8 Hour CA-DBO SAFE Comprehensive: Compliance for 2018

STUDY MANUAL

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Date of Course Content: 4/12/18
Date of Course Approval:
Provider ID: 1400037

Rules of Conduct for NMLS Approved Pre-Licensure (PE) and Continuing Education (CE) Courses

The Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), requires that state-licensed MLOs complete pre-licensing (PE) and continuing education (CE) courses as a condition to be licensed. The SAFE Act also requires that all education completed as a condition for state licensure be NMLS approved. Since 2009 NMLS has established course design, approval, and delivery standards which NMLS approved course providers are required to meet. To further ensure students meet the education requirements of the SAFE Act, NMLS has established a Rules of Conduct (ROC). The ROC, which have been approved by the NMLS Mortgage Testing & Education Board, and the NMLS Policy Committee, both of which are comprised of state regulators, are intended to stress that NMLS approved education be delivered and completed with integrity.
Rules of Conduct

As an individual completing either pre-licensure education (PE) or continuing education (CE), I agree to abide by the following rules of conduct:

1. I attest that I am the person who I say I am and that all my course registration information is accurate.

2. I acknowledge that I will be required to show a current government issued form of identification prior to, and during the course, and/or be required to answer questions that are intended to verify/validate my identity prior to, and during the course.

3. I understand that the SAFE Act and state laws require me to spend a specific amount of time in specific subject areas. Accordingly, I will not attempt to circumvent the requirements of any NMLS approved course.

4. I will not divulge my login ID or password or other login credential(s) to another individual for any online course.

5. I will not seek or attempt to seek outside assistance to complete the course.

6. I will not give or attempt to give assistance to any person who is registered to take an NMLS approved pre-licensure or continuing education course.

7. I will not engage in any conduct that creates a disturbance or interferes with the administration of the course or other students' learning.

8. I will not engage in any conduct that would be contrary to good character or reputation, or engage in any behavior that would cause the public to believe that I would not operate in the mortgage loan business lawfully, honestly or fairly.

9. I will not engage in any conduct that is dishonest, fraudulent, or would adversely impact the integrity of the course(s) I am completing and the conditions for which I am seeking licensure or renewal of licensure.

I understand that NMLS approved course providers are not authorized by NMLS to grant exceptions to these rules and that I alone am responsible for my conduct under these rules. I also understand that these rules are in addition to whatever applicable rules my course provider may have.
I understand that the course provider or others may report any alleged violations to NMLS and that NMLS may conduct an investigation into alleged violations and that it may report alleged violations to the state(s) in which I am seeking licensure or maintain licenses, or to other states.
I further understand that the results of any investigation into my alleged violation(s) may subject me to disciplinary actions by the state(s) or the State Regulatory Registry (SRR), including removal of any course from my NMLS record, and/or denial or revocation of my license(s).

Lesson 1: Truth – In – Lending Act (TILA)

LESSON OBJECTIVES

By the end of this lesson:

- Students should be familiar with TILA provisions
- Students should be familiar with loans covered by TILA
- Finance charges on the Loan Estimate

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.

Two of the most Important Consumer Protection Laws Regarding Mortgage Loans are:

- Truth in Lending Act (TILA) [Bureau of Consumer Financial Protection 12 CFR Chapter X, Part 1026- Truth in Lending-Regulation Z]
- Real Estate Settlement Procedures Act (RESPA) [FDIC Law, Regulations, Related Acts, 6500- Consumer protection, Part 1024- Real Estate Settlement Procedures, RESPA, Regulation X, 12 CFR, Part 1024

The Truth in Lending Act (TILA)

We will begin with a discussion on the Truth in Lending Act and some of the provisions that remain the same currently before moving on to the next lesson where we will discuss the ways that the Dodd-Frank Act has changed this Act as well as the Real Estate Settlement Procedures Act.

The Truth in Lending Act (TILA), 15 U.S.C. 1601 et seq., was enacted on May 29, 1968, as title I of the Consumer Credit Protection Act (Pub. L. 90-321). The TILA, implemented by Regulation Z (12 CFR §1026), became effective July 1, 1969.

TILA has been amended several times.

To name just a few, TILA has been amended by the Fair Credit Billing Act of 1974, the Consumer Leasing Act of 1976, The Truth in Lending Simplification and Reform Act of 1980, the Fair Credit and Charge Card Disclosure Act of 1988, the Home Equity Loan Consumer Protection Act of 1988, The Competitive Equality Banking Act of 1987, the Home Ownership and Equity Protection act of 1994 (HOEPA),

The Economic Growth and Regulatory Paperwork Reduction Act of 1996, The Electronic Signatures in Global and National Commerce Act (the E-Sign Act) in 2000, The Mortgage Disclosure Improvement Act of 2008 (MDIA), The Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act), the Higher Education Opportunity Act (HEOA), and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

You get the point; this particular law has changed over time and continues to change to this day as the Dodd-Frank Act continues to be implemented in stages in the real estate financing industry.

The Truth in Lending Act has the following as its stated purpose: [Regulation Z, 12 CFR §1026.1(b)]

> "The purpose of this part is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The regulation also includes substantive protections. It gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes.
>
> The regulation does not generally govern charges for consumer credit, except that several provisions in Subpart G set forth special rules addressing certain charges applicable to credit card accounts under an open-end (not home-secured) consumer credit plan. The regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling.
>
> It also imposes limitations on home-equity plans that are subject to the requirements of Regulation Z, 12 CFR §1026.40 and mortgages that are subject to the requirements of Regulation Z, 12 CFR §1026.32. The regulation prohibits certain acts or practices in connection with credit secured by a dwelling in Regulation Z, 12 CFR §1026.36, and credit secured by a consumer's principal dwelling in Regulation Z, 12 CFR §1026.35. The regulation also regulates certain practices of creditors who extend private education loans as defined in Regulation Z, 12 CFR §1026.46(b)(5)."

In other words, TILA's purpose is to ensure that credit terms are disclosed in a meaningful way so that consumers are well equipped to compare credit terms. With the implementation of this law, credit terminology is standard across the industry and disclosures and documents are as well, making it easier for the consumer to understand what they are getting into.

The act also does the following: [Regulation Z, 12 CFR §1026(b)]

- protects consumers against inaccurate and unfair credit billing and credit card practices
- prohibits unfair deceptive lending practices
- provides rate caps on certain loans
- specifies limitations on home equity lines of credit and some closed-end home mortgages
- and provides the right of rescission for consumer

Considering that TILA is meant to establish certain consumer protections, it is no surprise that it requires that certain documents be provided to the consumer that contain pertinent information regarding their credit transaction. The following are a few of the requirements proposed by TILA:

- Creditors must follow the same guidelines when disclosing certain charges and rates to consumers
- Ensures all creditors will use the same format when discussing or showing these items
- Gives creditors the right to cancel certain credit transactions if it includes a line on their principal dwelling
- On variable-rate transactions secured by a dwelling, the law requires a maximum interest rate be stated
- Imposes limits regarding certain home equity plans
- Prohibits certain practices for credit that is secured by a dwelling

The application of TILA, by an individual or business entity, should be adhered to when the following conditions are met: [Regulation Z, 12 CFR §1026.1 (c)(1)]

- When offering or extending credit to consumers [Regulation Z, 12 CFR §1026.1 (c)(1)(i)]
- The service of offering or extending credit is done on a regular basis [Regulation Z, 12 CFR §1026.1 (c)(1)(ii)]
- If a finance charge is attached to this credit or is payable in more than four monthly installments as per a written agreement [Regulation Z, 12 CFR §1026.1 (c)(1)(iii)]
- The use of this credit will be primarily for personal, family, or household purposes [Regulation Z, 12 CFR §1026.1 (c)(1)(iv)]

The Truth in Lending Act contains rules for open-end and closed end credit transactions [Subpart B – Open End Credit and Subpart C Closed End Credit]

- Open-end credit involves the consumer being given credit in which creditor reasonably contemplates repeated transactions [Regulation Z, 12 CFR §1026.2 (a)(20)(i)]
- The creditor may impose a finance charge from time to time on an outstanding unpaid balance [Regulation Z, 12 CFR §1026.2 (a)(20)(ii)]
- The amount of credit limited by the creditor may be extended to the consumer during the term of the plan [Regulation Z, 12 CFR §1026.2 (a)(20)(iii)]
- This is generally made available to the extent that any outstanding balance is repaid [Regulation Z, 12 CFR §1026.2 (a)(20)(iii)]
- Examples of open-end credit would be
    - Bank credit cards
    - Home Equity Lines of Credit (HELOC)
    - Department store or service station credit cards
    - Overdraft privileges

Closed-end credit involves all other transactions, such as, car loans or mortgages [Regulation Z, 12 CFR §1026.2 (a)(10)]

- One objective of the Truth in Lending Act is to require the mortgage originator to disclose to the consumer their interest rate reflected as an annual percentage rate (APR), showing [Regulation Z, 12 CFR §1026.22 (a)]
    - The cost of credit, within three business days of application [Regulation Z, 12 CFR §1026.19 (a)]
    - Pre-Paid finance charge and what it includes [Regulation Z, 12 CFR §1026.4 (a)]
    - How it was used to calculate the annual percentage rate
- Truth in Lending Act applies to any mortgage loan used for personal, family, or household purposes such as:
    - Buying/remodeling a home
    - Consolidating personal debt
    - Sending children to college
    - Truth In Lending Act only applies to loans made to natural persons [Regulation Z, 12 CFR §1026.2 (a)(11)]
- TILA does not apply to:
    - Loans made to corporations or organizations [Regulation Z, 12 CFR §1026.3 (a)]
    - Loans made for business, commercial, or agricultural purposes [Regulation Z, 12 CFR §1026.3 (a)(1)]

- Most seller financing is also exempt.
    - TILA's disclosure requirements apply to lenders and credit arrangers (including mortgage brokers).
    - Must give applicant disclosure statement with estimates of loan costs within 3 business days of receiving consumer's written application [Regulation Z, 12 CFR §1026.19 (a)]

Mortgage Disclosure Improvement Act

It is important to discuss the Mortgage Disclosure Improvement Act as it has changed certain lending practices associated with the Truth in Lending Act.

The Housing Economic Recovery Act or HERA includes amendments to the Truth in Lending Act.

- These amendments are known as the Mortgage Disclosure Improvement Act or MDIA, which specifies certain disclosures that are required.
- HERA denotes the following:
    - Requires creditors to give consumers transaction-specific cost disclosures
    - For dwelling secured closed end mortgage transactions subject to the Real Estate Settlement Procedures Act
    - Even though it is not the consumer's principal place of residence

After these amendments to TILA, early disclosures now cover different transaction types [Regulation Z, 12 CFR §1026.19 (a) (1) (i)]:

- Purchase a home; principal dwelling or second home
- Construct a home
- Refinance a home
- Second mortgages
- Home equity loans; Does not include Home Equity Lines of Credit, as they have different disclosure requirements

Prior to the MDIA amendments to TILA, TILA Section 128 (b) (2) applied only to a *residential mortgage transaction* subject to the Real Estate Procedures Act or RESPA. After the MDIA amendments were implemented, and currently, the TILA extends early disclosure requirements to *any extension of credit secured by the dwelling of a consumer* [Regulation Z, 12 CFR §1026.19 (a) (1) (i). This includes refinance and home equity loans.

The following are other changes created by MDIA:

- Changes also include initial fee restrictions. [Regulation Z, 12 CFR §1026.19 (a)(1)(iii)]
    - The only fee that is acceptable by law is a reasonable credit report fee. Other than this fee, there are no upfront fees allowed.
- Disclosure time frames have also changed [Regulation Z, 12 CFR §1026.19 (a)(1)(i)]
    - Initial Disclosures must be delivered or placed in the mail no later than 3 business days after a loan application has been taken.
- For these purposes, business days are defined as days in which the creditor is open for business [Regulation Z, 12 CFR §1026.2 (a)(6)].

- Another major change is the waiting period placed prior to consummation [Regulation Z, 12 CFR §1026.19 (a)(2)]
    - After the delivery of initial disclosures, there must be a period of 7 business days prior to consummation. Therefore, a loan can never close in less than 7 days.
    - For these purposes, business days are defined as all calendar days except for Sundays and legal holidays [Regulation Z, 12 CFR §1026.2(a)(6)]
- Along with the new waiting period after initial disclosures and before consummation, corrected disclosures must be received by the consumer on or before three business days prior to consummation.
    - For these purposes, business days are defined as all calendar days except Sundays and legal holidays [Regulation Z, 12 CFR §1026.2 (a)(6)]
    - Please note that the definition of business day is different with the corrected disclosures than what it is defined as under initial disclosures.
- The above waiting periods are now part of what we call the "3-7-3 Rule" of the Mortgage Disclosure Improvement Act. Please refer to the calendar provided.

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
1 Loan Application is taken (If application taken in person, disclosures are considered given that day)	2 Day 1	3 Day 2	4 Day 3	5 Day 4	6 Day 5	-------------
8 Day 6	9 Day 7 This day is the earliest the loan can go to closing	10	11	12	3	-------------
15 If the loan is approved and a new quoted rate and APR have increased by .125 then new disclosures must be delivered and signed	16 Day 1	17 Day 2	18 Day 3 Now the loan can close and fund	19	20	-------------

As you can see, the rule literally denotes that after application is taken, you have three business days to deliver initial disclosures, after which the loan can only close after an additional 7 business days.

Please note that Day 1 starts the day after the application was taken if disclosures were delivered in person on that day; also note that if the loan is approved and a new rate is quoted and the APR increases by .125, new disclosures must be signed. Day 1 will then begin the following day and on Day 3 the loan can close and fund.

- Regarding APR changes
    - Tolerance levels are also denoted in the Act
    - For regular transactions the APR is considered accurate if it varies by no more than 1/8 or .125 of 1 percentage point. [Regulation Z, 12 CFR §1026.22 (a)(2)]
- For irregular transactions the APR is considered accurate if it varies by no more than ¼ or .25 of 1 percentage point. [Regulation Z, 12 CFR §1026.22 (a)(3)]
- If the APR changes by more than .125 on regular transactions or by more than .25 on irregular transactions, disclosures must be re-disclosed and signed at least three business days before consummation must be received by consumer
- If the APR changes by less than .125 on regular transactions or by less than .25 on irregular transactions, the initial disclosures will be considered accurate.

The 3-7-3 Rule must be followed; however, there are waivers for this waiting period.

- The consumer can waive this waiting period and consummate earlier than the 7 day period, if he/she can show a bona fide personal emergency.
- In order to state the personal emergency, the consumer must prepare a handwritten statement that is signed and dated, specifically describing the emergency, specifying the request for waiver of the 7 days waiting period.

Aside from changes the time frame of disclosure delivery and consummation, there are several changes in documentation and forms. First, the Truth in Lending Form is no longer used. This form has been replaced with integrated disclosures.

We will discuss these in the next lesson. For now, let's continue discussing other sections of the Truth in Lending Act and some sections within the Real Estate Settlement Procedures Act, as the new changes in integrated forms affect both of these.

One of the several important parts of the consumer protection laws is the right of rescission [Regulation Z, 12 CFR § 1026].

