately misrepresent their intended use for the property. Loan program pricing and guidelines change depending on the type of occupancy.

Transaction fraud occurs when the nature of the mortgage loan transaction is misrepresented. The risk includes third-party risk, non-arm length transactions and straw buyers. Straw buyers are often used when the fraudster has no intention of using or controlling the purchase of the home and disguises the true buyer or the true nature of the loan transaction.

Multi-closing fraud is a scam that takes advantage of the lag time between closing and recording showing in public record to obtain multiple loans on a single property. The fraudster will close several home loans simultaneously, often on the same day, allowing multiple liens on the property to provide cash out on each to the fraudster.

Identity Theft Fraud

The Red Flag Rules provision from amendments to the Fair Credit Reporting Act (FCRA) requires financial institutions to implement an identity theft prevention program. The Red Flag Rules requires a financial institution with consumers private information maintain policies and procedures for detecting, preventing, and mitigating identity theft.[92]

Identity theft is when one person uses another person's identity with illegal intensions. They may use someone's social security number or other personal information with illegal intensions for any number

[92] http://www.ftc.gov/bcp/edu/microsites/redflagsrule/diy-template.shtm

of illegal financial crimes, including opening new accounts, making purchases, buying a home, or getting someone's tax refund.

Mortgage loan originators are licensed professionals that are required to operate in a sound business manner that does not harm the consumer. Creditors require their staff to follow their company's comprehensive fraud and identity theft prevention program. While working with borrowers' mortgage loan originators must ensure who they are working with is in fact the person they presented to be. They must look for red flags that fall into five categories:

1. alerts, notifications, or warnings from a consumer reporting agency
2. suspicious documents
3. suspicious personally identifying information, such as a suspicious address (document information does not match credit report information)
4. unusual use of – or suspicious activity relating to – a covered account (such as checking account or credit card)
5. notices from customers, victims of identity theft, law enforcement authorities, or other businesses about possible identity theft in connection with covered accounts

When fraud is detected, the ethical procedure is to report the suspicious activity to a compliance or BSA officer. A mortgage loan originator is responsible to ensure they do not fund a fraudulent mortgage loan.[93]

ID Theft Prevention Program Compliance: A Four Step Process

The Red Flag Rules require mortgage lenders to have a comprehensive Fraud Prevention Program designed to identify and detect the warning signs (red flags) of identity theft in their day-to-day operations and prevent and mitigate identity theft from occurring. The Federal Trade Commission offers the following four step process for compliance.[94]

[93] https://www.finra.org/sites/default/files/Industry/p119095.pdf
[94] https://www.ftc.gov/tips-advice/business-center/guidance/fighting-identity-theft-red-flags-rule-how-guide-business

1. Identify Relevant Red Flags

The first step is to be able to identify and understand what the potential patterns, practices, or specific activities are indicating the possibility of identity theft.

Mortgage lenders must:

a. Understand the Risk Factors
   - Different types of accounts pose different kinds of risk. **For example** -a red flags for an owner-occupied home loan may differ from red flags for an investor home loan.
   - Consider other sources of information, including the other parties in the mortgage transaction. **For example** – is the transaction arms-length or do the parties have a previous relationship?
   - Technology and criminal techniques change constantly. Mortgage professionals must stay informed and up to date on new scams. **For example** – regulations require annual training to understand ethics and how to mitigate fraud.

b. Listen to the Red Flags, Alerts, Notifications, and Warnings from a Credit Reporting Company. Credit reports will flag information that is different from the last time the borrower had their credit pulled. Changes in a credit report or a consumer's credit activity might signal identity theft and requires the MLO to ask probing questions to identify if the person they are working with is the person they say they are. Some alerts could be:
   - a fraud or active-duty alert on a credit report
   - a notice of credit freeze in response to a request for a credit report
   - a notice of address discrepancy provided by a credit reporting company
   - a credit report indicating they work at different jobs or lines of work than what was provided on the loan application
     - **For example –** credit report shows borrower work for catering type companies, but the job on the application show he has worked in construction for ten years

c. Pay attention to Suspicious Documents. Reviewing the documents supplied by the borrower for red flags is an important part for MLOs. Loan document reg flags to look for include:
   - identification looks altered or forged
   - the person presenting the identification does not look like the photo, match the physical description, or wrong age
   - the bank statement columns look out of alignment

- fonts on the document vary and are not aligned

d. Look for Suspicious Personal Identifying Information. Personal identifying information can indicate identity theft inconsistencies with what is known.
   - information on the identification or application differs from information in borrower's credit file shows:
     - an address that does not match the credit report
     - the use of a Social Security number that is listed on the Social Security Administration Death Master File
     - a person who omits required information on an application and does not respond to notices that the application is incomplete

e. Review Notices from Other Sources. A customer, a victim of identity theft, a law enforcement authority, or someone else notifies the MLO that an account has been opened or identity used fraudulently.

2. Detect Red Flags

The Program must address the detection of red flags in connection with the opening of covered accounts and existing covered accounts. The mortgage lender's program must consider how the process can ensure the accuracy of the borrowers' identity and authentication methods that are effective. The method to obtain an identity verification or authentication will vary depending on if the loan application is taken in person, by telephone, mail, or online.

For online authentication, the Federal Financial Institutions Examination Council's guidance explores the application of multi-factor authentication techniques in high-risk environments, including using passwords, PINs, smart cards, tokens, and biometric identification. Certain types of personal information like a Social Security number, date of birth, mother's maiden name, or mailing address are not considered reliable authenticators because they are accessible online.[95]

3. Prevent and Mitigate Identity Theft

Once an MLO identifies a red flag, an MLO must be prepared to respond by following its company's policies and procedures in compliance with this regulation. Questionable activities or documents

[95] https://www.ffiec.gov/guidance/Authentication-and-Access-to-Financial-Institution-Services-and-Systems.pdf

should be escalated according to the degree of fraud suspected. When warranted, the MLO will need to complete a SAR (Suspicious Activity Report) to send to the BSA Officer or Compliance Officer in accordance with their company's policies. It is the MLOs responsibility to prevent fraud, and not fund fraudulent loans into the secondary market.

Funding a fraudulent loan is not worth losing your mortgage license or potential criminal record. Fraud costs the mortgage industry billions every year. If MLOs can help to prevent fraud, lenders would have better pricing and the home loan process would flow smoothly for the legitimate home loans. Fraud prevention is a team effort on all levels.

4. Update the Program

Mortgage companies spend a good portion of the budget on technology and protection of their software, facilities, and databases. As regulations and procedures change to stop fraud, fraudsters adapt and create new scams. A mortgage company must continually update and recognize new red flags as they emerge.

The Program must provide for the continued administration of the Program and must:

- Obtain approval of the initial written Program from either its board of directors or an appropriate committee of the board of directors. Fraud prevention comes from the top-down through a company.
- Involve the board of directors, an appropriate committee, or a designated employee at the level of senior management in the oversight, development, implementation, and administration of the Program.
- Train staff no less than annually to effectively implement the Program.

Customer Identification Program (CIP)

The Red Flag Rule contains guidance for what are considered "reasonable policies and procedures." A creditors program should contain procedures for verifying the customer's identity, starting with the identifying information obtained from the customer and non-documentary methods. These borrower identification procedures should address customer verification through documents and third-party verifications.[96]

A CIP should specify acceptable personally identifying information that will be required of each customer applying for a covered account. At a minimum, this should include name, date of birth, address, and photo. The main government agencies require the borrower to provide a government issued photo ID (passport or driver's license) and copy of their social security card or other government tax identification.

For example - copy of a resident alien or individual taxpayer identification number (ITIN) card.

Additional verification for certain borrowers (for example, self-employed borrowers) who may need to document their liability and authority over the business.

Address Discrepancies Duties

The mortgage company's policies and procedures should be designed to train and enable an MLO or other employees who receives the notice of address discrepancy from a consumer reporting agency to take appropriate action to investigate the information discrepancy. The notice should indicate the address used to order the report given by the consumer differs from the address contained in the consumer report. Underwriters will require a satisfactory letter of explanation from the consumer.

The mortgage lender must document that an address is accurate by any of the following means:

1. Verification of the address with the consumer
2. Review of the organization's records
3. Verification of the address through third-party sources
4. Confirmation against other loan documents received and verified
5. Other reasonable means

If the mortgage lender cannot confirm the proposed borrower's information, this is a red flag and will require additional scrutiny of the information in the loan file and escalation to the BSA Officer in charge.

[96] https://www.consumerfinance.gov/rules-policy/regulations/1022/82/

Change of Address

According to the United States Postal Service (USPS), nearly 33.2 million addresses changes went through the post office in 2022.[97] In terms of identity theft, address fraud is one of the easiest crimes for criminals to perpetrate. The online ease to change your address opens the door for an exploitable weakness in the process.

USPS is very aware of address fraud and does what they can to prevent it from happening. Notably sending move validation letters to both the consumer's previous address and new address when they receive an address change request. USPS has changed to only accepting online address change requests with added layers of online fraud protection.

A criminal can do a lot of damage in a brief period of time. Some identity thieves have found a way to get around the USPS notice letter by putting a vacation hold on all mail to your current address.[98] This allows them even more time before you become aware of the identity theft crisis.

With FCRA regulations, the creditor is supposed to identify when a consumer is acting out of character and notice that the request for credit is not valid. Mortgage lenders have good reason to be concerned about the validity of address information.

Inconsistencies in the loan file are often a tip-off that the file contains misrepresentations, such as an address discrepancy warning on the credit report. The presence of one or more red flags in a file does not necessarily mean that there was fraudulent intent. However, several red flags in a file may signal a fraudulent transaction that will trigger additional scrutiny in providing this consumer with a mortgage or legal actions.

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[97] https://facts.usps.com/total-address-changes/
[98] https://www.moving.com/tips/address-fraud-what-it-is-and-how-to-avoid-it/

Module 3 – Non-Traditional

Course Objective

In this lesson, the student will understand and learn about TILA Qualified Mortgage requirements as nontraditional loan programs may be termed non-qualified mortgages. Nontraditional loan programs reviewed in this course include a detailed review of adjustable-rate mortgages and how they function, and a review of commonly available renovation home loans. Students will understand the rehabilitation loan process and how to manage the different rehab loan requirements to help their consumers choose the program that meets their needs.

Traditional Mortgage Loan Defined

The Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) defined what is considered a traditional loan as a 30-year fixed rate mortgage loan regardless of the type of occupancy or mortgage program investor. Any add-ons to the 30-year Note, such as balloon payments, rate adjustments, and interest-only payments will term a 30-year loan non-traditional.

For example - an owner-occupied 30-year fixed USDA home loan is considered traditional. An owner-occupied conforming 15-year fixed home loan would be considered a non-traditional.