If security property for a home equity loan is the borrower's existing principal residence, the borrower has a "right of rescission" [Regulation Z, 12 CFR §1021.23 (ALL)].

What this means is that a borrower has the right to rescind the transaction any time within 3 days after either

- Signing
- Receiving disclosure statement
- Receiving a notice of right of rescission; If the borrower does not receive a notice of right of rescission, the borrower's right of rescission will not expire for three years.

Consumers will have until midnight of the third business day to cancel or revoke the transaction [Regulation Z, 12 CFR §1026.23(a)(3)]

In line with the consumer protection laws, the purpose of having this right of rescission is to ensure that the borrower has enough time to really think through this very important decision. Having the right of rescission will enable to the borrower time to decide whether the transaction is in their best interest.

The first day of rescission begins after the last of the following conditions are met [Regulation Z, 12 CFR §1026.23 (a)(3)]

- Consummation of the transactions
- Receipt of a Truth in Lending Disclosure Form (this particular condition has changed and we will discuss the change in the next lesson when reviewing the new integrated disclosures)
    - Receipt of the notice of right to rescind
    - When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers. [Regulation Z, 12 CFR §1026.23(a)(4)]

For these purposes, business day is defined as a day in which the creditor's offices are open to the public for conducting the majority of their business. [Regulation Z, 12 CFR §1026.2 (a)(6)]

In order for the consumer to actually exercise his/her right of rescission, the following must be provided [Regulation Z, 12 CFR §1026.23 (b)(1)(i)(ii)(iii)(iv)(v)]:

- The Notice of Right to Cancel must be clearly provided
- The consumer must understand that they are permitting the creditor to place a security interest on their home
- The document states their right under federal law to cancel the entire transaction within three business days
- The document will also detail the three actions that must occur for the rescission period to begin.

The rescission period will begin after the last of the following occurs: the creditor has included the date of transaction on the Notice of Right to Cancel, the date that the consumer has received disclosures, and the date the Notice of Right to Cancel was actually received.

As an example, the time frame for rescission in terms of the definition of a business day [Regulation Z, 12 CFR §1026.2(a)(6)] would be the following:

- If a loan closes on a Monday, then it would come out of rescission on Thursday at midnight, giving the full legally necessary three days.
- The funds would then be disbursed on Friday.
- Please note that legal holidays will not count as part of the three business days for these purposes.

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
Loan Closes	Day 1	Day 2	Day 3 12:00am-loan comes out of rescission	Funds Dispersed		

If the consumer decides to cancel the transaction, or in other words, rescind the loan, all of the following must occur [Regulation Z, 12 CFR §1026.23 (e-All)]:

1. Notification must be provided in writing from the consumer
2. The Notice must include the date and the consumer's signature
3. The Notice must be delivered in person to the creditor

To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business.

The cancellation cannot be done by telephone or face-to-face conversation

If all of the following conditions are met, then the transaction can be rescinded, and the consumer will not be liable for any dollar amount including any finance charge [Regulation Z, 12 CFR §1026.23 (d)(1)]. The creditor will then be obligated to return any money the consumer has given in relation to this transaction within 20 calendar days [Regulation Z, 12 CFR §1026.23 (d)(2)].

It is also important to note that a consumer can waive his/her right to rescind in order to forgo the waiting period. They can do so if there is a bona fide personal financial emergency [Regulation Z, 12 CFR §1026.23 (e)(1)(2)].

There are also situations where a Right of Rescission is not available [Regulation Z, 12 CFR §1026.23 (f)]. For instance, if the application is to purchase or build a home. If there is a consolidation or refinance with the same creditor, or if the creditor for the loan is a state agency.

Another important part of the Truth in Lending Act has to do with advertising rules. In an effort to protect consumers from unfair or deceptive lending and advertising practices, TILA denotes certain advertising behavior as unacceptable due to its misleading capabilities. Since most of these rules are straight forward, I will keep this section brief.

All of the following are prohibited by law:

- Advertising a fixed rate when the rate is only fixed for a limited time period and not for the full term of the loan [Regulation Z, 12 CFR §1026.24 (1)(i)(A)(B)(ii)(iii)(A)(B)]
- Using a comparison model demonstrating a hypothetical consumer's current rate or payment obligations to the advertised product [Regulation Z, 12 CFR §1026.24 (i)(2)(ii)]
- Advertisements that characterize the products offered as "government loan programs," "government-supported or government sponsored loans" unless it is an actual government loan program such as FHA or VA [Regulation Z, 12 CFR §1026.24(i)(3)]
- Any advertisements that display the name of the consumer's current lender, unless it is prominently disclosed on the advertisement that the mortgage lender is not affiliated with the consumer's current lender [Regulation Z, 12 CFR §1026.(I)(4)(i)(ii)]
- Advertisements that make claims that they can eliminate debt if the advertised product will only be replacing one debt with another debt obligation [Regulation Z, 12 CFR §1026.24 (i)(5)]
- Advertisements that falsely give the impression that the mortgage broker or lender has a "counselor" relationship with the consumer [Regulation Z, 12 CFR §1026.24(i)(6)]
- Lastly, advertisements in foreign languages where certain information such as low introductory teaser rate, is provided in a different language, while required disclosures are only provided in English within the same advertisement [Regulation Z, 12 CFR §1026.24(i)(7)].

Regulation Z, 12 C.F.R. §1026.4(b): Examples of finance charges.

The finance charge includes the following types of charges, except for charges specifically excluded by paragraphs (c) through (e) of this section:

1. Interest, time price differential, and any amount payable under an add-on or discount system of additional charges.
2. Service, transaction, activity, and carrying charges, including any charge imposed on a checking or other transaction account to the extent that the charge exceeds the charge for a similar account without a credit feature.
3. Points, loan fees, assumption fees, finder's fees, and similar charges.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(b)(3)
Paragraph 4(b)(3)

ASSUMPTION FEES. *The assumption fees mentioned in Regulation Z, 12 CFR §1026.4(b)(3) are finance charges only when the assumption occurs, and the fee is imposed on the new buyer. The assumption fee is a finance charge in the new buyer's transaction.*

4. Appraisal, investigation, and credit report fees.
5. Premiums or other charges for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(b)(5)
Paragraph 4(b)(5)

- ***CREDIT LOSS INSURANCE.*** *Common examples of the insurance against credit loss mentioned in Regulation Z, 12 CFR §1026.4(b)(5) are mortgage guaranty insurance, holder in due course insurance, and repossession insurance. Such premiums must be included in the finance charge only for the period that the creditor requires the insurance to be maintained.*

6. Charges imposed on a creditor by another person for purchasing or accepting a consumer's obligation, if the consumer is required to pay the charges in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation.
7. Premiums or other charges for credit life, accident, health, or loss-of-income insurance, written in connection with a credit transaction.
8. Premiums or other charges for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, written in connection with a credit transaction.
9. Discounts for the purpose of inducing payment by a means other than the use of credit.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(b)(9)
Paragraph 4(b)(9)

- ***DISCOUNTS FOR PAYMENT BY OTHER THAN CREDIT****. The discounts to induce payment by other than credit mentioned in Regulation Z, 12 CFR §1026.4(b)(9) include, for example, the following situation: The seller of land offers individual tracts for $10,000 each. If the purchaser pays cash, the price is $9,000, but if the purchaser finances the tract with the seller the price is $10,000. The $1,000 difference is a finance charge for those who buy the tracts on credit.*

- ***EXCEPTION FOR CASH DISCOUNTS***.
  - *Creditors may exclude from the finance charge discounts offered to consumers for using cash or another means of payment instead of using a credit card or an open-end plan. The discount may be in whatever amount the seller desires, either as a percentage of the regular price (as defined in section 103(z) of the Act, as amended) or a dollar amount. Pursuant to section 167(b) of the Act, this provision applies only to transactions involving an open-end credit plan or a credit card (whether open-end or closed-end credit is extended on the card). The merchant must offer the discount to prospective buyers whether or not they are cardholders or members of the open-end credit plan. The merchant may, however, make other distinctions. For example:*
    - *The merchant may limit the discount to payment by cash and not offer it for payment by check or by use of a debit card.*
    - *The merchant may establish a discount plan that allows a 15% discount for payment by cash, a 10% discount for payment by check, and a 5% discount for payment by a particular credit card. None of these discounts is a finance charge.*
  - *Pursuant to section 171(c) of the Act, discounts excluded from the finance charge under this paragraph are also excluded from treatment as a finance charge or other charge for credit under any state usury or disclosure laws.*
- ***DETERMINATION OF THE REGULAR PRICE.***
  - *The regular price is critical in determining whether the difference between the price charged to cash customers and credit customers is a discount or a surcharge, as these terms are defined in amended section 103 of the Act. The regular price is defined in section 103 of the Act as—* * * the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged for the property or service when payment is made by use of an open-end credit account or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted * * *.*

10. Charges or premiums paid for debt cancellation or debt suspension coverage written in connection with a credit transaction, whether or not the coverage is insurance under applicable law.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(b)(10)
Paragraph 4(b)(10)

- ***DEFINITION.*** *Debt cancellation coverage provides for payment or satisfaction of all or part of a debt when a specified event occurs. The term "debt cancellation coverage" includes guaranteed automobile protection, or "GAP," agreements, which pay or satisfy the remaining debt after property insurance benefits are exhausted. Debt suspension coverage provides for suspension of the obligation to make one or more payments on the date(s) otherwise required by the credit agreement, when a specified event occurs. The term "debt suspension" does not include loan payment deferral arrangements in which the triggering event is the bank's unilateral decision to allow a deferral of payment and the borrower's unilateral election to do so, such as by skipping or reducing one or more payments ("skip payments").*
- ***COVERAGE WRITTEN IN CONNECTION WITH A TRANSACTION.*** *Coverage sold after consummation in closed-end credit transactions or after the opening of a home-equity plan subject to the requirements of Regulation Z, 12 CFR §1026.4 is not "written in connection with" the credit transaction if the coverage is written because the consumer requests coverage after consummation or the opening of a home-equity plan subject to the requirements of*

Regulation Z, 12 CFR §1026.4 (although credit-sale disclosures may be required for the coverage sold after consummation if it is financed). Coverage sold before or after an open-end (not home-secured) plan is opened is considered "written in connection with a credit transaction."

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(b)
4(b) Examples of Finance Charges

- *RELATIONSHIP TO OTHER PROVISIONS. Charges or fees shown as examples of finance charges in Regulation Z, 12 CFR §1026.4 (b) may be excludable under Regulation Z, 12 CFR §1026.4 (c), (d), or (e).*
- *For example:*
  - *Premiums for credit life insurance, shown as an example of a finance charge under § 1026.4(b)(7), may be excluded if the requirements of Regulation Z, 12 CFR §1026.4 (d)(1) are met.*
  - *Appraisal fees mentioned in Regulation Z, 12 CFR §1026.4 (b)(4) are excluded for real property or residential mortgage transactions under Regulation Z, 12 CFR §1026.4 (c)(7).*

Regulation Z, 12 C.F.R. §1026.4(c)

Charges excluded from the finance charge. The following charges are not finance charges:

1. Application fees charged to all applicants for credit, whether or not credit is actually extended.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(c)(1)
Paragraph 4(c)(1)

APPLICATION FEES. *An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans. However, if the fee is to be excluded from the finance charge under Regulation Z, 12 CFR §1026.4 (c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.*

2. Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(c)(2)
Paragraph 4(c)(2)

- ***LATE PAYMENT CHARGES.***
  - *Late payment charges can be excluded from the finance charge under Regulation Z, 12 CFR §1026.4 (c)(2) whether or not the person imposing the charge continues to extend credit on the account or continues to provide property or services to the consumer. In determining whether a charge is for actual unanticipated late payment on a 30-day account, for example, factors to be considered include:*
    - *The terms of the account. For example, is the consumer required by the account terms to pay the account balance in full each month? If not, the charge may be a finance charge.*

        - *The practices of the creditor in handling the accounts. For example, regardless of the terms of the account, does the creditor allow consumers to pay the accounts over a period of time without demanding payment in full or taking other action to collect? If no effort is made to collect the full amount due, the charge may be a finance charge.*
    - *Regulation Z, 12 CFR §1026.4 (c)(2) applies to late payment charges imposed for failure to make payments as agreed, as well as failure to pay an account in full when due.*
- ***OTHER EXCLUDED CHARGES.*** *Charges for "delinquency, default, or a similar occurrence" include, for example, charges for reinstatement of credit privileges or for submitting as payment a check that is later returned unpaid.*

3. Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing.
4. Fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis.
5. Seller's points.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(c)(5)
Paragraph 4(c)(5)

- ***SELLER'S POINTS.*** *The seller's points mentioned in Regulation Z, 12 CFR §1026.4 (c)(5) include any charges imposed by the creditor upon the noncreditor seller of property for providing credit to the buyer or for providing credit on certain terms. These charges are excluded from the finance charge even if they are passed on to the buyer, for example, in the form of a higher sales price. Seller's points are frequently involved in real estate transactions guaranteed or insured by governmental agencies. A commitment fee paid by a noncreditor seller (such as a real estate developer) to the creditor should be treated as seller's points. Buyer's points (that is, points charged to the buyer by the creditor), however, are finance charges.*
- ***OTHER SELLER-PAID AMOUNTS.*** *Mortgage insurance premiums and other finance charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. The creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge if, based on the seller's payment, the consumer is not legally bound to the creditor for the charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available.*

6. Interest forfeited as a result of an interest reduction required by law on a time deposit used as security for an extension of credit.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(c)(6)
Paragraph 4(c)(6)

LOST INTEREST. *Certain Federal and state laws mandate a percentage differential between the interest rate paid on a deposit and the rate charged on a loan secured by that deposit. In some situations, because of usury limits the creditor must reduce the interest rate paid on the deposit and, as a result, the consumer loses some of the interest that would otherwise have been earned. Under Regulation Z, 12 CFR §1026.4(c)(6), such "lost interest" need not be included in the finance*

charge. This rule applies only to an interest reduction imposed because a rate differential is required by law and a usury limit precludes compliance by any other means. If the creditor imposes a differential that exceeds that required, only the lost interest attributable to the excess amount is a finance charge. [See the commentary to Regulation Z, 12 CFR §1026.4(a)]

7. **REAL-ESTATE RELATED FEES.** The following fees in a transaction secured by real property or in a residential mortgage transaction, if the fees are bona fide and reasonable in amount:
   - Fees for title examination, abstract of title, title insurance, property survey, and similar purposes.
   - Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents.
   - Notary and credit-report fees.
   - Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood-hazard determinations.
   - Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(c)(7)
4(c)(7) Real-Estate Related Fees

- ***REAL ESTATE OR RESIDENTIAL MORTGAGE TRANSACTION CHARGES.*** *The list of charges in Regulation Z, 12 CFR §1026.4(c)(7) applies both to residential mortgage transactions (which may include, for example, the purchase of a mobile home) and to other transactions secured by real estate. The fees are excluded from the finance charge even if the services for which the fees are imposed are performed by the creditor's employees rather than by a third party. In addition, the cost of verifying or confirming information connected to the item is also excluded. For example, credit-report fees cover not only the cost of the report but also the cost of verifying information in the report. In all cases, charges excluded under Regulation Z, 12 CFR §1026.4(c)(7) must be bona fide and reasonable.*
- ***LUMP-SUM CHARGES.*** *If a lump sum charged for several services includes a charge that is not excludable, a portion of the total should be allocated to that service and included in the finance charge. However, a lump sum charged for conducting or attending a closing (for example, by a lawyer or a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in Regulation Z, 12 CFR §1026.4(c)(7) (for example, reviewing or completing documents), even if other incidental services such as explaining various documents or disbursing funds for the parties are performed. The entire charge is excluded even if a fee for the incidental services would be a finance charge if it were imposed separately.*
- ***CHARGES ASSESSED DURING THE LOAN TERM.*** *Real estate or residential mortgage transaction charges excluded under Regulation Z, 12 CFR §1026.4(c)(7) are those charges imposed solely in connection with the initial decision to grant credit. This would include, for example, a fee to search for tax liens on the property or to determine if flood insurance is required. The exclusion does not apply to fees for services to be performed periodically during the loan term, regardless of when the fee is collected. For example, a fee for one or more determinations during the loan term of the current tax-lien status or flood-insurance requirements is a finance charge, regardless of whether the fee is imposed at closing, or when*

the service is performed. If a creditor is uncertain about what portion of a fee to be paid at consummation or loan closing is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.

8. Discounts offered to induce payment for a purchase by cash, check, or other means, as provided in section 167(b) of the Act.

Regulation Z 12 C.F.R. §1026.4(e)(1)

E. Certain security interest charges. If itemized and disclosed, the following charges may be excluded from the finance charge:
   a. Taxes and fees prescribed by law that actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest.
   b. The premium for insurance in lieu of perfecting a security interest to the extent that the premium does not exceed the fees described in paragraph (e)(1) of this section that otherwise would be payable.
   c. TAXES ON SECURITY INSTRUMENTS. Any tax levied on security instruments or on documents evidencing indebtedness if the payment of such taxes is a requirement for recording the instrument securing the evidence of indebtedness.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.4(e)
4(e) Certain Security Interest Charges

- ***EXAMPLES.***
  - ***Excludable charges.*** *Sums must be actually paid to public officials to be excluded from the finance charge under Regulation Z, 12 CFR §1026.4(e)(1) and (e)(3). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents, as well as intangible property or other taxes even when the charges or fees are imposed by the state solely on the creditor and charged to the consumer (if the tax must be paid to record a security agreement). (See comment 4(a)-5 regarding the treatment of taxes, generally.)*
  - ***CHARGES NOT EXCLUDABLE.*** *If the obligation is between the creditor and a third party (an assignee, for example), charges or other fees for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents relating to that obligation are not excludable from the finance charge under this section.*
- ***ITEMIZATION.*** *The various charges described in Regulation Z, 12 CFR §1026.4(e)(1) and (e)(3) may be totaled and disclosed as an aggregate sum, or they may be itemized by the specific fees and taxes imposed. If an aggregate sum is disclosed, a general term such as security interest fees or filing fees may be used.*
- ***NOTARY FEES.*** *In order for a notary fee to be excluded under Regulation Z, 12 CFR §1026.4(e)(1), all of the following conditions must be met:*
  - *The document to be notarized is one used to perfect, release, or continue a security interest.*
  - *The document is required by law to be notarized.*
  - *A notary is considered a public official under applicable law.*
  - *The amount of the fee is set or authorized by law.*

- ***NONFILING INSURANCE.*** *The exclusion in Regulation Z, 12 CFR §1026.4(e)(2) is available only if nonfiling insurance is purchased. If the creditor collects and simply retains a fee as a sort of "self-insurance" against nonfiling, it may not be excluded from the finance charge. If the nonfiling insurance premium exceeds the amount of the fees excludable from the finance charge under Regulation Z, 12 CFR §1026.4(e)(1), only the excess is a finance charge. For example:*

    The fee for perfecting a security interest is $5.00 and the fee for releasing the security interest is $3.00. The creditor charges $10.00 for nonfiling insurance. Only $8.00 of the $10.00 is excludable from the finance charge.

<u>Regulation Z, 12 C.F.R. §1026.18(d)(1)</u>

D. Finance charge. The finance charge, using that term, and a brief description such as "the dollar amount the credit will cost you."

1. MORTGAGE LOANS. In a transaction secured by real property or a dwelling, the disclosed finance charge and other disclosures affected by the disclosed finance charge (including the amount financed and the annual percentage rate) shall be treated as accurate if the amount disclosed as the finance charge:
    i. Is understated by no more than $100; or
    ii. Is greater than the amount required to be disclosed.

OFFICIAL INTERPRETATION TO Regulation Z, 12 CFR §1026.18(d)
18(d) Finance Charge

DISCLOSURE REQUIRED. *The creditor must disclose the finance charge as a dollar amount, using the term finance charge, and must include a brief description similar to that in Regulation Z, 12 CFR §1026.18(d). The creditor may, but need not, further modify the descriptor for variable rate transactions with a phrase such as which is subject to change. The finance charge must be shown on the disclosures only as a total amount; the elements of the finance charge must not be itemized in the segregated disclosures, although the regulation does not prohibit their itemization elsewhere.*

<u>SUMMARY</u>

The TILA has been amended various times with the purpose of protecting the consumer.

TILA's purpose is to ensure that credit terms are disclosed in a meaningful way so that consumers are well equipped to compare credit terms.

The Truth in Lending Act:

- protects consumers against inaccurate and unfair credit billing and credit card practices
- prohibits unfair deceptive lending practices
- provides rate caps on certain loans
- specifies limitations on home equity lines of credit and some closed-end home mortgages
- provides the right of rescission for consumer

TILA denotes that:

- Creditors must follow the same guidelines when disclosing certain charges and rates to consumers

- Ensures all creditors will use the same format when discussing or showing these items
- Gives creditors the right to cancel certain credit transactions if it includes a line on their principal property
- On variable-rate transactions secured by a dwelling, the law requires a maximum interest rate be stated
- Imposes limits regarding certain home equity plans
- Prohibits certain practices for credit that is secured by a dwelling

The MDIA amendments changed several sections of the Truth in Lending Act. Changes include the application of TILA to all transaction involving any extension of credit secured by the dwelling of a consumer, rather than just to residential mortgage transactions subject to RESPA.

MDIA also imposed initial fee restrictions and created a timeline for the issuance of disclosures to the actual date of closing. You may recall MDIA is also known as the 3-7-3 Rule.

The time frame is as follows:

- Initial disclosures must be delivered or placed in the mail no later than 3 business days after a loan application is taken
- Consummation can only occur 7 days after the disclosures have been given
- If a loan is approved and a new rate quoted and the APR increase by .125, new disclosures must be signed and there is a three day waiting period before the loan can close.
- Remember, for irregular transactions, new disclosures must be signed if the APR increases by more than .25.
- If a new rate is given and it does not surpass the .125 on a regular transaction or the .25 on an irregular transaction, there is no need for the three day waiting period before consummation.

TILA also denotes that the consumer must have a right of rescission. However, there are also situations where a Right of Rescission is not available (if the application is to purchase or build a home; if there is a consolidation or refinance with the same creditor; or if the creditor for the loan is a state agency).

This means that the borrower has a right to rescind the transaction any time within 3 days after either:

- Signing
- Receiving disclosure statement
- Receiving a notice of right of rescission; If the borrower does not receive a notice of right of rescission, the borrower's right of rescission will not expire for three years.

In order for the consumer to actually exercise his/her right of rescission, the following must be provided:

- The Notice of Right to Cancel must be clearly provided
- The consumer must understand that they are permitting the creditor to place a security interest on their home
- The document states their right under federal law to cancel the entire transaction within three business days

The document will also detail the three actions that must occur for the rescission period to begin. The rescission period will begin after the last of the following occurs:

- the creditor has included the date of transaction on the Notice of Right to Cancel,
- the date that the consumer has received disclosures, and
- the date the Notice of Right to Cancel was actually received.

TILA also offers rules regarding advertisements.

Certain advertising behavior is prohibited by TILA.

- One cannot advertise a fixed rate when the rate is only fixed temporarily
- One cannot advertise using a comparison model demonstrating a hypothetical consumer's rate or payment obligations to the advertised product.
- One cannot advertise stating the product offered is a "government loan program," "government sponsored loan," or a "government supported loan" unless the product being advertised is one such as FHA or VA.
- One cannot state in an advertisement the name of the consumer's current lender, unless it is prominently disclosed on the advertisement that the mortgage lender is not affiliated with the consumer's current lender
- One cannot state in an advertisement that debt will be eliminated or relieved if the advertised product will only replace one debt with another debt obligation.
- One cannot give the false impression that the mortgage broker or lender has a "counselor" relationship with the consumer

Additionally, TILA specifies which fees, charges, interest, etc. are allowed to be included in the finance charge. Similarly, it also specifies which fees are not allowed to be included in the finance charge.

Lesson 2: Real Estate Settlement Procedures Act (RESPA)

Upon completion of this lesson, you will

- Recognize the Real Estate Settlement Procedures Act and documentation required
- Know the types of loans to which RESPA is applicable
- Know the steps in the foreclosure process
- Understand which payments are prohibited by the Marketing Service Agreements

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.

Real Estate Settlement Procedures Act (RESPA) [FDIC Law, Regulations, Related Acts, 6500 – Consumer Protection, Part 1024 – Real Estate Settlement Procedures, RESPA, Regulation X, 12 CFR, Part 1024]

- Real Estate Settlement Procedures Act (RESPA), passed in 1974
- RESPA has two main goals:
  - To provide borrowers with information about closing costs
  - To eliminate kickbacks and referral fees that unnecessarily increase settlement costs
- The purpose of RESPA of 1974 – REG X
  - Essentially the Real Estate Settlement Procedures Act is divided into two groupings
    - One section manages disclosures and servicing requirements for transactions involving a "federally related residential loan"
    - The second set prohibits the payment or receipts of fees from the borrower that were not actually earned
    - The payment or receipt of unearned fees (fee-splitting) or referral fees are prohibited for anyone, not just borrower [Regulation X, 12 CFR §1024.14 (a)(b)]
- RESPA ensures the consumer receives certain disclosures in a timely manner. Disclosures should:
  - Detail the costs associated with each loan transaction
  - Provide information on lender servicing and escrow account practices
  - Describe business relationships between settlement providers
- The Real Estate Settlement Procedures Act involves [Regulation X, 12 CFR §1024.2 (b) (Under "Federally Related Mortgage Loan or Mortgage Loan means as follows")]
  - One-to-four family residential property
    - Which includes most loans secured by a lien (first or subordinate position).
- Included in this grouping are [Regulation X, 12 CFR §1024.2 (b) (Under "Federally Related Mortgage Loan or Mortgage Loan means as follows")]
  - Purchase loans
  - Assumptions
  - Refinances
  - Property improvement loans
  - Equity lines of credit
  - Reverse mortgages

RESPA Covered Transactions

- RESPA applies to "federally related" loan transactions. Loan is federally related if [Regulation X, 12 CFR §1024.2 (b)(1) (all) (Under "Federally Related Mortgage Loan or Mortgage Loan means as follows")] :
    - It is secured by a mortgage or deed of trust against:
        - Property with (or loan funds will be used to build) dwelling of four units or less;
        - Condominium unit or cooperative apartment; or
        - Lot with mobile home;

          AND
    - Lender is federally regulated, has federally insured accounts, is assisted by federal government, makes loans in connection with federal program, sells loans to Fannie Mae, Ginnie Mae, or Freddie Mac, or makes real estate loans that total more than $1,000,000 per year
    - Basically, any loan other than temporary financing and exemptions in next section

RESPA Exemptions

- RESPA doesn't apply to loans [Regulation X, 12 CFR §1024.5 (a)(b)]:
    - To purchase 25 acres or more
    - Primarily for business, commercial, or agricultural purpose
    - To vacant land, unless within two years from the date of the settlement of the loan, a structure or a manufactured home will be constructed or placed on the real property using the loan proceeds
    - Temporary financing (construction loan)
    - Assumption without lender approval
- RESPA has certain requirements for federally related loan transactions
- Lender must give applicants within 3 days of written loan application:
    - Booklet about settlement procedures [Regulation X, 12 CFR §1024.6 (all)]
    - Loan Estimate [Regulation Z, 12 CFR §1026.19(e)(1)(iii)]
    - Mortgage servicing disclosure statement [Regulation X, 12 CFR §2605 (All)]
- Closing agent must itemize loan settlement charges on Uniform Settlement Statement form [Regulation X, 12 CFR §1024.8 (b)(1)]
- If borrower required to make deposits into impound account, lender can't require excessive deposits [Regulation X, 12 CFR §1024.17 (a)]
- Lender or provider of settlement services may not:
    - Pay kickbacks or referral fees [Regulation X, 12 CFR §1024.14 (b)]
    - Accept unearned fees [Regulation X, 12 CFR §1024.14 (c)]
    - Charge a document preparation fee
- Property seller may not require buyer to use a particular title company
[Regulation X, 12 CFR §1024.14 (f)(2)]

RESPA – Definitions [Regulation X, 12 CFR §1024.2 (b)]

Origination service means any service involved in the creation of a mortgage loan, including but not limited to the taking of the loan application, loan processing, and the underwriting and funding of the loan, and the processing and administrative services required to perform these functions.

Mortgage broker means a person (not an employee of a lender) or entity that renders origination services and serves as an intermediary between a borrower and a lender in a transaction involving a federally related mortgage loan, including such a person or entity that closes the loan in its own name in a table funded transaction. A loan correspondent approved under 24 CFR 202.8 for Federal Housing Administration programs is a mortgage broker for purposes of this part.

Loan originator means a lender or mortgage broker.

Third party means a settlement service provider other than a loan originator.

Title service means any service involved in the provision of title insurance (lender's or owner's policy), including but not limited to: title examination and evaluation; preparation and issuance of title commitment; clearance of underwriting objections; preparation and issuance of a title insurance policy or policies; and the processing and administrative services required to perform these functions. The term also includes the service of conducting a settlement.