TILA Qualified Mortgage

A non-Qualified Mortgage (non-QM) loan may be a 30-year fixed traditional mortgage loan, but because of certain risky loan features it would not be considered a qualified mortgage (QM). These TILA rules apply to owner-occupied properties requiring the lenders to verify the borrower is a qualified borrower and their loan program may not have any predatory lending features. These qualified mortgages must document the owner-occupied borrowers' ability to repay the debt, and in turn the creditor has some safe-harbor protections against potential fines and penalties for violating this regulation.[99]

A Qualified Mortgage is a category of loans that have certain, less risky features that help make it more likely the consumer will be able to afford their home loan. A lender must make a good-faith

[99] https://www.consumerfinance.gov/ask-cfpb/what-is-a-qualified-mortgage-en-1789/

effort to determine that all owner-occupied home loan applicants have the ability to repay their mortgage before the creditor closes the loan. This is known as the "ability-to-repay" rule. To be a Qualified Mortgage means the lender met specific requirements that include the ability-to-repay rule.[100]

Generally, the requirements for a qualified mortgage rule include:

- No risky loan features are permitted, such as:
  - An "interest-only" period, when they pay only the interest due without paying down the principal, which does not decrease the amount of money they borrowed.
  - "Negative amortization," which can allow their loan principal to increase over time, because they are making less than interest accruing on the loan.
  - "Balloon payments," which are bulk amount payments at the end of a loan term or specific period of time in the loan repayment.
  - Loan terms that are longer than 30 years.
- Limits on the price of a loan. The annual percentage rate, or APR, on a Qualified Mortgage cannot be higher than a specified threshold. These thresholds are posted annually in the federal register.
- No excess upfront points and fees. Thresholds are used to determine when fees are excessive. Not all loan fees are included in the threshold. **For example** - FHA insurance premiums are included in this limit. If the points and fees exceed the threshold, then the loan cannot be considered a Qualified Mortgage.
- Diligently verify income, assets, and debts. A Qualified Mortgage must consider and verify the qualifying income and assets to determine the borrower can manage their monthly obligation at loan closing. This requires lenders to include any proposed or known additional debts the borrower will have even after closing. All debts must be included to determine the total debt-to-income ratio. In addition, the creditor should review the money a borrower has left after paying all their monthly debts, known as residual income, to ensure the borrower can repay the Qualified Mortgage.[101]

[100] https://www.consumerfinance.gov/rules-policy/regulations/1026/43/#e-2
[101] https://www.consumerfinance.gov/ask-cfpb/what-is-a-qualified-mortgage-en-1789/

Qualified Mortgage Thresholds

For qualified mortgages (QMs), the thresholds for the spread between the annual percentage rate (APR) and the average prime offer rate (APOR) change annually. In 2024 they will be as follows:

- 2.25 or more percentage points for a first lien covered transaction with a loan amount greater than or equal to $130,461
- 3.5 or more percentage points for a first lien covered transaction with a loan amount greater than or equal to $78,277 but less than $130,461
- 6.5 or more percentage points for a first lien covered transaction with a loan amount less than $78,377
- 6.5 or more percentage points for a first lien covered transaction secured by a manufactured home with a loan amount less than $130,461
- 3.5 or more percentage points for a subordinate-lien covered transaction with a loan amount greater than or equal to $78,277; or
- 6.5 or more percentage points for a subordinate-lien covered transaction with a loan amount less than $78,277.

For all categories of QMs, the thresholds for total points and fees as of the writing of this course:

- Three percent of the total loan amount for a loan greater than or equal to $130,461
- $3,914 for a loan amount greater than or equal to $78,277 but less than $130,461
- Five percent of the total loan amount for a loan greater than or equal to $26,092 but less than $78,277
- $1,305 for a loan amount greater than or equal to $16,308 but less than $26,092; and
- Eight percent of the total loan amount for a loan amount less than $16,308.[102]

Ability to Repay

The Dodd-Frank Act required lenders to make a reasonable, good-faith determination of a consumer's ability to repay (ATR) any mortgage home loan secured by their owner-occupied dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan), and establishes

[102] https://www.federalregister.gov/documents/2023/09/21/2023-20476/truth-in-lending-regulation-z-annual-threshold-adjustments-credit-cards-hoepa-and-qualified

certain safe harbor protections for creditors from liability under this requirement for Qualified Mortgages (QM).

The ATR rule applies to all owner-occupied QM loans regardless of the loan terms or funding investor. The ATR/QM rule requires lenders to retain evidence of compliance with the rule for three years after a covered loan is consummated.

To rebut the presumption of compliance, it must be proven that, despite meeting the prerequisites in the regulations, the creditor did not make a reasonable and good faith determination of the consumer's repayment ability at the time of consummation. The lender may disprove this by showing that the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and on any simultaneous loans the creditor was aware at consummation would leave the consumer with sufficient residual income or assets. The lender must properly document how it made the assumption the borrower would be able to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation.[103]

Exempt From Ability-to-repay Rule

According to the regulations, a few special types of lenders are exempt from the ability-to-repay rule. Lenders and programs that may not have to follow the ability-to-repay rules are:

- Community Development Financial Institutions. These groups are certified by the U.S. Department of the Treasury to provide credit and financial services to underserved populations. The Department of the Treasury has more information on Community Development Financial Institutions.
- Community Housing Development Organizations or Down payment Assistance Providers of Secondary Financing. These are nonprofit service groups that receive aid from the Department of Housing and Urban Development (HUD) to help provide affordable housing in their communities.

[103] https://www.consumerfinance.gov/rules-policy/regulations/1026/43/#e-1-ii-B

- Nonprofit organizations that lend less than two hundred times a year and provide credit only to low- or moderate-income consumers. These groups must follow their own written procedures to determine that consumers have a reasonable ability to repay their loans.
- Housing Finance Agencies, which are state agencies that offer certain mortgages with low rates for low- and moderate-income borrowers.
- Loans made through programs under the Emergency Economic Stabilization Act. These programs help those communities hardest hit by the financial crisis of 2007 and 2008.[104]

Alternative Mortgage Transactions According to Regulation D

Alternative mortgage transaction means a loan, credit sale, or account:

1. That is secured by an interest in a residential structure that contains one to four units, whether or not that structure is attached to real property, including an individual condominium unit, cooperative unit, mobile home, or trailer, if it is used as a residence.
2. That is made primarily for personal, family, or household purposes; and
3. In which the interest rate or finance charge may be adjusted or renegotiated.

Regulation D was issued by the Bureau of Consumer Financial Protection (CFPB) to implement the Alternative Mortgage Transaction Parity Act as amended and the Truth in Lending Act.[105] Consistent with the Alternative Mortgage Transaction Parity Act, the Truth in Lending Act, and the Dodd-Frank Wall Street Reform and Consumer Protection Act, the purpose of this regulation is to balance access to responsible credit and enhanced parity between State and federal housing creditors regarding the making, purchase, and enforcement of alternative mortgage transactions with consumer protection and the interests of the States in regulating mortgage transactions generally.

Alternative mortgage transaction that includes any consumer credit transaction secured by a mortgage, deed of trust, or other equivalent consensual security interest in a dwelling or in residential real property that includes a dwelling. The dwelling need not be the primary dwelling of

[104] https://www.consumerfinance.gov/ask-cfpb/my-mortgage-lender-told-me-it-was-exempt-from-the-ability-to-repay-mortgage-rule-is-this-true-en-1793/
[105] Alternative Mortgage Transaction Parity Act, 12 U.S.C. §3801 et seq.

the consumer. Home equity lines of credit and subordinate lien mortgages are alternative mortgage transactions for purposes of this regulation.[106]

Examples of alternative mortgage transactions include:

- Transactions in which the interest rate changes in accordance with fluctuations in an index.
- Transactions in which the interest rate or finance charge may be increased or decreased after a specified period of time or under specified circumstances.
- Balloon transactions in which payments are based on an amortization schedule and a large final payment is due after a shorter term than the amortization. The creditor makes a commitment to renew the transaction at specified intervals throughout the amortization period, but the interest rate may be renegotiated at renewal. **For example** - a fixed-rate mortgage loan with a 30-year amortization period but it has a balloon payment due five years after consummation is an alternative mortgage transaction if the creditor commits to renew the mortgage at five-year intervals for the entire 30-year amortization period.
- Transactions in which the creditor and the consumer agree to share some or all of the appreciation in the value of the property (shared equity/shared appreciation).

The following are examples of transactions that are not alternative mortgage transactions:

- Transactions with a fixed interest rate where one or more of the regular periodic payments may be applied solely to accrued interest and not to loan principal (an interest-only feature).
- Balloon transactions with a fixed interest rate where payments are based on an amortization schedule and a large final payment is due after a shorter term, where the creditor does not make a commitment to renew the transaction at specified intervals throughout the amortization period.
- Transactions with a fixed interest rate where one or more of the regular periodic payments may result in an increase in the principal balance (a negative amortization feature).[107]

A creditor that makes an alternative mortgage transaction with an adjustable rate or finance charge may only increase the interest rate or finance charge as follows:

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[106] https://www.consumerfinance.gov/rules-policy/regulations/1004/2/#2-a-Interp-3-ii
[107] https://www.consumerfinance.gov/rules-policy/regulations/1004/2/#c-3

- The creditor must comply with the general TILA disclosure requirements
- For all other transactions, the creditor must use either:
  - An index to which changes in the interest rate are tied that is readily available to and verifiable by the borrower and beyond the control of the creditor; or
  - A formula or schedule identifying the amount that the interest rate or finance charge may increase and the times at which, or circumstances under which, a change may be made.[108]

A creditor may use any measure of index values that meets the requirements in the regulations**. For example** - the index may be either single values as of a specific date or an average of values calculated over a specified period.

A creditor may increase an adjustable interest rate only if the increase is based on an index that is beyond the creditor's control. An index is not beyond the creditor's control if the index is the creditor's own prime rate or cost of funds. A creditor is permitted, however, to use a published prime rate, such as the prime rate published in the Wall Street Journal, even if the creditor's own prime rate is one of several rates used to establish the published rate.[109]

The index must be available to the public. A publicly available index need not be published in a newspaper, but it must be one the consumer can independently obtain **(for example** - by telephone) and use to verify the annual percentage rate applied to the alternative mortgage transaction.

Mortgages With Adjustable or Renegotiable Rates or Finance Charges

A creditor that makes an alternative mortgage transaction with payments based on an amortization period and a large final payment due after a shorter term may negotiate an increase or decrease in the interest rate when the transaction is renewed only if the creditor makes a written commitment to renew the transaction at specified intervals throughout the amortization period. However, the creditor is not required to renew the transaction if:

- Any action or inaction by the consumer materially and adversely affects the creditor's security for the transaction or any right of the creditor in such security

[108108] https://www.consumerfinance.gov/rules-policy/regulations/1004/4/#de38a82277268f404065254dafd5d4914192d0c3b36d54d4642f206f
[109] § 1004.4(a)(2)(i)

- There is a material failure by the consumer to meet the repayment terms of the transaction
- There is fraud or a willful or knowing material misrepresentation by the consumer in connection with the transaction
- Federal law dealing with credit extended by a depository institution to its executive officers specifically requires that as a condition of the extension the credit shall become due and payable on demand, provided that the creditor includes such a provision in the initial agreement.[110]

State Law Restrictions

State laws may put restrictions on the adjustment or renegotiation of an interest rate or finance charge, including restrictions on the circumstances under which a rate or charge may be adjusted, the method by which a rate or charge may be adjusted, and the amount of the adjustment to the rate or charge.

For example - if a provision of State law prohibits creditors from increasing an adjustable rate more than two percentage points or from increasing an adjustable rate more than once during a year, that provision is preempted with respect to alternative mortgage transactions that comply. Similarly, if a provision of State law prohibits housing creditors from renewing balloon transactions that meet the definition of an alternative mortgage transaction on different terms, that provision is preempted only to the extent that it restricts a state housing creditor's ability to adjust or renegotiate the interest rate or finance charge at renewal.

State laws may restrict the ability of a housing creditor to change the amount of interest or finance charges included in regular periodic payments as a result of the adjustment or renegotiation of an interest rate or finance charge.

For example - if a provision of State law prohibits housing creditors from increasing payments or limits the amount of such increases with respect to both alternative mortgage transactions and other mortgage transactions, to the extent that it restricts a housing creditor's ability to adjust payments because of the adjustment or renegotiation of an interest rate. Other restrictions on changes to payments are not preempted, including restrictions on transactions in which one or more of the

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[110] https://www.consumerfinance.gov/rules-policy/regulations/1004/4/#7ae2562961d72df6ca35db9818a90553ee87215eec5e8e9b1b9521e1

regular periodic payments may result in an increase in the principal balance (a negative amortization feature) or may be applied solely to accrued interest and not to loan principal (an interest-only feature).

State regulations may have restrictions on the creditor and the consumer sharing some or all of the appreciation in the value of the property (shared equity/shared appreciation).

Preempted State Laws

The following are examples of State laws that are not preempted regardless of whether the provision applies solely to alternative mortgage transactions or to both alternative mortgage transactions and other mortgage or consumer credit transactions:

- Restrictions on prepayment penalties or late charges (including an increase in an interest rate or finance charge as a result of a late payment).
- Restrictions on transactions in which one or more of the regular periodic payments may result in an increase in the principal balance (a negative amortization feature) or may be applied solely to accrued interest and not to loan principal (an interest-only feature).
- Requirements that disclosures be provided.[111]

Adjustable-Rate Mortgage

An adjustable-rate mortgage (ARM) allows lenders the ability to increase their profits more so than a fixed rate home loan. Adjustable rates change over the entire life of a loan as indexes adjust, according to the terms in the note, to reflect the current cost of money. Many lenders like ARMs because they can pass the risk of fluctuating interest rates onto the borrowers. Lenders may offer multiple types of ARM programs.