Settlement service means any service provided in connection with a prospective or actual settlement, including, but not limited to, any one or more of the following:

1. Origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of such loans);
2. Rendering of services by a mortgage broker (including counseling, taking of applications, obtaining verifications and appraisals, and other loan processing and origination services, and communicating with the borrower and lender);
3. Provision of any services related to the origination, processing or funding of a federally related mortgage loan;
4. Provision of title services, including title searches, title examinations, abstract preparation, insurability determinations, and the issuance of title commitments and title insurance policies;
5. Rendering of services by an attorney;
6. Preparation of documents, including notarization, delivery, and recordation;
7. Rendering of credit reports and appraisals;
8. Rendering of inspections, including inspections required by applicable law or any inspections required by the sales contract or mortgage documents prior to transfer of title;
9. Conducting of settlement by a settlement agent and any related services;
10. Provision of services involving mortgage insurance;
11. Provision of services involving hazard, flood, or other casualty insurance or homeowner's warranties;

12. Provision of services involving mortgage life, disability, or similar insurance designed to pay a mortgage loan upon disability or death of a borrower, but only if such insurance is required by the lender as a condition of the loan;

13. Provision of services involving real property taxes or any other assessments or charges on the real property;

14. Rendering of services by a real estate agent or real estate broker; and

15. Provision of any other services for which a settlement service provider requires a borrower or seller to pay.

<u>Disclosures Required at Loan Application</u>

- HUD's Settlement Cost Booklet [Regulation X, 12 CFR §1024.6 (a)(1)]
  - The booklet enables the consumer to better understand the purpose and expenses involved in a real estate transaction
  - Purchase transactions only [Regulation X, 12 CFR §1024.6 (a)]
- The HUD Special Information Booklet should be delivered or placed in the mail to the borrower [Regulation X, 12 CFR §1024.6 (a)(1)]
  - Not later than three business days after the application is rec'd or prepared
  - Two or more persons apply, only one person needs to be given booklet
  - If mortgage broker is used, they may deliver booklet
  - Intent is to ensure booklet is rec'd at earliest possible date
- The HUD Special Information Booklet does not need to be provided for [Regulation X, 12 CFR §1024.6 (a)(3)]:
  - Refinancing transactions;
  - Closed end loans with subordinate lien;
  - Reverse mortgages;
  - Any federally related mortgage whose purpose is not to purchase a 1 – 4 family residential property.
- The Consumer Financial Protection Bureau (CFPB) has updated the special information or settlement cost booklet now known as "Your Home Loan Toolkit: A step-By-Step Guide". This new booklet will replace the "Shopping for Your Home Loan: Settlement Cost Booklet". The goals are basically the same in this new guide with the focus being the consumers understanding of the ability to repay and the mortgage payment's affordability.
- One section deals with steps to get the best mortgage
  - Inform and educate consumers on the steps to take to get best mortgage loan for their needs
  - Help them in understanding closing costs
  - Provide helpful information on becoming a successful homeowner
  - This segment provides worksheets to calculate their monthly mortgage payment, understand the credit report, choose the best mortgage program, down payment choices, etc.
- Another section provides information on understanding closings costs and what it takes to buy a home. This portion reviews the closing process including understanding the revised loan estimate and closing disclosure.
- Also included is a section on ways to be a successful homeowner:
  - Act fast if you get behind on your payments
  - Keep up with ongoing costs

  - Determine if you need flood insurance
  - Understand Home Equity Lines of Credit and refinancing
- Every applicant is given a "Servicing Disclosure Statement" at application
  - Located under RESPA – Appendix MS-1 to Part 1024
  - Reveals mortgage loan payments may be transferred
  - Defines "Servicing"

<u>Disclosures Required Before Settlement/Closing Occurs</u>

- Affiliated Business Arrangement (AfBA) Disclosure [Regulation X, 12 CFR §1024.15 (All)]
  - Required whenever a settlement provider refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest [Regulation X, 12 CFR §1024.15 (b)(1)]
  - Necessary whenever a transaction involves a RESPA covered transaction.
  - The referring party is responsible for providing the Affiliated Business Arrangement Disclosure to the consumer either at or prior to the time of the referral [Regulation X, 12 CFR §1024.15 (b)(1)]
    - Gives a description of the business affiliation between the two parties [Regulation X, 12 CFR §1024.15 (b)(1)]
    - An estimate of the second provider's charges [Regulation X, 12 CFR §1024.15 (b)(1)]
    - Sample located in RESPA under Appendix D
- Initial Escrow Statement [Regulation X, 12 CFR §1024.17]
  - Monthly collection the lender receives from the borrower for property taxes and insurance premiums
  - Submitted at closing or within 45 days of closing [Regulation X, 12 CFR §1024.17 (g)(i)(ii)]
- The "Initial Escrow Statement" reveals to the borrower an itemization of charges to be paid from the Escrow Account during the first twelve months of the loan. [Regulation X, 12 CFR §1024.17 (g)(i)(ii)]
  - Discloses
    - Escrow payment
    - Any additional funds (cushion) kept in the escrow account
  - Lender is obligated to deliver the Initial Escrow Statement 45 days from date of settlement

<u>Disclosures After Settlement</u>

- The loan servicer usually produces the following two documents:
  - The Annual Escrow Statement [Regulation X, 12 CFR §1024.17 (i)(1)(i–viii)(2)(3)(4)(i)(ii)(iii)(j)]
  - The Servicing Transfer Statement [Regulation X, 12 CFR §1024.21 (All)]
- Annual Escrow Statement
  - A summary, delivered to the borrower annually,
  - Lists deposits and payments made during the lenders or loan servicers twelve-month computation year
  - Notifies borrower of any shortages or overages in the account
  - What course should be taken to correct any discrepancies the account

- Servicing Transfer Agreement - It is common in the lending industry for a loan servicer to sell or assign the servicing rights of a borrower's loan to another servicer
- The loan servicer must notify the borrower with a Servicing Transfer Statement
  - The current loan servicer has 15 days before the effective date of the loan transfer to notify the borrower
  - The borrowers new loan servicer has 15 days after the effective date of the loan transfer to notify the borrower of this action
- Information on the Servicing Transfer Statement will list:
  - The name and address of the new servicer
  - Toll-free numbers
  - The date the new servicer will begin accepting payment

Consumer Protections and Prohibited Practices

- Section 8 - Kickbacks, Fee Splitting, Unearned Fees [Regulation X, 12 CFR §1024.14]
  Section 8 (a) of RESPA states, "No person shall give and no person shall accept any fee, kickback or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."
  [Regulation X, 12 CFR §1024.14 (a)(b)]
- Section 8 forbids anyone to accept or give a fee, kickback or anything of value in exchange for referrals
- Section 8 (b) states, "No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate service in connection with a transaction involving a federally related mortgage loan other than for services actually performed." [Regulation X, 12 CFR §1024.14 (c)]
- Example of Section 8 – Prohibited Practices
- Suppose a lender is offering a contest for appraisers, realtors, and attorneys where the person who sends the lender the most referrals for the month of March wins four free dinners for two at an area restaurant. This would not be allowed under RESPA since the dinner is considered a thing of value in exchange for the referral of business. Also, the fact the lender offered or gave an opportunity to win the dinners is considered a thing of value
- Alternatively the lender can offer to a borrower an incentive; such as a chance to win the same dinner for two as long as the promotion is not based on the borrower referring business to the lender
- Promotional items from the lender, can be given to realtors, attorneys, etc., such as:
  - Ink pens
  - Post it note pads
  - Magnets
- Materials must be normal promotional items with the lenders information attached
- Lender may not purchase promotional items for an attorney, with that attorney's name on the items, for the attorney to use to market clients for real estate business. This is an item of value given for referral of loan business

- Section 8 (c) does not prohibit these practices [Regulation X, 12 CFR §1024.14]
    - An attorney is compensated for services performed [Regulation X, 12 CFR §1024.14 (g) (i)]
    - A title company is paid a fee to its appointed agent for services fulfilled in the issuance of a title insurance policy. [Regulation X, 12 CFR §1024.14 (g)(ii)]
    - A lender compensating its mortgage loan originator for services performed in the making of a loan [Regulation X, 12 CFR §1024.14 (g)(iii)], as long as it's a bona fide payment to a person for services actually performed or salary or compensation for goods furnished [Regulation X, 12 CFR §1024.14 (g)(iv)]
- Section 9 – Title Companies [Regulation X, 12 CFR §1024.16 (All)]
    - It is a violation of Section 9 for the seller of a property to require the homebuyer to use a particular title company as a condition of the sale
    - If this provision is violated the seller shall be liable to the buyer in an amount equal to three times the charges for title insurance
- **Regulation X, 12 C.F.R. § 1024.14(e)**

  Agreement or understanding. An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.
- **Regulation X, 12 C.F.R. § 1024.14(g)(2)**

  Fees, salaries, compensation, or other payments -The Bureau may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (*i.e.,* the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. The fact that the transfer of the thing of value does not result in an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.

RESPA Enforcements

Violation of Section 8 [Regulation X, 12 CFR §1024.19 (All)]

- Violations of Section 8's anti-kickback, referral fees, and unearned fees provisions of RESPA are subject to criminal and civil penalties
- Section 8 (d) specifies anyone who violates this section shall be fined not more than $10,000.00 or imprisonment for not more than one year, or both
- It continues to state in a private lawsuit, a person who violates Section 8 may be liable to the person charged for the settlement service, an amount equal to three times the amount of the charge initially paid for the service
- Any violations of Sections 8 or 9 have a one-year deadline for an individual to bring forth a private law suit

Escrow Accounts and RESPA

- An escrow account is:
  - A system that guarantees to the lender the taxes and insurance on the property will be paid
  - A non-interest bearing account designed for use in paying borrower's:
    - Annual taxes
    - Insurance
    - Any other charges related to the property
- The same method is performed for city and parish/county taxes
  - The lender will charge the borrower 1/12 of the total annual taxes and place this amount in the escrow account each month
  - At the end of the one-year period, funds are available to pay the taxes
- Lenders are allowed to maintain a "cushion" in the escrow account to make up for any shortages that may arise from increasing insurance costs or tax increases over the term of the loan
  - Cushion amount may not exceed 1/6 of the total disbursement for the year
  - Cushion amount is allowed but not a requirement of RESPA
- Escrow Analysis
  - An escrow analysis is to be performed annually by the lender
  - Any excess of $50.00 or more over the cushion amount must be returned to the borrower
  - Any shortages in the escrow account must be disclosed to the borrower on this analysis
- Escrow Review
  - It is the individual lender's discretion to decide when and if an escrow account is required
  - HUD regulations only limit the maximum amount that a lender can require a borrower to maintain in an account
  - The Real Estate Settlement Procedures Act does not force lenders to require an escrow account for each borrower

Early Intervention Requirements for Certain Borrowers [Regulation X, 12 CFR §1024.39]

Live contact. [Regulation X, 12 CFR §1024.39(a)]
A servicer shall establish or make good faith efforts to establish live contact with a delinquent borrower not later than the 36th day of the borrower's delinquency and, promptly after establishing live contact, inform such borrower about the availability of loss mitigation options if appropriate.

[Official Interpretation]

1. ***DELINQUENCY.*** A borrower is delinquent for purposes of Regulation X, 12 CFR §1024.39 as follows:
   i. Delinquency begins on the day a payment sufficient to cover principal, interest, and, if applicable, escrow for a given billing cycle is due and unpaid, even if the borrower is afforded a period after the due date to pay before the servicer assesses a late fee. For example, if a payment due date is January 1 and the amount due is not fully paid during the 36-day period after January 1, the servicer must establish or make good faith efforts to establish live contact not later than 36 days after January 1— i.e., by February 6.

ii. A borrower who is performing as agreed under a loss mitigation option designed to bring the borrower current on a previously missed payment is not delinquent for purposes of Regulation X, 12 CFR §1024.39.

iii. During the 60-day period beginning on the effective date of transfer of the servicing of any mortgage loan, a borrower is not delinquent for purposes of Regulation X, 12 CFR §1024.39 if the transferee servicer learns that the borrower has made a timely payment that has been misdirected to the transferor servicer and the transferee servicer documents its files accordingly. See Regulation X, 12 CFR §1024.33(c)(1) and comment 33(c)(1)-2.

iv. A servicer need not establish live contact with a borrower unless the borrower is delinquent during the 36 days after a payment due date. If the borrower satisfies a payment in full before the end of the 36-day period, the servicer need not establish live contact with the borrower. For example, if a borrower misses a January 1 due date but makes that payment on February 1, a servicer need not establish or make good faith efforts to establish live contact by February 6.

2. ***ESTABLISHING LIVE CONTACT.*** Live contact provides servicers an opportunity to discuss the circumstances of a borrower's delinquency. Live contact with a borrower includes telephoning or conducting an in-person meeting with the borrower, but not leaving a recorded phone message. A servicer may, but need not, rely on live contact established at the borrower's initiative to satisfy the live contact requirement in Regulation X, 12 CFR §1024.39(a). Good faith efforts to establish live contact consist of reasonable steps under the circumstances to reach a borrower and may include telephoning the borrower on more than one occasion or sending written or electronic communication encouraging the borrower to establish live contact with the servicer.

3. ***PROMPTLY INFORM IF APPROPRIATE.***

    i. ***SERVICER'S DETERMINATION.*** It is within a servicer's reasonable discretion to determine whether informing a borrower about the availability of loss mitigation options is appropriate under the circumstances. The following examples demonstrate when a servicer has made a reasonable determination regarding the appropriateness of providing information about loss mitigation options.

        A. A servicer provides information about the availability of loss mitigation options to a borrower who notifies a servicer during live contact of a material adverse change in the borrower's financial circumstances that is likely to cause the borrower to experience a long-term delinquency for which loss mitigation options may be available.

        B. A servicer does not provide information about the availability of loss mitigation options to a borrower who has missed a January 1 payment and notified the servicer that full late payment will be transmitted to the servicer by February 15.

    ii. ***PROMPTLY INFORM.*** If appropriate, a servicer may inform borrowers about the availability of loss mitigation options orally, in writing, or through electronic communication, but the servicer must provide such information promptly after the servicer establishes live contact. A servicer need not notify a borrower about any particular loss mitigation options at this time; if appropriate, a servicer need only inform borrowers generally that loss mitigation options may be available. If appropriate, a servicer may satisfy the requirement in Regulation X, 12 CFR §1024.39(a) to inform a borrower about loss mitigation options by providing the written notice required by Regulation X, 12 CFR §1024.39(b)(1), but the servicer must provide such notice promptly after the servicer establishes live contact.

4. ***BORROWER'S REPRESENTATIVE.*** Regulation X, 12 CFR §1024.39 does not prohibit a servicer from satisfying the requirements Regulation X, 12 CFR §1024.39 by establishing live contact with and, if applicable, providing information about loss mitigation options to

a person authorized by the borrower to communicate with the servicer on the borrower's behalf. A servicer may undertake reasonable procedures to determine if a person that claims to be an agent of a borrower has authority from the borrower to act on the borrower's behalf, for example, by requiring a person that claims to be an agent of the borrower provide documentation from the borrower stating that the purported agent is acting on the borrower's behalf.

Written notice. *[Regulation X, 12 CFR §1024.39(b)]*

Notice required. [Regulation X, 12 CFR §1024.39(b)(1)]

Except as otherwise provided in this section, a servicer shall provide to a delinquent borrower a written notice with the information set forth in paragraph (b)(2) of this section not later than the 45th day of the borrower's delinquency. A servicer is not required to provide the written notice more than once during any 180-day period.

[Official Interpretation]

1. ***DELINQUENCY.*** For guidance on the circumstances under which a borrower is delinquent for purposes of Regulation X, 12 CFR §1024.39, see comment 39(a)-1. For example, if a payment due date is January 1 and the payment remains unpaid during the 45-day period after January 1, the servicer must provide the written notice within 45 days after January 1— i.e., by February 15. However, if a borrower satisfies a late payment in full before the end of the 45-day period, the servicer need not provide the written notice. For example, if a borrower misses a January 1 due date but makes that payment on February 1, a servicer need not provide the written notice by February 15.
2. ***FREQUENCY OF THE WRITTEN NOTICE.*** A servicer need not provide the written notice under Regulation X, 12 CFR §1024.39(a) more than once during a 180-day period beginning on the date on which the written notice is provided. For example, a borrower has a payment due on March 1. The amount due is not fully paid during the 45 days after March 1 and the servicer provides the written notice within 45 days after March 1— i.e., by April 15. If the borrower subsequently fails to make a payment due April 1 and the amount due is not fully paid during the 45 days after April 1, the servicer need not provide the written notice again during the 180-day period beginning on April 15.
3. ***RELATIONSHIP TO Regulation X, 12 CFR §1024.39(A).*** The written notice required under Regulation X, 12 CFR §1024.39(b)(1) must be provided even if the servicer provided information about loss mitigation and foreclosure previously during an oral communication with the borrower under Regulation X, 12 CFR §1024.39(a).

Content of the written notice. [Regulation X, 12 CFR §1024.39(b)(2)]

The notice required by paragraph (b)(1) of this section shall include:

i. A statement encouraging the borrower to contact the servicer;
ii. The telephone number to access servicer personnel assigned pursuant to Regulation X, 12 CFR §1024.40(a) and the servicer's mailing address;
iii. If applicable, a statement providing a brief description of examples of loss mitigation options that may be available from the servicer;
iv. If applicable, either application instructions or a statement informing the borrower how to obtain more information about loss mitigation options from the servicer; and
v. The Web site to access either the Bureau list or the HUD list of homeownership counselors or counseling organizations, and the HUD toll-free telephone number to access homeownership counselors or counseling organizations.

[Official Interpretation]

1. ***MINIMUM REQUIREMENTS.*** Section 1024.39(b)(2) contains minimum content requirements for the written notice. A servicer may provide additional information that the servicer determines would be helpful or which may be required by applicable law or the owner or assignee of the mortgage loan.
2. ***DELIVERY.*** A servicer may satisfy the requirement to provide the written notice by combining other notices that satisfy the content requirements of Regulation X, 12 CFR §1024.39(b)(2) into a single mailing, provided each of the statements required by Regulation X, 12 CFR §1024.39(b)(2) satisfies the clear and conspicuous standard in Regulation X, 12 CFR §1024.32(a)(1).
3. ***NUMBER OF EXAMPLES.*** Section 1024.39(b)(2)(iii) does not require that a specific number of examples be disclosed, but borrowers are likely to benefit from examples of options that would permit them to retain ownership of their home and examples of options that may require borrowers to end their ownership to avoid foreclosure. The servicer may include a generic list of loss mitigation options that it offers to borrowers. The servicer may include a statement that not all borrowers will qualify for the listed options.
4. ***BRIEF DESCRIPTION.*** An example of a loss mitigation option may be described in one or more sentences. If a servicer offers a loss mitigation option comprising several loss mitigation programs, the servicer may provide a generic description of the option without providing detailed descriptions of each program. For example, if the servicer offers several loan modification programs, the servicer may provide a generic description of "loan modification."
5. ***EXPLANATION OF HOW THE BORROWER MAY OBTAIN MORE INFORMATION ABOUT LOSS MITIGATION OPTIONS.***A servicer may comply with Regulation X, 12 CFR §1024.39(b)(2)(iv) by directing the borrower to contact the servicer for more detailed information on how to apply for loss mitigation options. However, to expedite the borrower's timely application for any loss mitigation options, servicers may provide more detailed instructions, such as by listing representative documents the borrower should make available to the servicer (such as tax filings or income statements), and an estimate of how quickly the servicer expects to evaluate a completed application and make a decision on loss mitigation options. Servicers may also supplement the written notice required by Regulation X, 12 CFR §1024.39(b)(1) with a loss mitigation application form.

Exemptions [Regulation X, 12 CFR §1024.39(d)]

Borrowers in bankruptcy. [Regulation X, 12 CFR §1024.39(d)(1)]

A servicer is exempt from the requirements of this section for a mortgage loan while the borrower is a debtor in bankruptcy under Title 11 of the United States Code.

[Official Interpretation]

1. ***COMMENCING A CASE.*** The requirements of Regulation X, 12 CFR §1024.39 do not apply once a petition is filed under Title 11 of the United States Code, commencing a case in which the borrower is a debtor.
2. ***OBLIGATION TO RESUME EARLY INTERVENTION REQUIREMENTS.***
    i. With respect to any portion of the mortgage debt that is not discharged, a servicer must resume compliance with Regulation X, 12 CFR §1024.39 after the first delinquency that follows the earliest of any of three potential outcomes in the borrower's bankruptcy case: the case is dismissed, the case is closed, or the borrower receives a discharge under 11 U.S.C. 727, 1141, 1228, or 1328. However, this requirement to resume

compliance with Regulation X, 12 CFR §1024.39 does not require a servicer to communicate with a borrower in a manner that would be inconsistent with applicable bankruptcy law or a court order in a bankruptcy case. To the extent permitted by such law or court order, a servicer may adapt the requirements of Regulation X, 12 CFR §1024.39 in any manner believed necessary.

ii. Compliance with Regulation X, 12 CFR §1024.39 is not required for any portion of the mortgage debt that is discharged under applicable provisions of the U.S. Bankruptcy Code. If the borrower's bankruptcy case is revived—for example if the court reinstates a previously dismissed case, reopens the case, or revokes a discharge—the servicer is again exempt from the requirement in Regulation X, 12 CFR §1024.39.

3. ***JOINT OBLIGORS.*** When two or more borrowers are joint obligors with primary liability on a mortgage loan subject to Regulation X, 12 CFR §1024.39, the exemption in Regulation X, 12 CFR §1024.39(d)(1) applies if any of the borrowers is in bankruptcy. For example, if a husband and wife jointly own a home, and the husband files for bankruptcy, the servicer is exempt from complying with § 1024.39 as to both the husband and the wife.

Continuity of Contact [Regulation X, 12 CFR §1024.40]

In general. [Regulation X, 12 CFR §1024.40(a)]

A servicer shall maintain policies and procedures that are reasonably designed to achieve the following objectives:

1. Assign personnel to a delinquent borrower by the time the servicer provides the borrower with the written notice required by Regulation X, 12 CFR §1024.39(b), but in any event, not later than the 45th day of the borrower's delinquency.
2. Make available to a delinquent borrower, via telephone, personnel assigned to the borrower as described in paragraph (a)(1) of this section to respond to the borrower's inquiries, and as applicable, assist the borrower with available loss mitigation options until the borrower has made, without incurring a late charge, two consecutive mortgage payments in accordance with the terms of a permanent loss mitigation agreement.
3. If a borrower contacts the personnel assigned to the borrower as described in paragraph (a)(1) of this section and does not immediately receive a live response from such personnel, ensure that the servicer can provide a live response in a timely manner.

[Official Interpretation]

1. ***DELINQUENT BORROWER.*** A borrower is not considered delinquent if the borrower has refinanced the mortgage loan, paid off the mortgage loan, brought the mortgage loan current by paying all amounts owed in arrears, or if title to the borrower's property has been transferred to a new owner through, for example, a deed-in-lieu of foreclosure, a sale of the borrower's property, including, as applicable, a short sale, or a foreclosure sale. For purposes of responding to a borrower's inquiries and assisting a borrower with loss mitigation options, the term “borrower” includes a person authorized by the borrower to act on the borrower's behalf. A servicer may undertake reasonable procedures to determine if a person that claims to be an agent of a borrower has authority from the borrower to act on the borrower's behalf, for example by requiring that a person who claims to be an agent of the borrower provide documentation from the borrower stating that the purported agent is acting on the borrower's behalf.
2. ***ASSIGNMENT OF PERSONNEL.*** A servicer has discretion to determine whether to assign a single person or a team of personnel to respond to a delinquent borrower. The personnel a servicer assigns to the borrower as described in Regulation X, 12 CFR §1024.40(a)(1) may be single-purpose or multi-purpose personnel. Single-purpose personnel are personnel whose

primary responsibility is to respond to a delinquent borrower's inquiries, and as applicable, assist the borrower with available loss mitigation options. Multi-purpose personnel can be personnel that do not have a primary responsibility at all, or personnel for whom responding to a delinquent borrower's inquiries, and as applicable, assisting the borrower with available loss mitigation options is not the personnel's primary responsibility. If the delinquent borrower files for bankruptcy, a servicer may assign personnel with specialized knowledge in bankruptcy law to assist the borrower.

3. ***DELINQUENCY.*** For purposes of Regulation X, 12 CFR §1024.40(a), delinquency begins on the day a payment sufficient to cover principal, interest, and, if applicable, escrow for a given billing cycle is due and unpaid, even if the borrower is afforded a period after the due date to pay before the servicer assesses a late fee. See the example set forth in comment 39(a)-1.i.

Loss Mitigation Procedures. [Regulation X, 12 CFR §1024.41]

Enforcement and limitations. [Regulation X, 12 CFR §1024.41(a)]
A borrower may enforce the provisions of this section pursuant to section 6(f) of RESPA (12 U.S.C. 2605(f)). Nothing in Regulation X, 12 CFR §1024.41 imposes a duty on a servicer to provide any borrower with any specific loss mitigation option. Nothing in Regulation X, 12 CFR §1024.41 should be construed to create a right for a borrower to enforce the terms of any agreement between a servicer and the owner or assignee of a mortgage loan, including with respect to the evaluation for, or offer of, any loss mitigation option or to eliminate any such right that may exist pursuant to applicable law.

Receipt of a loss mitigation application. [Regulation X, 12 CFR §1024.41(b)]

COMPLETE LOSS MITIGATION APPLICATION. [Regulation X, 12 CFR §1024.41(b)(1)]
A complete loss mitigation application means an application in connection with which a servicer has received all the information that the servicer requires from a borrower in evaluating applications for the loss mitigation options available to the borrower. A servicer shall exercise reasonable diligence in obtaining documents and information to complete a loss mitigation application.

[Official Interpretation]

1. ***IN GENERAL.*** A servicer has flexibility to establish its own application requirements and to decide the type and amount of information it will require from borrowers applying for loss mitigation options.
2. ***WHEN AN INQUIRY OR PREQUALIFICATION REQUEST BECOMES AN APPLICATION.*** A servicer is encouraged to provide borrowers with information about loss mitigation programs. If in giving information to the borrower, the borrower expresses an interest in applying for a loss mitigation option and provides information the servicer would evaluate in connection with a loss mitigation application, the borrower's inquiry or prequalification request has become a loss mitigation application. A loss mitigation application is considered expansively and includes any “prequalification” for a loss mitigation option. For example, if a borrower requests that a servicer determine if the borrower is “prequalified” for a loss mitigation program by evaluating the borrower against preliminary criteria to determine eligibility for a loss mitigation option, the request constitutes a loss mitigation application.
3. ***EXAMPLES OF INQUIRIES THAT ARE NOT APPLICATIONS.*** The following examples illustrate situations in which only an inquiry has taken place and no loss mitigation application has been submitted:

i. A borrower calls to ask about loss mitigation options and servicer personnel explain the loss mitigation options available to the borrower and the criteria for determining the borrower's eligibility for any such loss mitigation option. The borrower does not, however, provide any information that a servicer would consider for evaluating a loss mitigation application.
ii. A borrower calls to ask about the process for applying for a loss mitigation option but the borrower does not provide any information that a servicer would consider for evaluating a loss mitigation application.

4. ***DILIGENCE REQUIREMENTS.*** Although a servicer has flexibility to establish its own requirements regarding the documents and information necessary for a loss mitigation application, the servicer must act with reasonable diligence to collect information needed to complete the application. Further, a servicer must request information necessary to make a loss mitigation application complete promptly after receiving the loss mitigation application. Reasonable diligence includes, without limitation, the following actions:
   i. A servicer requires additional information from the applicant, such as an address or a telephone number to verify employment; the servicer contacts the applicant promptly to obtain such information after receiving a loss mitigation application;
   ii. Servicing for a mortgage loan is transferred to a servicer and the borrower makes an incomplete loss mitigation application to the transferee servicer after the transfer; the transferee servicer reviews documents provided by the transferor servicer to determine if information required to make the loss mitigation application complete is contained within documents transferred by the transferor servicer to the servicer; and
   iii. A servicer offers a borrower a payment forbearance program based on an incomplete loss mitigation application; the servicer notifies the borrower that he or she is being offered a payment forbearance program based on an evaluation of an incomplete application, and that the borrower has the option of completing the application to receive a full evaluation of all loss mitigation options available to the borrower. If a servicer provides such a notification, the borrower remains in compliance with the payment forbearance program, and the borrower does not request further assistance, the servicer could suspend reasonable diligence efforts until near the end of the payment forbearance program. Near the end of the program, and prior to the end of the forbearance period, it may be necessary for the servicer to contact the borrower to determine if the borrower wishes to complete the application and proceed with a full loss mitigation evaluation.
5. ***INFORMATION NOT IN THE BORROWER'S CONTROL.*** A loss mitigation application is complete when a borrower provides all information required from the borrower notwithstanding that additional information may be required by a servicer that is not in the control of a borrower. For example, if a servicer requires a consumer report for a loss mitigation evaluation, a loss mitigation application is considered complete if a borrower has submitted all information required from the borrower without regard to whether a servicer has obtained a consumer report that a servicer has requested from a consumer reporting agency.

Review of loss mitigation application submission. [Regulation X, 12 CFR §1024.41(b)(2)]
i. Requirements.
If a servicer receives a loss mitigation application 45 days or more before a foreclosure sale, a servicer shall:
A. Promptly upon receipt of a loss mitigation application, review the loss mitigation application to determine if the loss mitigation application is complete; and
B. Notify the borrower in writing within 5 days (excluding legal public holidays, Saturdays, and Sundays) after receiving the loss mitigation application that the servicer acknowledges receipt of the loss mitigation application and that the servicer has determined that the loss mitigation

application is either complete or incomplete. If a loss mitigation application is incomplete, the notice shall state the additional documents and information the borrower must submit to make the loss mitigation application complete and the applicable date pursuant to paragraph (b)(2)(ii) of this section. The notice to the borrower shall include a statement that the borrower should consider contacting servicers of any other mortgage loans secured by the same property to discuss available loss mitigation options.

ii. Time period disclosure. The notice required pursuant to paragraph (b)(2)(i)(B) of this section must include a reasonable date by which the borrower should submit the documents and information necessary to make the loss mitigation application complete.

[Official Interpretation]

1. ***LATER DISCOVERY OF ADDITIONAL INFORMATION REQUIRED TO EVALUATE APPLICATION.*** Even if a servicer has informed a borrower that an application is complete (or notified the borrower of specific information necessary to complete an incomplete application), if the servicer determines, in the course of evaluating the loss mitigation application submitted by the borrower, that additional information or a corrected version of a previously submitted document is required, the servicer must promptly request the additional information or corrected document from the borrower pursuant to the reasonable diligence obligation in Regulation X, 12 CFR §1024.41(b)(1). See Regulation X, 12 CFR §1024.41(c)(2)(iv) addressing facially complete applications.

Time period disclosure.