Sometimes it does not make sense to take an adjustable-rate mortgage, but that is short sited.

For example - If you have a borrower that plans to pay their principal down rapidly or with a large lump sum inheritance, an ARM could be a benefit. If you have a consumer making a large lump sum or extra loan payments because they want an overall lower payment, an ARM loan would work the

[111] https://www.consumerfinance.gov/rules-policy/regulations/1004/interp-3/

best for this consumer. The monthly payment would go down when the loan adjusts because the principal is less. The loan will amortize with the lower outstanding balance with every adjustment.

With a fixed rate loan, the payment will never change even if the mortgage balance changes drastically, although it would pay off sooner than 360 payments.

Terms, rate changes, and many other aspects of ARMs are regulated primarily by TILA disclosure requirements. Any ARM guidelines of Fannie Mae, Freddie Mac, FHA, and private mortgage insurers must be followed as well.

Components of an ARM Loan

There are several parts to an ARM:

- Index
- Margin
- Rate adjustment period
- Interest rate cap
- Floor rate
- Conversion option (if applicable)

Index

For an adjustable-rate mortgage, the index is a benchmark interest rate that reflects general market conditions, and the margin is a number set by the lender when the borrower applies for a home loan.

With an adjustable-rate mortgage, the rate stays the same, generally for the first year or a few years, and then it begins to adjust periodically. Once the rate begins to adjust, the changes to the interest rate are based on the market index, not on the borrowers' personal financial situation.

Once the initial interest rate for the loan is set at the time of rate lock. The interest rate for the loan is tied to a widely recognized and published index. The index is often referred to as the cost of money.

Changes in the index, along with the loan's set margin, determine the changes to the interest rate for an adjustable-rate mortgage loan. The lender decides which index your loan will use when you apply for the loan, and this choice will not change after closing.[112]

Common ARM mortgage indices include:

COFI - A monthly cost-of-funds index (COFI) reflecting the weighted-average interest rate paid by 11th Federal Home Loan Bank District savings institutions for savings and checking accounts. The 11th district covers Arizona, California, and Nevada. The Federal Cost of Funds Index (COFI) is used as a benchmark for some types of mortgage loans and securities. It is calculated as the sum of the monthly average interest rates for marketable Treasury bills and for marketable Treasury notes, divided by two, and rounded to three decimal places.[113]

The Federal COFI is made available by Freddie Mac on or about the 20th day of each month. Freddie Mac first began publicly providing the Federal COFI in March 1991. The Federal COFI is not adjusted to reflect subsequent changes in the underlying Treasury rates once the value has been posted.

CMT – Constant Maturity Treasury is an index published by the Federal Reserve Board based on the monthly average yield of a range of Treasury securities, all adjusted to the equivalent of a one-year maturity. Yields on Treasury securities at constant maturity are determined by the U.S. Treasury from the daily yield curve. CMT is less volatile than the daily 11th District Cost of Funds and is used for many ARM loan programs.[114]

SOFR - The Secured Overnight Financing Rate (SOFR) is based on actual transactions in the Treasury repurchase (repo) market, where extensive trading happens daily. This is the market where investors offer borrowers overnight loans backed by their U.S. Treasury bond assets.[115]

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[112] https://www.consumerfinance.gov/ask-cfpb/for-an-adjustable-rate-mortgage-arm-what-are-the-index-and-margin-and-how-do-they-work-en-1949/

[113] https://www.google.com/search?q=11th+district+cost+of+funds+index&rlz=1C1CHZN_enUS1022US1022&oq=11th+district+cost+of+funds+index&gs_lcrp=EgZjaHJvbWUyCQgAEEUYORiABDIHCAEQABiABDIICAIQABgWGB4yDQgDEAAYhgMYgAQYigXSAQg2MzUwajBqNKgCALACAQ&sourceid=chrome&ie=UTF-8

[114][114] https://www.bankrate.com/rates/interest-rates/1-year-cmt/

[115] https://sf.freddiemac.com/working-with-us/origination-underwriting/mortgage-products/sofr-indexed-arms#:~:text=The%20Secured%20Overnight%20Financing%20Rate,their%20U.S.%20Treasury%20bond%20assets.

Each business day, the New York Fed publishes the SOFR on the New York Fed website at approximately 8:00 a.m. ET.[116] Lenders use the 30-day average SOFR to price mortgage loan programs. This is the index that replaced the previously popular LIBOR index.

Prime Rate Index – The prime rate is the underlying index for most credit cards, home equity loans and lines of credit, auto loans, and personal loans. Many small business loans are also indexed to the Prime rate.

The Prime Rate is consistent because banks want to offer businesses and consumers loan products that are both profitable and competitive. Most home equity lines of credit will use the Prime Rate Index + margin to determine the rates offered.[117]

Margin

The margin is the number of percentage points added to the index to set the interest rate on an adjustable-rate mortgage (ARM) after the initial rate period ends. The margin is set when the loan is locked and included in the ARM loan agreement that cannot change after closing. The margin amount depends on the particular lender, costs paid at closing and type of loan.[118] The lower the margin generally the higher the start rate, because the lower the margin the less the rate adjustment changes.

The margin added to the index is termed the fully indexed rate.

For Example -

5.33%	Current SOFR Index Value as of 3/30/2024
+ 2.00%	Margin
7.33%	Fully Indexed Rate will be rounded down to the nearest 1/8th. 7.325%

Rate Adjustment Period

The rate adjustment period is the length of time between interest rate changes with ARMs. This period can vary depending on the terms in the Note.

[116] https://www.newyorkfed.org/markets/reference-rates/sofr
[117] http://www.fedprimerate.com/
[118] https://www.consumerfinance.gov/ask-cfpb/for-an-adjustable-rate-mortgage-arm-what-are-the-index-and-margin-and-how-do-they-work-en-1949/

Discounted Rates

When the initial rate on an ARM, or start rate, is less than the current fully indexed rate, the ARM rate is considered a discounted rate. The discounted rate ('Teaser Rate') can make the ARM loans more attractive to consumers who have a short-term period before moving or refinancing and will benefit with a lower monthly payment.

Interest Rate Cap

Interest rate caps are used with ARMs to limit the percentage points interest rate may increase during the adjustment period and life of the loan. Caps limit on interest rate and payment increase to prevent large fluctuations in mortgage payments and payment shock for borrowers.

Rate caps are often shown as two numbers, for example, 2/6

- 2/6 – The first number – 2 - indicates the maximum amount the interest rate can increase or potentially decrease from one adjustment period to the next. Provided the rate does not go lower than the allowable floor rate.
- 2/6 – The second number – 6 - indicates the maximum amount the interest rate can increase during the life of the loan. At the 6% cap, no additional increase can be made in the rate. The rate can go down as the market allows, but never higher than the life of loan cap allows.

Some ARMs allow for a higher rate adjustment for the first adjustment, especially with hybrid ARM programs. After the first adjustment, then a lower subsequent adjustment cap applies to future adjustments. These ARMs are usually identified with three numbers, where the first number is the interest rate cap for the first adjustment period, the second number is the subsequent adjustment cap, and the third number is the lifetime interest rate cap.

For example - if you see a rate cap described as 3/2/6, the interest rate cannot increase more than:

- 3% at the first adjustment period
- 2% for subsequent adjustment periods through the life of the loan
- 6% total over the life of the loan

Floor Rate – the minimum an ARM loan may adjust down over the life of the loan. Many ARM loans use the start rate as the floor rate.

ARM Functions

When attempting to understand how an ARM loan works and how payments adjust, think of an ARM as a set of steps. The floor (bottom of the steps), where the ARM rate begins, is the initial rate's period of time from closing until the first adjustment period – start rate, initial rate, or teaser rate. The next number is the subsequent adjustments of the entire term of the loan, but the ARM interest rate may never exceed the start rate plus the life of loan cap.

For example - 1 year ARM loan closes with 6% start rate, 3% margin and 2/6 adjustment caps. At the first adjustment one year later, with the SOFR index at 5.375%, what will the interest rate be at time of adjustment and how long will the rate be effective?

1. The first calculation is to identify the fully indexed rate. The max rate may increase based on the index. The first adjustment after one year may be the current index + the margin = fully indexed rate. (5.375% SOFR index + 3% margin = 8.375% Fully index rate)
2. The second calculation uses the caps to identify the maximum adjustment allowed. Start rate plus the first adjustment cap. (6% start rate + 2% first & subsequent cap = 8% maximum interest rate increase for first adjustment)
3. The lesser of the fully indexed rate or the maximum interest rate cap for the adjustment sets the interest rate for the coming year. In this case the first adjustment cap kept the interest rate from increasing to the fully indexed rate.
4. For this first adjustment, the borrower's rate for the 13th through 24th month repayments will be based on amortization of 8.00%.

Use the same method for next year's interest rate adjustment. With the "stairs" method, the 1-year ARM loan coming up on a subsequent adjustment is currently at 8%. The margin is the same at 3% and adjustment caps are 2/6. For the subsequent adjustment on the second year after closing, and one year from last adjustment this is the process. We estimate the SOFR is 4.75%. Calculate the second subsequent adjustment as follows:

1. The fully indexed rate. The subsequent adjustment after one year would be the current index + the margin = fully indexed rate. (4.75% SOFR index + 3% margin = 7.75% Fully index rate)
2. The second calculation uses the caps to identify the maximum adjustment allowed. Current interest rate plus the subsequent adjustment cap. (8.00% start rate + 2% subsequent cap = 10.00% maximum interest rate for this adjustment).

3. The lesser of the fully indexed rate or the maximum interest rate sets the interest rate for the coming year. In this scenario, the fully indexed rate is the lowest calculation.
4. For this adjustment, the borrower's rate for the 25th through 32nd month repayments will be based on amortization of 7.75%.
5. As previously stated, the loan's interest rate may never exceed the lifetime cap. Start rate + lifetime cap = highest interest rate capped.
   a. For this scenario, 6% start rate + 6% life of loan cap = 12% max the interest rate may ever be in this scenario.

Hybrid ARM

A hybrid ARM is an ARM with an initial fixed-rate period greater than one year. That is, the loan has a fixed rate for a specific number of years, and then the interest rate adjusts regularly for the remaining term of the loan. The adjustments are set by the terms in the Note.

For example - A 3/1 hybrid ARM has an introductory rate period or teaser rate for the first three years after closing. Other longer period options include 5/1, 7/1, or 10/1 ARMs, where the fixed period is for five, seven, or ten years and the interest rate adjust annually for the remainder of the loan term.

For hybrid loans, often the longer the initial period of stable payments, the higher the first adjustment cap. The caps for a 5/1 hybrid ARM are generally 3/2/6. With this configuration, the first number is the first adjustment cap, the second is the subsequent adjustment cap and the last is the lifetime cap.

For example - 3/1 year ARM loan closes with 7.5% start rate, 2.50% margin and 3/2/6 adjustment caps. At the first adjustment three years later, with the SOFR index at 5.125%, what will the interest rate be at time of adjustment?

1. The first calculation is to identify the fully indexed rate. The max the interest rate may increase based on the index. The first adjustment after three years would be the current index + the margin = fully indexed rate. (5.125% SOFR index + 2.50% margin = 7.625% Fully index rate)
2. The second calculation uses the caps to identify the maximum adjustment allowed. Start rate plus the first adjustment cap. (7.50% start rate + 3% first cap = 10.50% maximum interest rate for first adjustment)

3. The lesser of the fully indexed rate or the maximum interest rate sets the interest rate for the coming year. For this first adjustment, the borrower's rate for the 37th through 49th month payments will be based on amortization of 7.625% interest rate.

After the initial interest rate adjustment, the 3/2/6 caps would use the 2% for subsequent adjustment caps with the lifetime 6% cap setting the maximum interest rate allowed.