1. ***REASONABLE DATE.*** Regulation X, 12 CFR § 1024.41(b)(2)(ii) requires that a notice informing a borrower that a loss mitigation application is incomplete must include a reasonable date by which the borrower should submit the documents and information necessary to make the loss mitigation application complete. In determining a reasonable date, a servicer should select the deadline that preserves the maximum borrower rights under Regulation X, 12 CFR §1024.41 based on the milestones listed below, except when doing so would be impracticable to permit the borrower sufficient time to obtain and submit the type of documentation needed. Generally, it would be impracticable for a borrower to obtain and submit documents in less than seven days. In setting a date, the following milestones should be considered (if the date of a foreclosure sale is not known, a servicer may use a reasonable estimate of the date for which a foreclosure sale may be scheduled):
   i. The date by which any document or information submitted by a borrower will be considered stale or invalid pursuant to any requirements applicable to any loss mitigation option available to the borrower;
   ii. The date that is the 120th day of the borrower's delinquency;
   iii. The date that is 90 days before a foreclosure sale;
   iv. The date that is 38 days before a foreclosure sale.

Determining Protections. [Regulation X, 12 CFR §1024.41(b)(3)]

DETERMINING PROTECTIONS. To the extent a determination of whether protections under this section apply to a borrower is made on the basis of the number of days between when a complete loss mitigation application is received and when a foreclosure sale occurs, such determination shall be made as of the date a complete loss mitigation application is received.

[Official Interpretation]

1. ***FORECLOSURE SALE NOT SCHEDULED.*** If no foreclosure sale has been scheduled as of the date that a complete loss mitigation application is received, the application is considered to have been received more than 90 days before any foreclosure sale.
2. ***FORECLOSURE SALE RE-SCHEDULED.*** The protections under Regulation X, 12 CFR §1024.41 that have been determined to apply to a borrower pursuant to Regulation X, 12 CFR §1024.41(b)(3) remain in effect thereafter, even if a foreclosure sale is later scheduled or rescheduled.

Evaluation of loss mitigation applications. [Regulation X, 12 CFR §1024.41(c)]

Complete loss mitigation application. [Regulation X, 12 CFR §1024.41(c)(1)]

If a servicer receives a complete loss mitigation application more than 37 days before a foreclosure sale, then, within 30 days of receiving a borrower's complete loss mitigation application, a servicer shall:

i. Evaluate the borrower for all loss mitigation options available to the borrower; and
ii. Provide the borrower with a notice in writing stating the servicer's determination of which loss mitigation options, if any, it will offer to the borrower on behalf of the owner or assignee of the mortgage loan. The servicer shall include in this notice the amount of time the borrower has to accept or reject an offer of a loss mitigation program as provided for in paragraph (e) of this section, if applicable, and a notification, if applicable, that the borrower has the right to appeal the denial of any loan modification option as well as the amount of time the borrower has to file such an appeal and any requirements for making an appeal, as provided for in paragraph (h) of this section.

[Official Interpretation]

1. ***DEFINITION OF "EVALUATION."*** The conduct of a servicer's evaluation with respect to any loss mitigation option is in the sole discretion of a servicer. A servicer meets the requirements of Regulation X, 12 CFR §1024.41(c)(1)(i) if the servicer makes a determination regarding the borrower's eligibility for a loss mitigation program. Consistent with Regulation X, 12 CFR §1024.41(a), because nothing in Regulation X, 12 CFR §1024.41 should be construed to permit a borrower to enforce the terms of any agreement between a servicer and the owner or assignee of a mortgage loan, including with respect to the evaluation for, or provision of, any loss mitigation option, Regulation X, 12 CFR §1024.41(c)(1) does not require that an evaluation meet any standard other than the discretion of the servicer.
2. ***LOSS MITIGATION OPTIONS AVAILABLE TO A BORROWER.*** The loss mitigation options available to a borrower are those options offered by an owner or assignee of the borrower's mortgage loan. Loss mitigation options administered by a servicer for an owner or assignee of a mortgage loan other than the owner or assignee of the borrower's mortgage loan are not available to the borrower solely because such options are administered by the servicer. For example:
   i. A servicer services mortgage loans for two different owners or assignees of mortgage loans. Those entities each have different loss mitigation programs. loss mitigation options not offered by the owner or assignee of the borrower's mortgage loan are not available to the borrower; or
   ii. The owner or assignee of a borrower's mortgage loan has established pilot programs, temporary programs, or programs that are limited by the number of participating borrowers. Such loss mitigation options are available to a borrower. However,

a servicer evaluates whether a borrower is eligible for any such program consistent with criteria established by an owner or assignee of a mortgage loan. For example, if an owner or assignee has limited a pilot program to a certain geographic area or to a limited number of participants, and the servicer determines that a borrower is not eligible based on any such requirement, the servicer shall inform the borrower that the investor requirement for the program is the basis for the denial.

3. ***OFFER OF A NON-HOME RETENTION OPTION.*** A servicer's offer of a non-home retention option may be conditional upon receipt of further information not in the borrower's possession and necessary to establish the parameters of a servicer's offer. For example, a servicer complies with the requirement for evaluating the borrower for a short sale option if the servicer offers the borrower the opportunity to enter into a listing or marketing period agreement but indicates that specifics of an acceptable short sale transaction may be subject to further information obtained from an appraisal or title search.

Incomplete loss mitigation application evaluation. [Regulation X, 12 CFR §1024.41(c)(2)]

- **i. In general.** Except as set forth in paragraphs (c)(2)(ii) and (iii) of this section, a servicer shall not evade the requirement to evaluate a complete loss mitigation application for all loss mitigation options available to the borrower by offering a loss mitigation option based upon an evaluation of any information provided by a borrower in connection with an incomplete loss mitigation application.
- ***ii. Reasonable time.*** Notwithstanding paragraph (c)(2)(i) of this section, if a servicer has exercised reasonable diligence in obtaining documents and information to complete a loss mitigation application, but a loss mitigation application remains incomplete for a significant period of time under the circumstances without further progress by a borrower to make the loss mitigation application complete, a servicer may, in its discretion, evaluate an incomplete loss mitigation application and offer a borrower a loss mitigation option. Any such evaluation and offer is not subject to the requirements of this section and shall not constitute an evaluation of a single complete loss mitigation application for purposes of paragraph (i) of this section.
- ***iii. Payment forbearance.*** Notwithstanding paragraph (c)(2)(i) of this section, a servicer may offer a short term payment forbearance program to a borrower based upon an evaluation of an incomplete loss mitigation application. A servicer shall not make the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process and shall not move for foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of a payment forbearance program offered pursuant to this section.
- ***iv. Facially complete application.*** If a borrower submits all the missing documents and information as stated in the notice required pursuant to Regulation X, 12 CFR §1026.41(b)(2)(i)(B), or no additional information is requested in such notice, the application shall be considered facially complete. If the servicer later discovers additional information or corrections to a previously submitted document are required to complete the application, the servicer must promptly request the missing information or corrected documents and treat the application as complete for the purposes of paragraphs (f)(2) and (g) of this section until the borrower is given a reasonable opportunity to complete the application. If the borrower completes the application within this period, the application shall be considered complete as of the date it was facially complete, for the purposes of paragraphs (d), (e), (f)(2), (g), and (h) of this section, and as of the date the application was actually complete for the purposes of paragraph (c). A servicer that complies with this paragraph will be deemed to have fulfilled its obligation to provide an accurate notice under paragraph (b)(2)(i)(B).

[Official Interpretation]

OFFER OF A LOSS MITIGATION OPTION WITHOUT AN EVALUATION OF A LOSS MITIGATION APPLICATION. Nothing in Regulation X, 12 CFR §1024.41(c)(2)(i) prohibits a servicer from offering loss mitigation options to a borrower who has not submitted a loss mitigation application. Further, nothing in Regulation X, 12 CFR §1024.41(c)(2)(i) prohibits a servicer from offering a loss mitigation option to a borrower who has submitted an incomplete loss mitigation application where the offer of the loss mitigation option is not based on any evaluation of information submitted by the borrower in connection with such loss mitigation application. For example, if a servicer offers trial loan modification programs to all borrowers who become 150 days delinquent without an application or consideration of any information provided by a borrower in connection with a loss mitigation application, the servicer's offer of any such program does not violate Regulation X, 12 CFR §1024.41(c)(2)(i), and a servicer is not required to comply with Regulation X, 12 CFR §1024.41 with respect to any such program, because the offer of the loss mitigation option is not based on an evaluation of a loss mitigation application.

Servicer discretion. Although a review of a borrower's incomplete loss mitigation application is within a servicer's discretion, and is not required by Regulation X, 12 CFR §1024.41, a servicer may be required separately, in accordance with policies and procedures maintained pursuant to Regulation X, 12 CFR §1024.38(b)(2)(v), to properly evaluate a borrower who submits an application for a loss mitigation option for all loss mitigation options available to the borrower pursuant to any requirements established by the owner or assignee of the borrower's mortgage loan. Such evaluation may be subject to requirements applicable to loss mitigation applications otherwise considered incomplete pursuant to Regulation X, 12 CFR §1024.41.

SIGNIFICANT PERIOD OF TIME. A significant period of time under the circumstances may include consideration of the timing of the foreclosure process. For example, if a borrower is less than 50 days before a foreclosure sale, an application remaining incomplete for 15 days may be a more significant period of time under the circumstances than if the borrower is still less than 120 days delinquent on a mortgage loan obligation.

SHORT-TERM PAYMENT FORBEARANCE PROGRAM. The exemption in Regulation X, 12 CFR §1024.41(c)(2)(iii) applies to short-term payment forbearance programs. A payment forbearance program is a loss mitigation option for which a servicer allows a borrower to forgo making certain payments or portions of payments for a period of time. A short-term payment forbearance program allows the forbearance of payments due over periods of no more than six months. Such a program would be short-term regardless of the amount of time a servicer allows the borrower to make up the missing payments.

PAYMENT FORBEARANCE AND INCOMPLETE APPLICATIONS. Regulation X, 12 CFR §1024.41(c)(2)(iii) allows a servicer to offer a borrower a short-term payment forbearance program based on an evaluation of an incomplete loss mitigation application. Such an incomplete loss mitigation application is still subject to the other obligations in Regulation X, 12 CFR §1024.41, including the obligation in § 1024.41(b)(2) to review the application to determine if it is complete, the obligation in Regulation X, 12 CFR §1024.41(b)(1) to exercise reasonable diligence in obtaining documents and information to complete a loss mitigation application (see comment 41(b)(1)–4.iii), and the obligation to provide the borrower with the Regulation X, 12 CFR §1024.41(b)(2)(i)(B) notice that the servicer acknowledges the receipt of the application and has determined the application is incomplete.

PAYMENT FORBEARANCE AND COMPLETE APPLICATIONS. Even if a servicer offers a borrower a payment forbearance program based on an evaluation of an incomplete loss mitigation application, the servicer must still comply with all the requirements in Regulation X, 12 CFR §1024.41 if the borrower completes his or her loss mitigation application.

REASONABLE OPPORTUNITY. Regulation X, 12 CFR §1024.41(c)(2)(iv) requires a servicer to treat a facially complete application as complete for the purposes of paragraphs (f)(2) and (g) until the borrower has been given a reasonable opportunity to complete the application. A reasonable opportunity requires the servicer to notify the borrower of what additional information or corrected documents are required, and to afford the borrower sufficient time to gather the information and documentation necessary to complete the application and submit it to the servicer. The amount of time that is sufficient for this purpose will depend on the facts and circumstances.

BORROWER FAILS TO COMPLETE THE APPLICATION. If the borrower fails to complete the application within the timeframe provided under Regulation X, 12 CFR §1024.41(c)(2)(iv), the application shall be considered incomplete.

Denial of loan modification options. [Regulation X, 12 CFR §1024.41(d)]
If a borrower's complete loss mitigation application is denied for any trial or permanent loan modification option available to the borrower pursuant to paragraph (c) of this section, a servicer shall state in the notice sent to the borrower pursuant to paragraph (c)(1)(ii) of this section the specific reason or reasons for the servicer's determination for each such trial or permanent loan modification option and, if applicable, that the borrower was not evaluated on other criteria.

INVESTOR REQUIREMENTS. If a trial or permanent loan modification option is denied because of a requirement of an owner or assignee of a mortgage loan, the specific reasons in the notice provided to the borrower must identify the owner or assignee of the mortgage loan and the requirement that is the basis of the denial. A statement that the denial of a loan modification option is based on an investor requirement, without additional information specifically identifying the relevant investor or guarantor and the specific applicable requirement, is insufficient. However, where an owner or assignee has established an evaluation criteria that sets an order ranking for evaluation of loan modification options (commonly known as a waterfall) and a borrower has qualified for a particular loan modification option in the ranking established by the owner or assignee, it is sufficient for the servicer to inform the borrower, with respect to other loan modification options ranked below any such option offered to a borrower, that the investor's requirements include the use of such a ranking and that an offer of a loan modification option necessarily results in a denial for any other loan modification options below the option for which the borrower is eligible in the ranking.

NET PRESENT VALUE CALCULATION. If a trial or permanent loan modification is denied because of a net present value calculation, the specific reasons in the notice provided to the borrower must include the inputs used in the net present value calculation.

DETERMINATION NOT TO OFFER A LOAN MODIFICATION OPTION CONSTITUTES A DENIAL. A servicer's determination not to offer a borrower a loan modification available to the borrower constitutes a denial of the borrower for that loan modification option, notwithstanding whether a servicer offers a borrower a different loan modification option or other loss mitigation option.

REASONS LISTED. A servicer is required to disclose the actual reason or reasons for the denial. If a servicer's systems establish a hierarchy of eligibility criteria and reach the first criterion that causes a denial but do not evaluate the borrower based on additional criteria, a servicer complies with the rule by providing only the reason or reasons with respect to which the borrower was actually

evaluated and rejected as well as notification that the borrower was not evaluated on other criteria. A servicer is not required to determine or disclose whether a borrower would have been denied on the basis of additional criteria if such criteria were not actually considered.

Borrower response. [Regulation X, 12 CFR §1024.41(e)]

IN GENERAL. [Regulation X, 12 CFR §1024.41(e)(1)]
Subject to paragraphs (e)(2)(ii) and (iii) of this section, if a complete loss mitigation application is received 90 days or more before a foreclosure sale, a servicer may require that a borrower accept or reject an offer of a loss mitigation option no earlier than 14 days after the servicer provides the offer of a loss mitigation option to the borrower. If a complete loss mitigation application is received less than 90 days before a foreclosure sale, but more than 37 days before a foreclosure sale, a servicer may require that a borrower accept or reject an offer of a loss mitigation option no earlier than 7 days after the servicer provides the offer of a loss mitigation option to the borrower.

REJECTION. [Regulation X, 12 CFR §1024.41(e)(2)]

i. ***In general.*** Except as set forth in paragraphs (e)(2)(ii) and (iii) of this section, a servicer may deem a borrower that has not accepted an offer of a loss mitigation option within the deadline established pursuant to paragraph (e)(1) of this section to have rejected the offer of a loss mitigation option.
ii. ***Trial Loan Modification Plan.*** A borrower who does not satisfy the servicer's requirements for accepting a trial loan modification plan, but submits the payments that would be owed pursuant to any such plan within the deadline established pursuant to paragraph (e)(1)of this section, shall be provided a reasonable period of time to fulfill any remaining requirements of the servicer for acceptance of the trial loan modification plan beyond the deadline established pursuant to paragraph (e)(1) of this section.
iii. ***Interaction with appeal process.*** If a borrower makes an appeal pursuant to paragraph (h) of this section, the borrower's deadline for accepting a loss mitigation option offered pursuant to paragraph (c)(1)(ii) of this section shall be extended until 14 days after the servicer provides the notice required pursuant to paragraph (h)(4) of this section.