Negative Amortization Loans

Negative amortization occurs anytime the monthly payment is not sufficient to cover the accrued interest from the previous month. For negative amortization, the borrower will pay a smaller percent of interest due, than what the loan is accruing interest at.

For example - if the fully indexed interest rate being charged by the lender is 7% and the borrower is paying 5% interest payments every month as their option ARM payment, the 2% of interest not being paid every month will be added to the principal balance each month. This causes the cost of the money to increase monthly as the outstanding loan balance increases.

According to CFPB interpretations, amortization means paying off a loan with regular payments, so that the amount you owe goes down with each payment. Negative amortization means that even when you pay, the amount you owe will still go up because you are not paying enough to cover the interest. These loans require added disclosure statements.

For example - The disclosure might state, "If any of your payments are not sufficient to cover the interest due, the difference will be added to your loan amount." Loans that provide for more than one way to trigger negative amortization are separate variable-rate programs requiring separate disclosures.

If a consumer is given the option to cap monthly payments that may result in negative amortization, the creditor must fully disclose the rules relating to the option, including the effects of exercising the option (such as negative amortization will occur and the principal loan balance will increase), however, the variable rate disclosure need not be provided.

Consumers are advised to pay the interest due at a minimum to avoid negative amortization. Paying the interest only provides the principal balance does not increase, but also the loan balance does not decrease like a fully amortized payment loan would do.

These types of loans were popular in the early 2000's, but after the market crash of 2007 and subsequent changes in federal laws, these loans have limited offerings except for risk layered investor loan programs.

Conversion Option

Some ARM loan programs may allow the borrower to convert the adjustable-rate mortgage into a fixed rate mortgage without the expense of a refinance or re-qualifying for a new loan if the original Note allows for this conversion. The Note will provide a window of time called the conversion period, and the borrower must exercise their option to convert the adjustable-rate mortgage to a fixed rate mortgage during this specific conversion period. Once this period has ended, the loan will remain an ARM loan until paid in full.

According to CFPB interpretations, if a loan program permits consumers to convert their variable-rate loans to fixed-rate loans, the lender must disclose that the interest rate may increase if the consumer converts the loan to a fixed-rate loan. The lender must also disclose the rules relating to the conversion feature, such as the period during which the loan may be converted, that fees may be charged at conversion, and how the fixed rate will be determined.

The lender should identify any index or other measure, or formula used to determine the fixed rate and state any margin to be added. In disclosing the period during which the loan may be converted and the margin, the lender may use information applicable to the conversion feature during the six months preceding preparation of the disclosures and state that the information is representative of conversion features recently offered by the lender.

Consumer Handbook on Adjustable-Rate Mortgages

The Consumer Handbook on Adjustable-Rate Mortgages (CHARM Booklet) is a TILA requirement for all home loans with an adjustable-rate mortgage loan. The CHARM Booklet is provided with the application disclosures and Loan Estimate.[119] The CHARM booklet explains the functions of the ARM loan program.

[119] https://files.consumerfinance.gov/f/documents/cfpb_charm_booklet.pdf

Loan Estimate for ARM Loan

When an MLO is offering an ARM loan there are more loan terms that need to be disclosed on the Loan Estimate. The following is an example of the Loan Term section provided by CFPB as an example. The Loan Terms section is on page one of the Loan Estimate.

Loan Terms		Can this amount increase after closing?	
Loan Amount	$216,000	**NO**	
Interest Rate	3%	**YES**	· Adjusts **every year** starting in year 6 · Can go **as high as 8%** in year 8 · See **AIR Table** for details
Monthly Principal & Interest *See Projected Payments Below for Your Total Monthly Payment*	$910.66	**YES**	· Adjusts **every year** starting in year 6 · Can go **as high as $1,467** in year 8
		Does the loan have these features?	
Prepayment Penalty		**NO**	
Balloon Payment		**NO**	

Projected payments show the borrower a worst-case scenario over the life of the loan. Found on page 1 of Loan Estimate.

Projected Payments				
Payment Calculation	**Years 1-5**	**Years 6**	**Years 7**	**Years 8-30**
Principal & Interest	$910.66	$838 min $1,123 max	$838 min $1,350 max	$838 min $1,467 max
Mortgage Insurance	+ 99	+ 99	+ 99	+ ––
Estimated Escrow *Amount can increase over time*	+ 341	+ 341	+ 341	+ 341
Estimated Total Monthly Payment	$1,290	$1,217 – $1,502	$1,217 – $1,729	$1,179 – $1,808
Estimated Taxes, Insurance & Assessments *Amount can increase over time*	$341 a month	**This estimate includes** ☒ Property Taxes ☒ Homeowner's Insurance ☐ Other: *See Section G on page 2 for escrowed property costs. You must pay for other property costs separately.*		**In escrow?** **YES** **YES**

Adjustable Interest Rate (AIR) table section gives the details of the ARM loan terms. Found on page two of the Loan estimate.[120]

[120] https://files.consumerfinance.gov/f/documents/cfpb_charm_booklet.pdf

Adjustable Interest Rate (AIR) Table	
Index + Margin	1 Year Cmt + 2.5%
Initial Interest Rate	3%
Minimum/Maximum Interest Rate	2.5% / 8%
Change Frequency	
First Change	Beginning of 61st month
Subsequent Changes	Every 12 months after first change
Limits on Interest Rate Changes	
First Change	2%
Subsequent Changes	2%

Collateral/Portfolio Loans

Commercial 'hard money,' portfolio lenders, or collateral lenders have been around since the first borrower used their homestead as collateral for a loan. Portfolio lending allows the individual with the money (investor) to determine the guidelines for the loan risk they are willing to take given the borrower's credit worthiness and property soundness to support the evaluation. The investor may then set the interest rate they will accept for the file risk. There are state usuary laws that can limit some loans depending, but many hard money lenders are reasonable as they want repeat business and referrals along with their high rates of return.

Private money lenders are mortgage brokers that will lend their own personal funds, or pooled investors funds. These investors set their guidelines and will ask for high-interest rates and points charged at closing to ensure their return on investment is worth funding the borrower's loan. These types of loans are not sellable on the normal secondary mortgage market but are retained and serviced by the funding investor.

Private money is generally a short-term loan and fixes a borrower's current need or issue. It is important MLOs provide the borrower with an exit plan to pay off the high-rate private money loan in the future and obtain a more affordable conforming home loan.

Seller Financing

Seller Financing is similar but should not be confused with collateral lending. Seller financing is an individual with sufficient equity in their property that they want to defer the tax burden or earn interest on the equity they use to lend to the purchaser.

Not all mortgage loan programs will allow seller financing. Check your guidelines for LTV and CLTV limits.

The use of scam seller financing has been used as a fraud scheme for decades. The seller forgives the seller financing or second mortgage after closing because the property was never worth the purchase price. The creditor is then sitting with a 100%+ LTV loan in their portfolio. Any home loan requests with seller financing will have extra scrutiny to ensure the transaction is arms-length.

Rehabilitation Loans

Eligible Property Types

- Single family homes
- Single family homes with eligible accessory dwelling units (ADUs)
- Two-to-four family units
- Townhomes
- Manufactured homes titled as real estate, where the rehabilitation does not affect the structural components
- Eligible condominium units and site condo units (improvements are limited to the unit's interior)
- HUD Homes/Real-Estate Owned properties (no additional FHA appraisal required with FHA home financing)
- Mixed use properties that are primarily residential (at least 51%)

FHA 203(k) Rehabilitation Mortgage Insurance Program

Section 203(k) insures mortgages covering the purchase or refinancing and rehabilitation of a home that is at least a year old. A portion of the loan proceeds are used to pay the seller, or if a refinance, to pay off the existing mortgage. The remaining funds are placed in an escrow account and released when the rehabilitation is completed.

Section 203(k) offers:

- a solution that helps both borrowers and lenders, insuring a single, long term, fixed or adjustable-rate loan that covers the acquisition and rehabilitation of a property.
- affordability and flexibility of FHA-insured financing.
- the lender protection by allowing them to have the loan insured prior to completion of rehabilitation, even before the condition and value of the property may offer adequate security.

- the lender the opportunity to help address climate change by insuring the financing of cost-effective energy efficient improvements.

Why Use 203(k) Program

Homebuyers may face a complicated and costly process or be excluded from certain loan programs to rehabilitate or make property improvements. The 203(k) Program may be a great option for a homeowner who wants to stay in their current home and wants or needs to make improvements.

Borrowers can obtain funds needed to purchase or refinance and renovate based on the appraised value once the proposed improvement is completed. Other home improvement loans often have high interest rates, short repayment terms, or balloon payments.

However, the 203(k) Program offers a solution that helps borrowers by insuring a single, long-term, fixed, or adjustable-rate loan that covers both the acquisition and rehabilitation of a property.

It saves time by combining both the purchase or refinance, with fund for rehabilitation of a property into a single loan instead of typical construction lending with two separate loans. The program saves money with its 3.5% low-down payment, like all FHA-insured mortgages. Also, the rates may be lower than other forms of financing, such as a home equity line of credit or credit cards.

Types of FHA Programs

Standard 203K for major rehabilitation or repairs, and the streamlined/limited 203k for less expensive repairs and updates.

Limited 203(k) Mortgage

- Permits homebuyers and homeowners to finance up to $35,000 into their mortgage to repair, improve, or upgrade their home.
- Homebuyers and homeowners can quickly and easily tap into cash to pay for property repairs or improvements, such as those identified by a home inspector or an FHA appraiser.
- Homeowners can make minor remodeling and non-structural repairs, improvements, or prepare their home for sale.
- Homebuyers can make their new home move-in ready by remodeling the kitchen, painting the interior, or purchasing new carpet.
- FHA-approved 203(k) Consultant is optional for Limited 203(k)
- No minimum amount of repairs required.

This type of rehabilitation loan is the most commonly one used because of the ease of use, and limited repairs needed on the property. When your homebuyer wants to purchase a home and the property inspection or appraiser requires repairs, the homebuyer may include the cost of those repairs in their purchase of the home. The home is appraised with the after-improvement value to help increase the loan amount to cover the costs. The improvements can be as extensive as remodeling a kitchen or as little as replacing an air conditioner. The improvements and repairs must stay under the $35,000 FHA improvement limit.

Streamline 203k program may be used for less extensive repairs that are non-structural in nature like minor remodeling, home improvements, energy efficient improvements, new appliances, or replacing dated carpeting.[121]

Standard 203(k) Mortgage

- The Standard 203(k) program is for major rehabilitation and repair of single-family property.
- The cost of the rehabilitation must be at least $5,000 but the total value of the property must still fall within the FHA mortgage limit for the area.
- The Standard 203(k) program is an important tool for major renovations, structural additions, community, and neighborhood revitalization, as well as to expand homeownership opportunities.[122]
- FHA-approved 203(k) Consultant is required

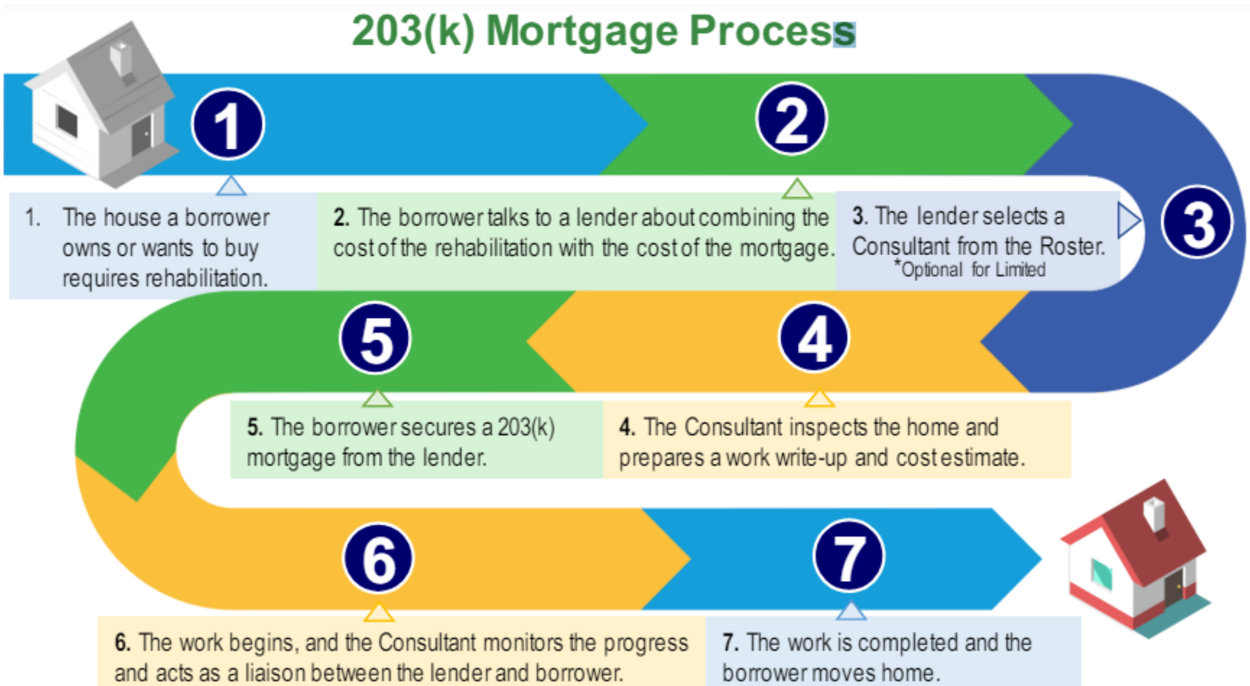
This rehabilitation program is for major remodeling or rehabilitation of a property. It can take a condemned property and provide the funds to bring it back to a livable space for a family. It can also add a bedroom onto a home that a couple has outgrown. With current unaffordable home prices, it may make more sense if the borrower expands their house footprint to be what they want. There is no limit on the amount of improvements or rehabilitation, provided the loan amount stays within the allowable loan limits for the area and the property appraises to support the rehab.

The 203(k) Program requires all building permits be obtained prior to commencement of work and posted onsite for the work being performed.

[121] https://www.hud.gov/sites/dfiles/SFH/documents/MO_FS_203(k)_Consumer.pdf
[122] https://www.hud.gov/program_offices/housing/sfh/203k

It is important to understand that with rehabilitation programs, the loan closes and the rehabilitation funds go into an escrow account to be disbursed in phases as the home is completed. The lender, MLO and realtor all get paid at closing, so there is no waiting for the home to be completed to get paid. A definite benefit to a realtor. An MLO can also work in revitalization areas to help improve the neighborhood. Churches and other local non-profits are good to partner with for these type of targeted rehab loans promotions.

Stages in the Process



Origination Stage

1. The borrower owns or finds a property that requires rehabilitation.
2. Borrower talks to an FHA-approved lender and selects FHA 203(k) program.
3. Lender selects a 203(k) HUD-approved consultant from the roster. This step is optional for the Limited 203(k) Mortgage.
4. Consultant visits the home with borrower and prepares a work write-up and cost estimate.
5. Work write-up and bids are provided to the lender. This document goes to the appraiser for consideration of the after-value of the property.
6. Lender processes, underwrites, closes, and funds the transaction.
7. The lender submits the loan for endorsement and FHA insures the loan.
8. Improvements can begin.

Repair/Improvements Stage

1. The contractor obtains the necessary permits prior to the start of the project.
2. Contractor completes the first phase of the project.
3. Borrower contacts the 203(k) consultant to request an inspection for draw release.
4. Consultant and borrower inspect the work and consultant certifies work is satisfactory.
5. Consultant and borrower sign the draw release and submit to lender for payment.
6. Lender issues a two-party check made payable to borrower and contractor.
7. This process continues until all work is completed.

Project Completion Stage

1. The borrower provides a release letter indicating all work is completed.
2. Consultant verifies completion.
3. Consultant obtains certificate of occupancy or building permit close-out approval if applicable.
4. Remaining escrow funds are released. If all funds are not used for improvements, the balance is applied to the outstanding principal balance.
5. Lender is responsible for closing out the entire project on the Escrow Close-Out Screen in FHA Connection.
6. 203k provides a maximum of one year to complete the project.

Role of an FHA-Approved 203(k) Consultant

The Consultant plays a guiding role throughout the rehabilitation process, acting as the liaison between the homeowner, contractor(s), and lender. The Consultant inspects the property and prepares a feasibility study, architectural exhibits, work write-ups, cost estimates, draw request inspections, and change orders; and ensures that all work is performed in compliance with FHA requirements. Any Consultant who performs work on a 203(k) project must be listed on the FHA-approved 203(k) Consultant Roster.

203(k) Consultant's Responsibilities Before Loan Closing

<u>Property Inspection and Permits</u>

The Consultant's first task is to personally perform an on-site property inspection, using FHA's 35-Point Checklist, listed in Handbook 4000.1, Section II.A.9.e.

The Consultant must:

- Address any deficiencies that exist
- Certify the condition of all major systems, health and safety issues, and pests
- Determine any repairs or improvements required to meet HUD's Minimum Property Requirements (MPR) or Minimum Property Standards (MPS) and local requirements
- Ensure all required building permits are obtained before the commencement of work are posted on-site for the work performed

Optional Feasibility Study

If the homebuyer is unsure of the repairs the home will need and their costs, the 203(k) Consultant can complete an optional feasibility study (for a fee) to identify the FHA-required repairs. When the borrower or lender requests to determine if the 203(k) project is financially feasible, the Consultant must prepare a feasibility study. This provides some protection the improvements will be supported in the property's valuation. A borrower may pay additional costs out of pocket if they choose to do so.

Work Write-Up and Cost Estimate

The Consultant must prepare and review the necessary architectural exhibits. If not qualified to prepare them, the Consultant must obtain the architectural exhibits from a qualified subcontractor.

For example - septic certifications, termite reports, foundation certifications, and engineering reports.

Based on this information, the Consultant must prepare a work write-up that addresses any of the work items on the 35-Point Checklist and those on the homeowner's project proposal. On the work write-up, each work item must have a reasonable cost estimate for the area in which the property is located and separately identifies the labor costs and itemized cost of materials. The work write-up and cost estimate must include the work being performed per the project proposal. Health and safety issues must be addressed before any other work items.[123]

203(k) Consultant's Responsibilities After the Mortgage Closes

[123] https://www.hud.gov/sites/dfiles/SFH/documents/MO_203k_CnsltRole_FS.pdf

At mortgage closing, the lender escrows (holds back) the funds designated for rehabilitation. After the escrow is established, the Consultant:

- Reviews the lender request for a draw of funds and must inspect the work for completion and quality of workmanship to ensure the work has been satisfactorily completed in compliance with all codes and ordinances.
- Keeps the lender informed of the progress of the rehabilitation, including any issues that may affect project eligibility, the health, and safety of the homeowner, or work stoppage.
- Reviews any proposed changes and prepares a change order for the lender to approve if changes to the work write-up are requested.

Benefits of Combining the 203K with FHA Energy and Disaster Programs

There are other loan programs offered by FHA that can benefit a borrower when the home they are purchasing needs improvements or repairs. The following FHA home loan programs do not have to be included with the 203k programs.

- **Energy Efficient Mortgages (EEM),** which offers financing of energy efficient improvements with an FHA-insured mortgage. Benefits include cost-effective energy efficient improvements that may lower utility bills and help homeowners save money. Improvements may qualify for Federal, state, and local tax credits.
    - The financed portion of an Energy Package must be cost-effective. Improvements are cost-effective when the cost of making them is equal to or less than the money saved on energy from those improvements. FHA has a cost-effective test for existing homes and newly constructed homes. The program also requires a Home Energy Assessment.
    - The maximum amount of the energy package that can be added to the borrower's regular FHA loan amount is the lesser of:
        - A cost-effective improvements to be made (energy package) based on the home energy assessment; or
        - the lesser of 5 percent of:
            - the Adjusted Value
            - 115 percent of the median area price of a Single-Family dwelling; or
            - 150 percent of the national conforming mortgage limit.

    - An FHA-approved lender can access FHA's EEM Calculator to determine the dollar maximum amount a borrower can finance for energy improvements.[124]
- **Solar and Wind Technologies program**, which offers financing of a new solar energy system with an FHA-insured mortgage at the time of purchase or refinance. Benefits include a reduction in the amount of electricity the consumer buys from their utility provider and the payment on the energy system is spread out over the mortgage term. Improvements may qualify for federal, state, and local tax credits.
    - The full cost of a new solar photovoltaic (PV) array can be added to a regular FHA-insured mortgage at the time of the home purchase or refinance. Installation of the PV system takes place after closing.
    - The solar system must be owned by the borrower and not leased.
    - The amount financed for the new system must not exceed 20% of the property's appraised value.
    - Energy system must be new and not existing.[125]
- **203(h) Mortgage Insurance for Disaster Victims**, which offers financing for the purchase or reconstruction of a single-family property to victims of a Presidentially Declared Major Disaster Area (PDMDA), if obtained within one year of declaration. One of the benefits is that the borrower is not required to make a Minimum Required Investment (MRI), that equates to 100 percent financing.
    - Insured mortgages may be used to finance the purchase or reconstruction of a one-unit family home that will be the principal residence of the homeowner.
    - Home was destroyed or damaged to such an extent that reconstruction or replacement is necessary.
    - No down payment required, eligible for 100% financing. Closing costs and prepaid expenses must be paid by the borrower or paid through premium pricing or by the 6% seller concession limits.[126]

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[124] https://www.hud.gov/program_offices/housing/sfh/eem/energy-r#:~:text=The%20energy%20package%20is%20the,passive%20solar%20and%20wind%20technologies.
[125] https://www.hud.gov/sites/documents/SOLAR-WIND.PDF
[126] https://www.hud.gov/program_offices/housing/sfh/ins/203h-dft

PACE Loan

Property Assessed Clean Energy Program (PACE) is an innovative mechanism for financing Energy Efficient and renewable energy improvements on private property. A PACE loan gives homeowners a way to borrow money for home improvements by increasing their property tax payment.[127]

The U.S. government does not pay for or insure PACE loans. PACE lending programs are approved by some states and are run by local government, or a private company hired by the local government.

The homeowner pays PACE loans by an additional assessment that is collected with their property taxes. While the consumer may not have to put cash down to pay for these upgrades, they will be required to pay the fees later with their property tax bill. Like a traditional property tax lien, they may lose their home if they don't make the payments. As with any form of financing, consumers should consider the costs and benefits of PACE loans before signing the contract.

Homeowners must make payments for PACE loans through their property taxes which makes their property tax bill go up. For some homeowners, the increase can be large. This could put the homeowner at risk of losing your home through a tax sale. Some other risks include:

- Unaffordable payments
- Limited means to dispute the work or costs once the consumer signs up
- Trouble selling or refinancing the home
- Loss of home equity[128]

Unaffordable Payments

The homeowner pays the PACE loan back plus interest and fees with their property taxes each year until it is paid off. They may have to repay the PACE loan for five, 10, or 20 years. This can lead to high assessments added to their property tax bill. Homeowners should pay attention to how long the PACE loan will last as it may be longer or shorter than other types of loans, which can affect the size of the payments.

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[127] https://www.consumerfinance.gov/ask-cfpb/what-is-a-pace-loan-en-1979/

[128] https://www.consumerfinance.gov/ask-cfpb/i-am-considering-a-pace-loan-for-home-improvements-what-should-i-keep-in-mind-before-signing-up-en-2128/

If the homeowner has a mortgage, the mortgage company will treat PACE loans like property taxes, because PACE payment is billed as part of the property tax payment. If the homeowner's home goes to tax sale, any portion of the outstanding PACE loan that is delinquent will be paid before the mortgage company will be paid anything. If the homeowner has an existing mortgage escrow account that collects the tax and insurance payments, most mortgage servicers will add the PACE payments into the mortgage escrow, to make sure that they are paid timely. This would cause the homeowners mortgage payments to rise. Most lenders will not refinance a mortgage or give homeowners a new mortgage if they have an outstanding PACE loan. MLOs should ask all refinance borrowers if they have acquired a PACE loan to ensure their payoff and underwriter guidelines will be met.

If the homeowner does not have an escrow account to collect property tax payments, homeowners will need to save up to make PACE payments along with their property taxes.

If the homeowner does not have a mortgage loan that collects their property tax payments, the homeowner may have to work with the local taxing authority if they fall behind. They may not be able to help beyond offering the homeowner a short-term payment plan, which may not be affordable.

Salespeople may tell the homeowner, but are not required to prove, that the proposed improvements "pay for themselves" in lower utility payments or other rebates. For some projects funded through PACE, these statements may not be true.

Limited Means to Dispute the Work or Costs

Because the homeowner pays PACE loans back with the property taxes, homeowners have limited options when they are not satisfied with the work, wish to dispute the charges, or cannot afford the payments.

Trouble Selling or Refinancing the Home

If the homeowner wants to sell their home before the PACE loan is paid off, they might face challenges completing the sale. When they sell a house, the buyer is responsible for continuing the PACE payments. Any buyer will face the same risks of losing the home if the payments are not made. That may make the home more expensive than buying another home without a PACE loan. Most lenders will not make a mortgage to the buyer when there is a PACE loan on the house.

In addition, most lenders will not refinance a mortgage if there is a PACE loan on the house. This may limit the number of buyers who will be willing to purchase a home if the homeowner cannot afford to pay the PACE loan off.

Loss of Home Equity

If the homeowner's home goes to tax sale, the tax authority will collect any unpaid taxes and any delinquent PACE payments, along with any penalties. This can take a large chunk of any equity in the home. Which means there will be less for the homeowner to use on other expenses.

For example - If the homeowner is planning to use that equity to pay the costs of moving out of the home, or for retirement.[129]

Conventional Rehab Loan

With a conventional rehab loan, the homeowner can finance both the purchase of a new home and the cost of renovations with a single mortgage product. This means the homeowner will not have to take out a second mortgage or pay for costly home improvement projects out of pocket. The funds are provided through private lenders and banks and can be used to pay for cosmetic and structural upgrades.

Here is what to expect with a conventional rehab loan:

Step 1: Apply for a loan product. If borrower is pre-approved, the lender will notify the borrower of the loan terms, including the required down payment.

Step 2: Retrieve contractor plans for the renovation project and submit them to the lender for approval.

Step 3: If the plans are approved, the lender sends an appraiser to assign an after-repair value (that considers the contractor's plans).

Step 4: Close on the home and commence renovations. They should be completed within six months, but some lenders permit the contract to spend up to a year on approved projects.

[129] https://www.consumerfinance.gov/ask-cfpb/i-am-considering-a-pace-loan-for-home-improvements-what-should-i-keep-in-mind-before-signing-up-en-2128/

Types of Conventional Rehab Loans

Homebuyers can choose from two types of conventional rehab loans.

Fannie Mae Home Style Renovation Loan

The Fannie Mae Home Style Renovation Loan can be used to cover upgrade costs on a home the borrower owns or plans to buy. It is limited to 95% of the homes' after-renovation value. The loan comes with an adjustable or fixed interest rate that is typically lower than what they will get with a home equity loan or line of credit. The program is a 15- or 30-year loan term.

Instead of taking out two separate loans, the loan rolls the purchase price and renovation costs into a single mortgage product. That means the borrower only pays closing costs once, and they will have a single monthly housing payment. However, if the borrower has an existing mortgage, they will have to pay it off with this loan, which means the homeowner could end up with a higher mortgage interest rate and payment.

Loans are capped at $766,550 in most markets for single-family properties. However, they could borrow as much as $1,149,825 if the property is in a pricier high-priced real estate markets.

Note, upgrades on manufactured homes are limited to $50,000 or 50% of the anticipated property value after renovations are complete.

This loan program can be used to complete most home upgrades and temporary living expenses during construction within six to 12 months of the closing date. However, borrowers are prohibited from building a second property, making temporary improvements, or demolishing the property with the loan proceeds.[130]

Freddie Mac CHOICE Renovation

The Freddie Mac CHOICE Renovation loan covers renovation costs on owner occupied, investment properties, second homes and multi-unit properties. It allows the homeowner to borrow up to 95% of the home's after-renovation value.

[130] https://www.banks.com/articles/loans/home-improvement/conventional-rehab-loan/

The homeowner may use the loan proceeds for rehab on a property they are purchasing or already own. An existing property would be considered a refinance requiring the borrower to refinance their existing mortgage which could be at a higher interest rate than they currently have.

The upside is this loan product is it is more flexible than the Fannie Mae Home Style Renovation Loan. The homeowner can use the funds to make most upgrades, and you can cover the costs of renovations that will shield the property from sustaining severe damage if a natural disaster strikes. The cost of repairs for damage caused by natural disasters is also covered.

Loan terms of 15 or 30 years are available. The owner-occupied homeowner will need at least 3.5% down, a credit score of 660, and the debt-to-income ratio should not exceed 43 percent. If the homeowner is planning to complete the renovations before closing, they may be eligible for a down payment credit if they finish the improvement job before closing.[131]

Difference Between a Conventional Loan and a Rehab Loan

A conventional loan is a standard mortgage that is not insured or backed by a government agency. These loans are offered by private lenders and usually require a down payment of around 5% to 20% of the home’s value. The terms and requirements for conventional loans can vary depending on the lender, but they have stricter qualifying guidelines than government insured loans.

But a rehab loan is a specialized mortgage that allows the homeowner to finance not only the purchase of a home but also its renovation costs using a single loan.

Advantages of Conventional Rehab Loans

Flexibility of Financing

Conventional rehab loans offer a great deal of flexibility in financing home improvement projects. With these loans, the homeowner can finance both the purchase of a new home and the cost of necessary renovations in a single mortgage product.

This means the homeowner will not need to take out a second mortgage or pay out of pocket for costly renovations. Furthermore, conventional rehab loans are not governed by the same strict rules as government-backed loans, offering them more options and potentially less paperwork.

[131] https://www.banks.com/articles/loans/home-improvement/conventional-rehab-loan/

Potential for Property Appreciation

Investing in a fixer-upper with a conventional rehab loan could lead to a significant increase in the property's value because of the improvements made. Since the loan covers both the purchase and renovation costs, the homeowner has the opportunity to transform a distressed property into a valuable asset. As property values rise in the neighborhood, the newly renovated home may appreciate value even more, making it a profitable long-term investment.

Lower Home Ownership Costs

By using a conventional rehab loan for a homeowner's fixer-upper, they can potentially save money on overall homeownership costs.

For example – they might be able to:

- Purchase the property at a lower price: Fixer-uppers are often priced lower than their renovated counterparts, giving homebuyers a chance to buy a property at an affordable price.
- Minimize additional loan expenses: With a single loan instead of multiple loans to finance the purchase and renovation, the homebuyer can avoid multiple closing costs, loan fees, and appraisals.
- Reduce ongoing maintenance costs: By renovating the home upfront with loan funds, the homebuyer can address potential maintenance issues and prevent the need for costly repairs down the line.

Disadvantages of Conventional Rehab Loans

As with any mortgage product, there are also downsides to consider.

- Stricter eligibility guidelines: Conventional rehab loans often have stricter qualification requirements compared to other renovation loan programs, such as FHA 203(k) loans. This means the homebuyer needs a good credit score and stable income to be eligible for a conventional rehab loan. Furthermore, the homebuyer might be required to make a larger down payment than other loan options, which could affect their budget.
- Limited loan amounts: These loans have a cap on the amount of money you can borrow, which may not cover all the desired renovations. Therefore, the homebuyer may need to scale back their plans or find alternative financing options for larger projects.
- More challenging renovation process: Managing the renovation process can be more challenging with a conventional rehab loan. The homeowner will need to collaborate closely

with their contractor to create detailed plans and ensure the work is completed on time and within budget. Some lenders may also require them to work with specific contractors, limiting borrower choices.

Understanding the Loan Process

Qualifying for Conventional Rehab Loans

The homebuyer qualifies for a conventional rehab loan if it meets the criteria below:

- Have good or excellent credit
- Have a down payment of at least five percent
- Have an acceptable debt-to-income ratio

Note - Some lenders require up to 20% down. Even if they qualify for a lower down payment, any amount below 20% requires private mortgage insurance. Also, know that poor credit does not necessarily disqualify a borrower for a loan, but they will need an excellent explanation to convince the lender they are a good candidate for funding.

The Expenses Involved in Rehab Loans

Conventional rehab loans come with several expenses that you should be aware of:

- Down payment: Conventional rehab loans typically require a down payment ranging from 5% to 20% of the total loan amount.
- Closing costs: These may include loan origination fees, appraisal fees, and other expenses related to processing the loan.
- Interest rates: The interest rates for these loans vary based on the borrower's credit rating, loan amount, and other factors.
- Rehabilitation expenses: Homebuyers need to account for the costs involved in renovating the property. As mentioned above, a single mortgage product covers both the purchase and renovation costs.

Alternative to Conventional Rehab Loans

Home equity loans and HELOCs (Home Equity Lines of Credit) are an attractive financing option for many homeowners looking to use their home's equity to make purchases, pay off debt, or finance a renovation. Home equity loans provide borrowers with a lump sum of money that is repaid over a predetermined period at a fixed interest rate. A HELOC works similarly but instead provides a line of credit that can be used however the borrower chooses. Both options offer substantial advantages for homeowners, including lower interest rates than most other loan types, flexible repayment plans, and tax benefits.[132]

[132] https://www.banks.com/articles/loans/home-improvement/conventional-rehab-loan/

Module 4

California Mortgage DFPI

In our culture it's generally not a good idea to offer unsolicited advice. Yet, before getting into the meat of this course I want to take a moment to provide a little information that may help you to remain in compliance with the laws that govern your actions as a Mortgage Loan Originator.

So, I would like to begin with a story told to me by a very capable trainer in mortgage finance about his early days in the business. He tells it like this:

At the time of this specific occurrence I was in my second year of mortgage lending, and all was going very well for me. While casually visiting one of my business acquaintances, the Loan Originator mentioned a way to increase my sales and revenue.

I had already established myself as one of the highest producers in the city but I rarely turn down a potential means of raising the production bar to a higher level. So, I listened intently.

When he finished detailing his somewhat unusual way of producing the extra revenue I said, "Is that really legal?" As a seasoned veteran with over fifteen years of experience he walked me through the process they had established to remain within the letter of the law. Then I asked, "But is it ethical? Do you think it's the right way to treat your customers?" He responded that his customers didn't lose because the profit he made was just passed along in the value of the house when it was resold.

On my way home I thought about his plan, and the more I thought about it the more I was convinced it just wasn't the right thing to do – regardless of whether or not it was legal. Then I didn't think any more about it…

Until about three years later when I was asking a mutual friend how the Loan Originator was doing. She said, "Oh, didn't you hear? He's serving a five year sentence in the state penitentiary for mortgage fraud."

I was stunned. His scheme really did appear to be legal, but it was clearly not ethical. As a small single person company he didn't make much of a blip on the enforcement radar. I never thought for a moment that he would create major legal issues for himself – let alone spend five years in the state penitentiary.

Something that seemed legal – even though it "felt" wrong – and something I never thought would catch the attention of any enforcement agency was a life changing experience for both of us.

Although the state wasn't California, the laws that governed mortgage lending began with the same sentences as the laws that govern California; I strongly suggest you take them very seriously.

Although the Continuing Education requirement is one hour, there is no possible way we could present to you all the legal aspects of mortgage lending in that hour. So, we've taken what we believe to be some of the most significant portions of the law to highlight.

Specifically, we'll be looking at the California Homeowner Bill of Rights, abbreviated HBOR, the California Financial Code Division 9 (known as the California Financing Law, abbreviated CFL), and Division 20 (known as the California Residential Mortgage Lending Act, abbreviated CRMLA.)

In an effort to strengthen consumer financial protections in California, the Governor's office sought to modernize and revamp the Department of Business Oversight (DBO), including an increase in staff and authority, to enhance its regulatory scope and become a national model for consumer protections. The Department of Financial Protection and Innovation (DFPI) was created to have regulatory powers to protect consumers from unfair, deceptive, or abusive practices committed by previously unlicensed financial services or products. These may include industries that currently exist unregulated in California or new products or services that may enter the market in the future.

The Department of Financial Protection and Innovation (DFPI) provides protection to consumers and services to businesses engaged in financial transactions. The Department regulates a variety of financial services, products and professionals. The Department oversees the operations of state-licensed financial institutions, including banks, credit unions, money transmitters, issuers of payment instruments and traveler's checks, and premium finance companies. Additionally, the Department licenses and regulates a variety of financial businesses, including securities brokers and dealers, investment advisers, deferred deposit (commonly known as payday loans) and certain fiduciaries and lenders. The Department also regulates the offer and sale of securities, franchises and off-exchange commodities.

Future references to the Commissioner or Department refer to the Commissioner of Financial Protection and Innovation or Department of Financial Protection and Innovation.

HOMEOWNER BILL OF RIGHTS

Let's begin with the Homeowner's Bill of Rights (SB900), or HBOR.

Succinctly stated, the HBOR was passed by the California Legislature in 2012 and became effective January 1, 2013. Its primary purpose is to reduce the number of foreclosures by imposing additional requirements and restrictions on lenders and on the foreclosure process.

- We will briefly discuss each of these individually, but here's an overview of the HBOR:
- Increased notifications to the borrowers of their rights prior to foreclosure.
- A single point of contact when homeowners seek the lender's assistance to avoid foreclosure.
- No "Dual Tacking" is permitted.
- Higher vigilance in the verification of documents by the lender.
- Enforceability gives homeowners an easier path to pursue lenders that are non-compliant.
- Tenant rights who live in homes that go through foreclosure.
- Neighborhood blight to ensure owners of abandon homes keep them in respectable condition.

If any of your clients (or friends, family, or anyone you are concerned about) is having difficulty paying their mortgage, you should refer them to the HBOR and let them know it is for their protection and could provide the solution they need to remain in their home.

Now let's look at some of the most pertinent parts of the HBOR in greater detail. As we discuss the HBOR we will be referring to the ***lender*** frequently. In reality it's actually the mortgage servicer – not the lender – who provides the service most of the time, but most borrowers neither understand nor can distinguish one from the other. And in some cases the mortgage service and the lender are the same entity.

<u>INCREASED NOTIFICATIONS</u>

- Before filing a notice of default (NOD), the lender must send written notice to the borrowers telling them they have the right to request critical loan documents as well as the payment history.
- This notice must be sent before ***filing*** a Notice of Default, and at least 30 days before ***recording*** the Notice of Default.
- If any of the borrowers are active duty military, the notice must explain that additional protections may be available.
- If the lender files a Notice of Default, a written notice must be sent to the borrower within

five business days with information about the possibility of being evaluated for an alternative to foreclosure, and how the borrower can pursue those alternatives.

- If the borrower qualifies as an eligible borrower under the law and the lender has foreclosure alternatives available, those alternatives (including potential loan modification) must be offered as appropriate to the borrower upon request. Note that the borrower must make this request for an evaluation into foreclosure alternatives.

SINGLE POINT OF CONTACT

- If the borrower responds to the lender and requests an evaluation for an alternative to foreclosure, the lender must provide a single point of contact so the borrower doesn't need to make repeated requests or explanations.
- The single point of contact may be an individual or a team of individuals so long as the entire team is familiar with the loan and can speak intelligently to the borrower about the status, alternatives, and any other aspects of the loan.
- Specifically, the single point of contact must be familiar with all the paperwork associated with the homeowner as well as all the pertinent facts of the homeowner's situation.
- The point of contact must also have the organizational ability to get a decision regarding loan modification for the homeowner.

The point of contact must remain consistent until the homeowner's case is resolved through some alternative payment arrangements or through foreclosure.

NO DUAL TRACKING IS PERMITTED

- Dual Tracking is the term used to describe a lender that pursues foreclosure at the same time the lender is working on loan alternatives.
- Dual Tracking clearly lessens the lender's need to be diligent in the foreclosure avoidance.
- When the borrower requests an evaluation and assistance with foreclosure alternatives, the foreclosure process is put on hold. If foreclosure has already been initiated, then it essentially halts until the alternative process is resolved or is deemed to be unavailable.

VERIFICATION OF DOCUMENTS

- This essentially stops the practice known as *robo-signing* where unqualified employees would forge the signature of the appropriate person who was supposed to review the documents for completeness and accuracy.

- While robo-signing was already illegal, the HBOR focuses more attention on the practice and provides for significant penalties to any lender who engages in the activity. Lenders are required to verify documents at the appropriate level before filing with the state.

Unverified documents are subject to a civil penalty up to $7,500 per loan. Violators are also subject to enforcement actions by the Department of Financial Protection and Innovation and the California Bureau of Real Estate (as appropriate.)

ENFORCEABILITY

- Enforceability gives borrowers greater ability to address *material violations* of the HBOR by the lender.
- If the borrower can show material violations by the lender, the borrower can seek injunctive relief prior to a foreclosure sale.
- Some examples of material violations include the failure of the lender to provide a single point of contact, the lender's assessment of late fees while a loan application is pending, and dual tracking by the lender. These are just a few examples.
- Homeowners are permitted to collect legal fees, court fees, and filing fees if their suit is successful.
- Even more stringent is the provision that lenders may be penalized by as much as triple the actual damages or $50,000 (whichever is greater) for intentional or reckless violations of ANY provision under the HBOR.

TENANT RIGHTS

- Tenants of foreclosed properties are given additional protection.
- Purchasers of foreclosed properties are required to give legitimate tenants a minimum of 90 days before initiating eviction actions.
- Furthermore, if the tenant has a fixed term lease that was initiated before the transfer of title at the foreclosure sale, the new owner must honor the lease unless the new owner can prove the lease is an attempt to circumvent the law by containing unreasonable terms (such as an excessively low rent) or other means.
- When notice of sale is posted at the property, the tenants must also receive a notice that

explains the tenant's rights. The tenant's notice must be posted and also mailed first class. Removing the posted notifications of renter's rights within 72 hours of the time it was posted can result in a $100 fine.

NEIGHBORHOOD BLIGHT

- Contrary to popular opinion, the distribution of home foreclosures is not random. Even within a specific hard-hit geographic area the distribution is not random. Rather, foreclosures tend to "favor" specific neighborhoods generally for economic reasons.
- Consequently, just a modest uptick in foreclosures can be devastating for specific neighborhoods, leaving them with a large number of foreclosed and abandoned houses.
- Since the owners of the foreclosed properties are typically institutional (lenders), there is no genuine consideration for the effect the abandon house has on the neighborhood, and since the lender understandably doesn't want to expend additional resources on a house that has already created a loss, the house can quickly become a neighborhood blight with high grass and weeds, a damaged exterior, broken windows, and other such things that are wholly undesirable to maintain neighborhood desirability.
- The growing number of unmaintained foreclosed homes tends to drive potential buyers away from homes in the neighborhood that are for sale. This reinforcing cycle tends to push prices lower, creating more short sales and foreclosures.
- The HBOR requires the owner of foreclosed homes to keep the home in respectable condition relative to the neighborhood. Homes that are cited as needing repair are given 14-30 days to correct the condition or pay hefty fines.
- While this provision in the HBOR may result in a better maintenance of foreclosed homes, some legal scholars in matters of real estate law question if the HBOR has the constitutional authority to saddle owners of foreclosed homes with the added expense of repairs and maintenance.

CALIFORNIA FINANCING LAW

In this section we'll take a brief look at portions of the California Financing Law, also known as the CFL. This is effectively DIVISION 9 of the California Financial Code, and it's one of the documents we urged you to read at the beginning of this course. [The provisions we will be discussing will be taken from sections of the Financial Code-Division 9, California Financing Law (22000-22780)].

Again, we highly recommend you download this document from the resources section and review it. Due to time constraints this course provides only a cursory review of the CFL and points out a few particularly important (or misunderstood) sections of the law. While the stated purpose seems obvious and unnecessary, it is important to know the purpose primarily due to the first sentence which is the most critical part of the section.

Chapter 1, Article 1, section 22001.

(a) This division shall be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) To ensure an adequate supply of credit to borrowers in this state.

(2) To simplify, clarify, and modernize the law governing loans made by finance lenders.

(3) To foster competition among finance lenders.

(4) To protect borrowers against unfair practices by some lenders, having due regard for the interests of legitimate and scrupulous lenders.

(5) To permit and encourage the development of fair and economically sound lending practices.

(6) To encourage and foster a sound economic climate in this state.

Let's look at the opening sentence again. Did you catch the words "liberally construed and applied" ? Do you understand what that really means? More specifically, do you understand what effect it has on you? Remember our cautionary tale from the beginning of this lesson?

Never forget that the words "liberally construed and applied to promote its underlying purposes"

When a law or policy is to be "liberally construed and applied" it is specifically telling the enforcement agencies and systems that it desires the "underlying purposes" of the code to trump any situation where the ***intent*** of the law is circumvented or violated regardless of whether or not an actual legal violation exists. That's admittedly a bit of an oversimplification, but it's substantially correct.

So be very careful when trying to devise schemes that may appear legal even though a judge and/or jury may disagree when they consider the words "liberally construed and applied."

For example, even if you complied with everything contained in this law, but you did something that hindered competition among finance lenders, you could be held in violation of the law due to its stated purpose *"to foster competition among finance lenders."*

Any idea or strategy that seems a bit irregular should be evaluated with your eyes wide open to the words "***liberally construed***." If the idea is contrary to the law's purpose or an obvious attempt to circumvent the law you could be in for some difficult times.

Admittedly, you'll see others doing things that are contrary to the law's purpose, and that makes it easy to justify doing it yourself. Just remember the story I told you at the beginning of the course where a Mortgage Loan Originator was sentenced to five years in the state penitentiary. Just as he was used as an example to the mortgage origination community, you could become the same kind of example in California. Borrowing a line from Nancy Reagan, "***Just say no***!"

Numerous definitions are provided in the law, but we've listed a few of the more pertinent ones:

BROKER - includes any person who is engaged in the business of negotiating or performing any act as broker in connection with loans made by a finance lender. (Chapter 1, Article 1, section 22004)

COMMISSIONER - means the Commissioner of Financial Protection and Innovation. (Chapter 1, Article 1, section 22005)

LICENSEE - means any finance lender or broker who receives a license in accordance with this division. (Chapter 1, Article 1, section 22007)

PERSON - means an individual, a corporation, a partnership, a limited liability company, a joint venture, an association, a joint stock company, a trust, an unincorporated organization, a government, or a political subdivision of a government. (Chapter 1, Article 1, section 22008)

FINANCE LENDER - includes any person who is engaged in the business of making consumer loans or making commercial loans. The business of making consumer loans or commercial loans may include lending money and taking, in the name of the lender, or in any other name, in whole or in part, as security for a loan, any contract or obligation involving the forfeiture of rights in or to personal property, the use and possession of which property is retained by other than the mortgagee or lender, or any lien on, assignment of, or power of attorney relative to wages, salary, earnings, income, or commission.

It is the intent of the Legislature that the definition of finance lender shall be interpreted to include a personal property broker as referenced in Section 1 of Article XV of the California Constitution. (Chapter 1, Article 1, section 22009)

FINANCE LENDER and BROKER - do ***not*** include employees regularly employed at the location specified in the license of the finance lender or broker, except that an employee, when acting within the scope of his or her employment, shall be exempt from any other law from which his or her employer is exempt. (Chapter 1, Article 1, section 22010)

MORTGAGE LOAN ORIGINATOR - means an individual who, for compensation or gain, or in the expectation of compensation or gain, takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan. (Chapter 1, Article 1, section 22013)

<u>There's a notable number of exceptions to whom the law applies</u>:

(Chapter 1, Article 1, section 22013)

A MORTGAGE LOAN ORIGINATOR DOES ***NOT*** INCLUDE ANY OF THE FOLLOWING:

(1) An individual who performs purely administrative or clerical tasks on behalf of a person meeting the definition of a mortgage loan originator, except as provided in subdivision (c) of Section 22014. The term "administrative or clerical tasks" means the receipt, collection, and distribution of information common for the processing or underwriting of a loan in the mortgage industry and communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan, to the extent that the communication does not include offering or negotiating loan rates or terms, or counseling consumers about residential mortgage loan rates or terms.

(2) An individual who solely renegotiates terms for existing mortgage loans held or serviced by his or her employer and who does not otherwise act as a mortgage loan originator, unless the

United States Department of Housing and Urban Development or a court of competent jurisdiction determines that the SAFE Act requires such an employee to be licensed as a mortgage loan originator under state laws implementing the SAFE Act.

(3) An individual that is solely involved in extensions of credit relating to timeshare plans, as that term is defined in Section 101(53D) of Title 11 of the United States Code.

(4) An individual licensed as a mortgage loan originator pursuant to the provisions of Article 2.1 (commencing with Section 10166.01) of Chapter 3 of Part 1 of Division 4 of the Business and Professions Code and the SAFE Act.

(5) An individual who is an employee of a federal, state, or local government agency or housing finance agency and who acts as a loan originator only pursuant to his or her official duties as an employee of the federal, state, or local government agency or housing finance agency

(6) (A) An employee of a bona fide nonprofit organization who exclusively originates residential mortgage loans for a bona fide nonprofit organization, and who acts as a mortgage loan originator only with respect to residential mortgage loans with terms that are favorable to the borrower.

(B) To qualify for the exemption under this paragraph, the bona fide nonprofit organization under this paragraph must register with the department on a form prescribed by the commissioner, along with documentation of all of the following by December 31 of each year:

(i) Status of a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986.

(ii) That the organization promotes affordable housing or provides home ownership education or similar services.

(iii) That the organization conducts its activities in a manner that serves public or charitable purposes, rather than commercial purposes.

(iv) That the organization receives funding and revenue, and charges fees in a manner that does not incentivize the organization or its employees to act other than in the best interests of its clients.

(v) That the organization compensates employees in a manner that does not incentivize employees to act other than in the best interests of its clients.

(vi) That the organization provides to, or identifies for, the borrower residential mortgage loans with terms favorable to the borrower and comparable to mortgage loans and housing assistance provided under government housing assistance programs.

(vii) That the organization is certified by the United States Department of Housing and Urban Development as a housing counselor who engages solely in traditional housing counseling services, if applicable.

(C) The commissioner may periodically require reports regarding the activities of the bona fide nonprofit organization, and shall examine the nonprofit organization's books and records in accordance with the regulations of the United States Department of Housing and Urban Development, or any successor guidance or requirement by the Consumer Financial Protection Bureau. If the nonprofit organization fails to provide documentation as required by subparagraph (B), or if it does not continue to meet the criteria under subparagraph (B), the commissioner may revoke the nonprofit organization's status as a registered bona fide nonprofit organization.

(D) For residential mortgage loans to have terms that are favorable to the borrower, the terms shall be consistent with loan origination in a public or charitable context, rather than a commercial context.

(E) In making its determinations and examinations, the commissioner may rely on the receipt and review of:

(i) Reports filed with federal, state, or local housing agencies and authorities.

(ii) Reports and attestations prescribed by the commissioner by rule or order.

(c) "Registered mortgage loan originator" means any individual who is all of the following:

(1) Meets the definition of mortgage loan originator.

(2) Is an employee of a depository institution, a subsidiary that is owned and controlled by a depository institution and regulated by a federal banking agency, or an institution regulated by the Farm Credit Administration.

(3) Is registered with, and maintains a unique identifier through, the Nationwide Mortgage Licensing System and Registry.

(d) "Loan processor or underwriter" means an individual who performs clerical or support duties as an employee at the direction of, and subject to the supervision and instruction of, a mortgage loan originator licensed by the state or a registered mortgage loan originator.

Note: The documentation is extensive. Take a look at the law if the required documentation is relevant or of interest to you.

The California Financing Law places a wide array of requirements on its licensed Mortgage Loan Originators. Again, in a one hour course we can review only a fraction of the requirements you must comply with under this law. And yes, this is yet another nudge to get you to read for yourself Divisions 9 and 20 of the California Financial Code.

However, there are just a couple more sections of the California Financing Law we want to specifically highlight.

Restrictions

NO PERSON SUBJECT TO THIS DIVISION SHALL DO ANY OF THE FOLLOWING:

(Chapter 1, Article 4, section 22161)

(a) Make a materially false or misleading statement or representation to a borrower about the terms or conditions of that borrower's loan, when making or brokering the loan.

(b) Advertise, print, display, publish, distribute, or broadcast, or cause or permit to be advertised, printed, displayed, published, distributed, or broadcast in any manner, any statement or representation with regard to the business subject to the provisions of this division, including the rates, terms, or conditions for making or negotiating loans, that is false, misleading, or deceptive, or that omits material information that is necessary to make the statements not false, misleading, or deceptive, or in the case of a licensee, that refers to the supervision of the business by the state or any department or official of the state.

(c) Commit an act in violation of Section 1695.13 of the Civil Code.

(d) Engage in any act in violation of Section 17200 of the Business and Professions Code.

(e) Knowingly misrepresent, circumvent, or conceal, through subterfuge or device, any material aspect or information regarding a transaction to which the person is a party.

(f) Commit an act that constitutes fraud or dishonest dealings.

CALIFORNIA RESIDENTIAL MORTGAGE LENDING ACT (CRMLA)

(Division 20, Chapter 2, Section 50124)

In this section we'll take a brief look at the California Residential Mortgage Lending Act, also known as the CRMLA. This is effectively DIVISION 20 of the California Financial Code.

Similar to the previous section where we looked at the California Financing Law, we could easily spend an entire day on this section alone. Don't fool yourself into believing that you're an expert in the applicable mortgage laws because you completed the one hour of Continuing Education.

With such limited time I want to make one last plea for you to help yourself and your clients by fully reading DIVISIONS 9 and 20 of the California Financial Code along with other areas and new publications that impact mortgage lending. We've made it easy by preparing Divisions 9 and 20 for download in a PDF document with extensive bookmarks to make specific sections easy to find.

It's easy to get caught up in the daily routine of your job and overlook a few small and seemingly insignificant requirements of the Commissioner. I can assure you the Commissioner does not believe ***any*** of your requirements or responsibilities as a residential mortgage lender are "insignificant."

Let me restate that a little differently: ***there are no "inconsequential" requirements for mortgage lenders.*** I suspect you can provide me with numerous examples of violations by others, and you may be able to demonstrate that you have personally ignored some of the requirements for years without any consequences. It's possible you can get by with your negligence or irresponsibility for your entire career.

It's also possible you could be one of that state's examples by suddenly finding yourself in serious trouble for what seems to be minor infractions that are common. Don't fall into that trap!

According to the California Residential Mortgage Lending Act, a residential mortgage lender or servicer shall do all of the following. Note that this section is for the ***lender***, not each originator. However, it should give you an insight into the costs of operating as a lender, explain why the lender extracts a noteworthy amount of the origination profit from your paycheck, and give you an increased understanding why your lender is very strict about some issues that may seem marginally consequential to you. (50124)

(1) Maintain staff adequate to meet the requirements of this division, as prescribed by rule or order of the commissioner.

(2) Keep and maintain for 36 months from the date of final entry the business records and other

information required by law or rules of the commissioner regarding any mortgage loan made or serviced in the course of the conduct of its business.

(3) File with the commissioner any report required under law or by rule or order of the commissioner.

(4) Disburse funds in accordance with its agreements and to make a good faith and reasonable effort to effect closing in a timely manner.

(5) Account or deliver to a person any personal property such as money, funds, deposit, check, draft, mortgage, other document, or thing of value, that has come into its possession and is not its property, or that it is not in law or equity entitled to retain under the circumstances, at the time that has been agreed upon or is required by law, or, in the absence of a fixed time, upon demand of the person entitled to the accounting or delivery.

6) File with the commissioner an amendment to its application prior to any material change in the information contained in the application for licensure, including, without limitation, the plan of operation. The commissioner shall, within 20 business days of receiving a completed amendment to the application, or within a longer time if agreed to by the licensee, approve or disapprove the effectiveness of the proposed amendment.

(7) Comply with the provisions of this division, and with any order or rule of the commissioner.

(8) Submit to periodic examination by the commissioner as required by this division.

(9) Advise the commissioner by amendment to its application of any material judgment filed against, or bankruptcy petition filed by, the licensee within five days of the filing.

(10) Notify the commissioner, in writing, prior to opening a branch office in this state or changing its business location or locations or its branch offices from which activities subject to this division are conducted.

(11) Comply with all applicable state and federal tax return filing requirements.

(12) Refrain from employing, or paying a commission or other fee to, a mortgage loan originator who is not licensed in this state, unless the individual is exempt from licensure.

(13) Refrain from committing a crime against the laws of any state or the United States, involving moral turpitude, misrepresentation, fraudulent or dishonest dealing, or fraud, and disclose to the commissioner any final judgment entered against it in a civil action upon grounds or

allegations of fraud, misrepresentation, or deceit.

(14) Refrain from engaging in conduct that would be cause for denial of a license.

(15) Remain solvent.

(16) Proceed with due care and competence in performing any act for which it is required to hold a license under this division.

(17) Comply with any other requirement established by rule of the commissioner.

The commissioner may require an applicant to submit a statement agreeing to comply with the requirements of this section.

Prohibited Practices and Penalties (Division 20, Chapter 7, Section 50500)

Chapter 7 of the Residential Mortgage Lending Act sets forth prohibited practices and penalties. It's definitely worth your time to read the entire chapter. Here's a few excerpts that should get your attention:

Any person who willfully violates any provision of this division, or any rule or order under this division, shall, upon conviction, be subject to a fine of not more than ***ten thousand dollars*** ($10,000) ***or imprisonment*** pursuant to subdivision (h) of Section 1170 of the Penal Code, or in a county jail for not more than one year, or to ***both that fine and imprisonment***.

Prohibited Practices and Penalties (Division 20, Chapter 7, Section 50513)

(a) The commissioner may do one or more of the following:

(1) Deny, suspend, revoke, condition, or decline to renew a mortgage loan originator license for a violation of this division, or any rules or regulations adopted thereunder.

(2) Deny, suspend, revoke, condition, or decline to renew a mortgage loan originator license if an applicant or licensee fails at any time to meet the requirements of Section 50141 or 50144, or withholds information or makes a material misstatement in an application for a license or license renewal.

(3) Order restitution against a mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator for a violation of this division.

(4) Impose fines on a mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator pursuant to subdivisions (b), (c), and (d).

(5) Issue orders or directives to mortgage loan originators under this division as follows:

(A) Order or direct a mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator to desist and refrain from conducting business, including immediate temporary orders to desist and refrain.

(B) Order or direct a mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator to cease any harmful activities or violations of this division, including immediate temporary orders to desist and refrain.

(C) Enter immediate temporary orders to cease business under a license issued pursuant to the authority granted under Section 50002 if the commissioner determines that the license was erroneously granted or the mortgage loan originator is currently in violation of this division.

(D) Order or direct any other affirmative action as the commissioner deems necessary.

(b) The commissioner may impose a civil penalty on a mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator, if the commissioner finds, on the record after notice and opportunity for hearing, that the mortgage loan originator or any residential mortgage lender or servicer licensee employing a mortgage loan originator has violated or failed to comply with any requirement of this division or any regulation prescribed by the commissioner under this division or order issued under authority of this division.

(c) The maximum amount of penalty for each act or omission described in subdivision (b) shall be twenty-five thousand dollars ($25,000).

(d) Each violation or failure to comply with any directive or order of the commissioner is a separate and distinct violation or failure.

Negligence and irresponsibility can have serious consequences for loan originators. Know the law, maintain diligence, and treat your clients with great respect. A good reputation can go a long way in minimizing the consequences of a mistake should you ever find yourself in an undesirable discussion with the commissioner. Be smart. Be vigilant. And be successful!