Prohibition on foreclosure referral. [Regulation X, 12 CFR §1024.41(f)]

PRE-FORECLOSURE REVIEW PERIOD. [Regulation X, 12 CFR §1024.41(f)(1)]
A servicer shall not make the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process unless:

i. A borrower's mortgage loan obligation is more than 120 days delinquent;
ii. The foreclosure is based on a borrower's violation of a due-on-sale clause; or
iii. The servicer is joining the foreclosure action of a subordinate lienholder.

[Official Interpretation]

PROHIBITED ACTIVITIES. Regulation X, 12 CFR §1024.41(f) prohibits a servicer from making the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process under certain circumstances. Whether a document is considered the first notice or filing is determined on the basis of foreclosure procedure under the applicable State law.

i. Where foreclosure procedure requires a court action or proceeding, a document is considered the first notice or filing if it is the earliest document required to be filed with a court or other judicial body to commence the action or proceeding (e.g., a complaint, petition, order to docket, or notice of hearing).

ii. Where foreclosure procedure does not require an action or court proceeding, such as under a power of sale, a document is considered the first notice or filing if it is the earliest document required to be recorded or published to initiate the foreclosure process.
iii. Where foreclosure procedure does not require any court filing or proceeding, and also does not require any document to be recorded or published, a document is considered the first notice or filing if it is the earliest document that establishes, sets, or schedules a date for the foreclosure sale.
iv. A document provided to the borrower but not initially required to be filed, recorded, or published is not considered the first notice or filing on the sole basis that the document must later be included as an attachment accompanying another document that is required to be filed, recorded, or published to carry out a foreclosure.

APPLICATION RECEIVED BEFORE FORECLOSURE REFERRAL. [Regulation X, 12 CFR §1024.41(f)(2)]
If a borrower submits a complete loss mitigation application during the pre-foreclosure review period set forth in paragraph (f)(1) of this section or before a servicer has made the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process, a servicer shall not make the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process unless:

i. The servicer has sent the borrower a notice pursuant to paragraph (c)(1)(ii) of this section that the borrower is not eligible for any loss mitigation option and the appeal process in paragraph (h) of this section is not applicable, the borrower has not requested an appeal within the applicable time period for requesting an appeal, or the borrower's appeal has been denied;
ii. The borrower rejects all loss mitigation options offered by the servicer; or
iii. The borrower fails to perform under an agreement on a loss mitigation option.

Prohibition on foreclosure sale. [Regulation X, 12 CFR §1024.41(g)]

If a borrower submits a complete loss mitigation application after a servicer has made the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process but more than 37 days before a foreclosure sale, a servicer shall not move for foreclosure judgment or order of sale, or conduct a foreclosure sale, unless:

1. The servicer has sent the borrower a notice pursuant to paragraph (c)(1)(ii) of this section that the borrower is not eligible for any loss mitigation option and the appeal process in paragraph (h) of this section is not applicable, the borrower has not requested an appeal within the applicable time period for requesting an appeal, or the borrower's appeal has been denied;
2. The borrower rejects all loss mitigation options offered by the servicer; or
3. The borrower fails to perform under an agreement on a loss mitigation option.

[Official Interpretation]

1. ***DISPOSITIVE MOTION.*** The prohibition on a servicer moving for judgment or order of sale includes making a dispositive motion for foreclosure judgment, such as a motion for default judgment, judgment on the pleadings, or summary judgment, which may directly result in a judgment of foreclosure or order of sale. A servicer that has made any such motion before receiving a complete loss mitigation application has not moved for a foreclosure judgment or order of sale if the servicer takes reasonable steps to avoid a ruling on such motion or issuance of such order prior to completing the procedures required by Regulation X, 12 CFR §1024.41, notwithstanding whether any such action successfully avoids a ruling on a dispositive motion or issuance of an order of sale.
2. ***PROCEEDING WITH THE FORECLOSURE PROCESS.*** Nothing in Regulation X, 12 CFR §1024.41(g) prevents a servicer from proceeding with the foreclosure process, including any publication, arbitration, or mediation requirements established by applicable law, when the first notice or filing for a foreclosure proceeding occurred before a servicer receives a complete loss mitigation application so long as any such steps in the foreclosure process do not cause or directly result in the issuance of a foreclosure judgment or order of sale, or the conduct of a foreclosure sale, in violation of Regulation X, 12 CFR §1024.41.
3. ***INTERACTION WITH FORECLOSURE COUNSEL.*** A servicer is responsible for promptly instructing foreclosure counsel retained by the servicer not to proceed with filing for foreclosure judgment or order of sale, or to conduct a foreclosure sale, in violation of Regulation X, 12 CFR §1024.41(g) when a servicer has received a complete loss mitigation application, which may include instructing counsel to move for a continuance with respect to the deadline for filing a dispositive motion.
4. ***LOSS MITIGATION APPLICATIONS SUBMITTED 37 DAYS OR LESS BEFORE FORECLOSURE SALE.*** Although a servicer is not required to comply with the requirements in Regulation X, 12 CFR §1024.41with respect to a loss mitigation application submitted 37 days or less before a foreclosure sale, a servicer is required separately, in accordance with policies and procedures maintained pursuant to Regulation X, 12 CFR §1024.38(b)(2)(v) to properly evaluate a borrower who submits an application for a loss mitigation option for all loss mitigation options available to the borrower pursuant to any requirements established by the owner or assignee of the borrower's mortgage loan. Such evaluation may be subject to requirements applicable to a review of a loss mitigation application submitted by a borrower 37 days or less before a foreclosure sale.
5. ***SHORT SALE LISTING PERIOD.*** An agreement for a short sale transaction, or other similar loss mitigation option, typically includes marketing or listing periods during which a servicer will allow a borrower to market a short sale transaction. A borrower is deemed to be performing under an agreement on a short sale, or other similar loss mitigation option, during the term of a marketing or listing period.
6. ***SHORT SALE AGREEMENT.*** If a borrower has not obtained an approved short sale transaction at the end of any marketing or listing period, a servicer may determine that a borrower has failed to perform under an agreement on a loss mitigation option. An approved short sale transaction is a short sale transaction that has been approved by all relevant parties, including the servicer, other affected lienholders, or insurers, if applicable, and the servicer has received proof of funds or financing, unless circumstances otherwise indicate that an approved short sale transaction is not likely to occur.

Appeal process. [Regulation X, 12 CFR §1024.41(g)]

1. **APPEAL PROCESS REQUIRED FOR LOAN MODIFICATION DENIALS.** If a servicer receives a complete loss mitigation application 90 days or more before a foreclosure sale or during the period set forth in paragraph (f) of this section, a servicer shall permit a borrower to appeal the servicer's determination to deny a borrower's loss mitigation application for any trial or permanent loan modification program available to the borrower.
2. **DEADLINES.**A servicer shall permit a borrower to make an appeal within 14 days after the servicer provides the offer of a loss mitigation option to the borrower pursuant to paragraph (c)(1)(ii) of this section.
3. **INDEPENDENT EVALUATION.** An appeal shall be reviewed by different personnel than those responsible for evaluating the borrower's complete loss mitigation application.
4. **APPEAL DETERMINATION.** Within 30 days of a borrower making an appeal, the servicer shall provide a notice to the borrower stating the servicer's determination of whether the servicer will offer the borrower a loss mitigation option based upon the appeal and, if applicable, how long the borrower has to accept or reject such an offer or a prior offer of a loss mitigation option. A servicer may require that a borrower accept or reject an offer of a loss mitigation option after an appeal no earlier than 14 days after the servicer provides the notice to a borrower. A servicer's determination under this paragraph is not subject to any further appeal.

[Official Interpretation]

1. ***SUPERVISORY PERSONNEL.*** The appeal may be evaluated by supervisory personnel that are responsible for oversight of the personnel that conducted the initial evaluation, as long as the supervisory personnel were not directly involved in the initial evaluation of the borrower's complete loss mitigation application.

Duplicative requests. [Regulation X, 12 CFR §1024.41(i)]

A servicer is only required to comply with the requirements of this section for a single complete loss mitigation application for a borrower's mortgage loan account.

[Official Interpretation]

1. ***SERVICING TRANSFERS.***A transferee servicer is required to comply with the requirements of Regulation X, 12 CFR §1024.41regardless of whether a borrower received an evaluation of a complete loss mitigation application from a transferor servicer. Documents and information transferred from a transferor servicer to a transferee servicer may constitute a loss mitigation application to the transferee servicer and may cause a transferee servicer to be required to comply with the requirements of § 1024.41 with respect to a borrower's mortgage loan account.
2. ***APPLICATION IN PROCESS DURING SERVICING TRANSFER.***A transferee servicer must obtain documents and information submitted by a borrower in connection with a loss mitigation application during a servicing transfer, consistent with policies and procedures adopted pursuant to Regulation X, 12 CFR §1024.38. A servicer that obtains the servicing of a mortgage loan for which an evaluation of a complete loss mitigation option is in process

should continue the evaluation to the extent practicable. For purposes of Regulation X, 12 CFR §1024.41(e)(1), 1024.41(f), 1024.41(g), and 1024.41(h), a transferee servicer must consider documents and information received from a transferor servicer that constitute a complete loss mitigation application for the transferee servicer to have been received by the transferee servicer as of the date such documents and information were provided to the transferor servicer.

Small servicer requirements. [Regulation X, 12 CFR §1024.41(j)]
A small servicer shall be subject to the prohibition on foreclosure referral in paragraph (f)(1) of this section. A small servicer shall not make the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process and shall not move for foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of an agreement on a loss mitigation option.

Summary

- The Real Estate Settlement Procedures Act's (RESPA) two main goals are to provide borrowers with information about closing costs and to eliminate kickbacks and referral fees that unnecessarily increase settlement costs.
- Section 8 of RESPA forbids anyone to accept or give a fee, kickback or anything of value in exchange for referrals.
- Section 9 of RESPA states the seller of a property cannot require the homebuyer to use a particular title company as a condition of the sale
- RESPA allows lenders to maintain a “cushion” in the escrow account to make up for any shortages that may arise from increasing insurance costs or tax increases over the term of the loan.
- The cushion amount may not exceed 1/6 of the total disbursement for the year. The cushion amount is allowed but not a requirement of RESPA.
- RESPA specifies the proper procedures to be followed in regards to the foreclosure process

Lesson 3: Equal Credit Opportunity Act (ECOA) – Regulation B

LESSON OBJECTIVES

Upon completion of this lesson, you should be able to:

- Explain the purpose of the Equal Credit Opportunity Act
- Discuss the ECOA disclosure
- Understand required collection of information

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.

The Equal Credit Opportunity Act (ECOA), Regulation B, was passed in 1974 and applies to all consumer credit. The definition of consumer credit under the ECOA is:

Credit extended to an individual for personal, family, or household purposes
[Regulation B 12 CFR §1002.2(h)]

The purpose of the Equal Credit Opportunity Act is: [Regulation B 12 CFR §1002.1(b)]

- *(b) Purpose." The purpose of this regulation is to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act.*
- The regulation prohibits creditor practices that discriminate on the basis of any of these factors. The regulation also requires creditors to notify applicants of action taken on their applications; to report credit history in the names of both spouses on an account; to retain records of credit applications; to collect information about the applicant's race and other personal characteristics in applications for certain dwelling- related loans; and to provide applicants with copies of appraisal reports used in connection with credit transactions."

The ECOA, Reg-B, prohibits discrimination based on: [Regulation B 12 CFR §1002.1(b)]

- Race/color
- Religion
- National origin
- Sex
- Marital status
- Age
- Public assistance

It is illegal to base lending decisions on assumptions of creditworthiness. Although the lender may ask about applicant's age or marital status [Regulation B 12 CFR §1002.13 (a)(iii)(iv)], they cannot ask about the applicant's childbearing plans [Regulation B 12 CFR §1002.5 (d)(3)]

The chart below shows how the Fair Housing Act and the Equal Credit Opportunity Act prohibit the same type discrimination:

FHA	ECOA
RACE	RACE
COLOR	COLOR
RELIGION	RELIGION
NATIONAL ORIGIN	NATIONAL ORIGIN
SEX	SEX

This chart demonstrates the differences in these two acts:

FHA	ECOA
HANDICAP	MARITAL STATUS
FAMILIAL STATUS	AGE
	ALL OR PART OF APPLICANT'S INCOME COMES FROM PUBLIC ASSISTANCE

The Equal Credit Opportunity Act was established to grant all consumers an equal chance to obtain credit. This law requires lending institutions and mortgage brokers to perform specific actions. Included in this law is anyone involved in granting credit: [Regulation B 12 CFR §1002.1]

- Real Estate Brokers who arrange financing
- Small loan and finance companies
- Retail and department stores
- Credit card companies
- Credit unions

Lenders must comply with ECOA in regards to any credit transaction:
[Regulation B 12 CFR §1002.1(a)(b)(c)(d)(1)(2)(e)]

- Interviewing/communicating with applicants
- Analyzing applicants' finances
- Offering credit terms to applicants

The Equal Credit Opportunity Law was put in place to:

- Protect individuals and businesses applying for credit
- Establish equality to the many consumers who apply for credit to:
- Finance the purchase or remodeling of a home
- Acquire a small business loan or to help fund an education

The ECOA enforces fair credit lending practices in the taking of loan applications. Here are some guidelines to follow:

- During the loan application process, the mortgage loan originator should ensure the client's best interests are always first and foremost
- The mortgage loan originator may not make any oral or written statement that would discourage an applicant or potential applicant, from making or pursuing a loan application [Regulation B 12 CFR §1002.4(b)]

This rule applies to:

- The application process
- Advertising
- Any method of promoting loan services

The mortgage lending industry should:

- Promote homeownership to all people
- Encourage and counsel potential and existing clients

The federal government requires lenders to report information regarding the applicant when applying for credit primarily for the purpose of [Regulation B 12 CFR §1002.13(a)]

- Obtaining a dwelling
- Refinancing a dwelling
- Occupied (or to be occupied) by the applicant

The required information to be reported is as follows [Regulation B 12 CFR §1002.1 (a)(i)(ii)(iii)(iv)]:

- Race or national origin
- Sex
- Marital Status
- Age

The categories used for race or national origin will be [Regulation B 12 CFR §1002.1(a)(i)]:

- American Indian or Alaska Native
- Asian
- Black or African American
- Native Hawaiian or other Pacific Islander
- White

The categories for ethnicity will be either [Regulation B 12 CFR §1002.1(a)(i)]:

- Hispanic or Latino
- Not Hispanic or Latino

"The applicant(s) shall be asked but not required to supply the requested information. If the applicant(s) chooses not to supply the information or any part of it, that fact shall be noted on the form. The creditor shall then also note on the form, to the extent possible, the ethnicity race, and sex of the applicant(s) on the basis of visual observation or surname" [Regulation B 12 CFR §1002.13(b)]

The Marital Status category will allow the use of [Regulation B 12 CFR §1002.1(a)(iii)]:

- Married,
- Unmarried (includes single, divorced, and widowed persons)
- Separated

Spouse or Former Spouse Info

The following information will pertain to a spouse or former spouse. It will also provide information regarding what the lender is allowed to request:

- If the client lives in a community property state or is relying on property located in such a state, the lender is permitted to request information concerning an applicant's spouse [Regulation B 12 CFR §1002.5 (c)(2(iv)]
- Information regarding a former spouse may be requested if the applicant is relying on alimony, child support, or separate maintenance as a means for repayment of the debt [Regulation B 12 CFR §1002.55 (c)(2(v)]
- If a client is applying for a separate unsecured debt the mortgage loan originator is not allowed under the Equal Credit Opportunity Act to request marital status, unless the applicant lives in a community property state [Regulation B 12 CFR §1002.5 (c)(3)(d)(1)]
- The states with community property laws are:
    - Arizona
    - California
    - Idaho
    - Louisiana
    - Nevada
    - New Mexico
    - Texas
    - Washington
    - Wisconsin

To clarify the rules regarding spousal information, a creditor may request information on a spouse when:

- The spouse will be permitted to use the account [Regulation B 12 CFR §1002.5 (c)(2(i)]
- The spouse will be liable on the account [Regulation B 12 CFR §1002.5 (c)(2(ii)]
- The applicant is relying on the spouse's income as a basis for repayment of the debt [Regulation B 12 CFR §1002.5 (c)(2(iii)]
- The applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the debt [Regulation B 12 CFR §1002.5 (c)(2(iv)]
- The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested [Regulation B 12 CFR §1002.5(c)(2(v)]

Age Discrimination

Age may not be a consideration in the loan decision process provided that the applicant has the capacity to enter into a binding contract [Regulation B 12 CFR §1002.6 (b)(2)(i)]

Certain situations to consider where age may be a factor are:

- Applicant is too young to sign the application (or any legal contract) [Regulation B 12 CFR §1002.6 (b)(2)(i)]
- In most states the legal age is 18 years old
- Client is 62 years old or older[Regulation B 12 CFR §1002.2 (o)]
- Consideration may be given to grant credit in favor of the applicant [Regulation B 12 CFR §1002.6 (b)(2)(iv)]
- When age is a positive factor it can be used to extend credit

Other factors allowing age to be a consideration
- Client is near retirement age [Regulation B 12 CFR §1002.6 (b)(5)]
- Creditor can consider the client's occupation and length of time until retirement
- Income may decrease and this could possibly have a negative impact on the client's ability to re-pay the credit obligation
- Evaluate applicant's retirement income to see if it will support the loan through to maturity
- Evaluation should be made on a case by case basis
- Always assess the borrower's other elements of creditworthiness

The mortgage loan originator is allowed to ask the client for information regarding outstanding debts [Regulation B 12 CFR §1002.6 (b)(6(i)]

Other information allowed to be collected is [Regulation B 12 CFR §1002.5 (c)(3)]
- Name and address under which the accounts are listed
- Former names used by the client to obtain credit in the past

Childbearing, Childrearing

In regards to childbearing and childrearing the ECOA allows a mortgage loan originator to inquire about the [Regulation B 12 CFR §1002.5 (d)(4)]
- Number of dependents the applicant has
- The dependent's ages
- Dependent-related financial obligations or expenses, provided such information is requested without regard to:
  - Sex,
  - Marital status
  - Any other prohibited basis

The following inquiries will not be allowed:
- The loan originator may not inquire about the consumer's
  - Childbearing
  - Childrearing
  - Birth control practices
  - Whether they are able to bear children

Required Disclosures

The mortgage loan originator shall provide an ECOA disclosure notice to each client [Regulation B 12 CFR §1002.9 (3)(ii)(b) (all)]
- Sometimes referred to as an ECOA Disclosure
- Explains the purpose of the Equal Credit Opportunity Act and the consumer's rights pertaining to this Act
- Recognizes the Federal Agency that administers compliance with the Equal Credit Opportunity Law
- Supplies their address to consumer should they decide to submit a complaint

The Equal Credit Opportunity Disclosure will:

- Advise the consumer of their rights
- Discuss the applicant's right to disclose or not to disclose income from alimony, child support or separate maintenance

The consumer has the right to know whether their credit application was accepted or rejected within 30 days of filing a completed loan application [Regulation B 12 CFR §1002.9 (a)(i)] An application is considered complete once a creditor has obtained all the information it normally considers in making a credit decision [Regulation B 12 CFR §1002.2 (f)]

- Application means the submission of a borrower's financial information, oral or written, using procedures in line for the type of credit requested.
- Completed Loan Application means the creditor has received all information usually obtained to make a credit decision for the amount and type of credit requested. Information will include, but will not be limited to:
    - Credit report
    - Additional information requested
    - Approvals or reports by governmental agencies needed to guarantee, insure, or provide security for the loan
      [Regulation B 12 CFR §1002.2 (f)]

The rules of the ECOA require the consumer to receive either of the following within 30 days of filing a completed loan application [Regulation B 12 CFR §1002.9 (a)(i)]

- Approval
- Adverse Action
- Counteroffer

The notification for approval can be:

- Expressed
- Implied

An incomplete application would be a denial for incompleteness and also the following:
[Regulation B 12 CFR §1002.9 (c)(1)(i) and (ii)]

- Applicant could complete the application but chose not to
- Creditor lacked sufficient data to warrant a credit decision

If an application is incomplete but there is enough information to grant a denial, the following apply:
[Regulation B 12 CFR §1002.9 (c)(1)(i)]

- Applicant must be given the specific reason for the denial
- Notice of right to receive the reasons
- Incompleteness of the application cannot be given as the reason for denial

Notice of Adverse Action Form - ECOA Notice

If the application for credit is rejected, the lender must disclose specific reasons to the client for rejection [Regulation B 12 CFR §1002.9 (a)(2)(i)]

- The reasons for rejecting the credit file should be clear and concise
  [Regulation B 12 CFR §1002.9 (a)(2)]
- Indefinite or vague reasons are illegal

It is important to always give explicit details when explaining the reason for denial.

The notification of adverse action is required to be in writing and must contain the following [Regulation B 12 CFR §1002.9 (a)(2)]

- A statement of action taken
- The name and address of the lender
- A statement of the provision known commonly as the ECOA Notice
- The name and address of the federal agency that administers compliance with respect to the lender
- Either a statement of specific reasons for the action taken or a disclosure of the applicant's right to a statement of specific reasons within a specified period of time

If the application was taken by phone, the following apply: [Regulation B 12 CFR §1002.9 (C)]

- Requirements are satisfied when the bank provides an oral statement of:
  - Action taken
  - Applicant's right to a statement of reasons for adverse action

Appraisal Notification

Mortgage lenders are required to notify applicants of their right to receive a copy of the appraisal. Under ECOA the following will apply regarding appraisal notification:
[Regulation B 12 CFR §1002.14 (a)(2)(i)]

- The client will receive a "Right to Receive a Copy of Appraisal" including the address, phone number, and contact name of lender [Regulation B 12 CFR §1002.14 (a)(2)(i)]
- A creditor shall provide a copy of the appraisal as a
  - Routine delivery [Regulation B 12 CFR §1002.14(a)(1)]; Whether credit is granted or denied, or,
  - Upon written request from applicant [Regulation B 12 CFR §1002.14 (a)(2)]
    - A creditor that does not routinely provide appraisal reports shall provide a copy upon an applicant's written request. Generally, within 30 days of written request
    - Notice - A creditor that provides appraisals only upon request [Regulation B 12 CFR §1002.14 (a)(1)]
      - Must provide applicant with right to receive copy of appraisal notice
      - Can be given at any time, but no later than notice of action taken
    - Delivery - For creditors that provide appraisals only upon request. Creditor will deliver/mail appraisal
      - Within 30 days of request [Regulation B 12 CFR §1002.14 (a)(2)(i)(ii)],
      - When report is received, or
      - When reimbursement is received for the report
      - Whichever is the last to occur
    - Deadline for request from applicant is 90 days - A creditor need not provide a copy of the appraisal when the request is received 90 days after notice from creditor or 90 days after application is withdrawn

Lesson 4: FHA Mortgage Program *(Non-Traditional Mortgage Products)*

LESSON OBJECTIVES:

Upon completion of this lesson, you should be able to:

- Understand FHA's different programs
- Comprehend graduated payment mortgages
- Compute FHA insurance premiums
- Know about sales concessions such as seller contributions
- Understand secondary financing and FHA loans
- Become familiar with the assumption rules for FHA loans

FHA

- Two federal home financing programs:
  - FHA-insured loan program
  - VA-guaranteed loan program
- Federal Housing Administration (FHA) was created in 1934 as part of National Housing Act
  - To generate new jobs by increasing construction activity
  - Stabilize mortgage market
  - Promote financing, repair, improvement, and sale of real estate
- Today, FHA is part of Department of Housing and Urban Development (HUD)
- Primary function is insuring mortgage loans
- Compensates lenders for losses from borrower default
- Does not build homes or make loans
- Mutual Mortgage Insurance Plan is FHA insurance program funded by premiums paid by FHA borrowers
- Direct endorsers - lenders authorized to handle entire underwriting process for FHA loans
- If FHA borrower defaults on loan:
  - FHA reimburses lender for full amount of loss
  - Borrower required to repay FHA

Characteristics of FHA Loans

- Typical FHA loan has a 30-year term, but borrower may have option for shorter term. Other characteristics of an FHA loan:
  - Required to have first lien position
  - Competitive interest rates
  - Lender charges an origination fee and may charge discount points
  - Borrowers may use gift funds
- Distinguishing features of FHA loans, almost every FHA-insured loan has these characteristics
  - Less stringent qualifying standards.
  - Borrowers with minimum decision credit score at or above 580 are eligible for maximum financing
  - 3.5% down payment
  - Borrowers with minimum credit score between 500 and 579 – limited to 90% LTV

- Borrowers with minimum credit score of less than 500 are not eligible for FHA-insured mortgage financing
    - Secondary financing restrictions
    - Maximum loan amounts set by local limits and by LTV rules
    - Borrower must come up with minimum cash investment plus funds for
        - Closing costs
        - Discount points
        - Prepaids
        - Mortgage insurance is required for the life of the loan
        - No pre-payment charges
        - Property must be owner-occupied primary residence

FHA Loan Programs

FHA has many different programs to fit different needs. Each is funded annually on a national basis

- These programs are of the greatest interest to home buyers:
    - Section 203(b) – fixed-rate mortgages on owner-occupied residences with up to four units
        - Borrower must meet standard FHA credit qualifications
        - Borrower is eligible for approx. 96.5% financing
        - Borrower is able to finance the upfront MIP
            - Also responsible for paying an annual premium
            - UPFMIP: When buyers are approved for FHA home loans, they are required to carry mortgage insurance. That includes both a Mortgage Insurance Premium (MIP) and an Up Front Mortgage Insurance Payment (UFMIP). The Upfront Mortgage Insurance Premium payments go into an escrow account set up by the U.S. Treasury Department and the funds are used to protect the government in case the borrower defaults on the FHA loan.
            - Eligible properties are 1 – 4 units
    - Section 203(k) – mortgages used to purchase/refinance and rehabilitate a residence with up to four units
    - Section 223(e) – loans in older, declining urban areas
    - Section 234(c) – loans on owner-occupied condominium units
    - Section 245 and Section 245(a) – graduated payment mortgages and growing equity mortgages
    - Section 251 – adjustable-rate mortgages
    - Owner-Occupancy Requirement
        - Borrowers must intend to occupy property
        - Must be the borrower’s principal residence
        - If more than one unit, borrower must use one as principal residence
    - Secondary Residences
        - This is a home borrower occupies less than 50% of the time
        - Can be financed only if denial would cause hardship
            - Must be need for employment-related reasons
            - Cannot be a vacation home

- Investor Loans
    - FHA generally does not insure investor homes
    - Exception may be made for investor who wants to purchase a property that HUD owns thru foreclosure
- Most FHA loans are 203(b) loans
- Program can be used for purchase loans or refinancing for residences with up to four units
- HUD imposes limits on size of loans that can be insured
- Two different limits:
  - Local loan amount limits
  - Loan-to-value ratio limits
- Local maximum loan amounts
  - FHA max loan amounts based on local median house prices; Vary from one area to another
  - Each has local max for 1, 2 3 & 4 units
  - FHA maximum loan amounts are tied to the conforming loan limits
    - Set annually by the secondary market agencies
    - Subject to annual adjustments
  - Currently FHA max is set at 65% of Freddie Mac's general conforming loan limit
  - One unit – Freddie Mac current loan limit for 2018 is $453,100
  - Therefore, FHA's basic max loan amount for a one unit for 2018 is $294,515
    $453,100 x .65 = $294,515
- Instead of one national mortgage limit like Fannie Mae, loan limits will depend on whether a property is in a general or high-cost area
- Each year, FHA recalculates its loan limits based on 115 % of the median house price in the area. For counties, or equivalent, located in Metropolitan Statistical Areas (MSAs) the limit for all areas in the MSA is calculated based on the highest cost county.
- FHA's loan limit "ceiling" was increased from $636,150 in 2017, up to $679,650 for 2018. FHA's minimum national loan limit "floor" is set at 65 percent of the national conforming loan limit of $453,100. The floor applies to those areas where 115 percent of the median home price is less than 65 percent of the national conforming loan limit.
- Any area where the loan limit exceeds the "floor" is considered a high cost area. The maximum FHA loan limit "ceiling" for high cost areas is 150 percent of the national conforming limit.
- Additional information and loan limit adjustments for two-, three-, and four-unit properties, and in Special Exception Areas, are noted in FHA's mortgagee letter. An attachment to the Mortgagee Letter provides

- Local loan amount limits - HUD often sets loan amounts on county-by-county basis
  - In county with large city, entire county may be treated as high-cost area
  - Housing is more expensive than average
  - FHA may increase the max loan amount to 125% of area median house price

2018 FHA Maximum Loan Amounts		
No. of Units	Basic Maximum Loan Amounts	Maximum Loan Amount in High Cost Areas †
1	$294,515	115% of median price, up to $679,650
2	$377,075	115% of median price, up to $870,225
3	$455,800	115% of median price, up to $1,051,875
4	$566,425	115% of median price, up to $1,307,175
† In Alaska, Hawaii, Guam, and the Virgin Islands, the 2018 ceilings are $1,019,475 for one unit; $1,305,325 for two units, $1,577,800 for three units; and $1,960,750 for four units.		

Minimum Cash Investment & LTV

- Borrower must make minimum cash investment of at least 3.5% of appraised value or sales price, lesser of two
- Max Loan To Value on FHA loan is 96.5%
- Closing costs paid by borrower no longer count towards min cash investment
  - Also not included:
    - Discount points
    - Prepaid expenses
  - Borrower must come up with min cash investment plus funds for:
    - Closing costs
    - Discount points
    - Prepaids
  - Borrower not allowed to use secondary financing from seller or lender for min cash investment
  - Can use funds provided by family member

Sales Concessions

- FHA places certain restrictions on sales concessions
- Purpose is to prevent parties from using contributions to defeat FHA's loan-to-value rules

Seller Contributions

- FHA considers it to be a seller contribution if seller (or other interested party) pays for all or part of:
  - Buyer's closing costs
  - Buyer's prepaid expenses
  - Any discount points
  - Temporary or permanent buydown
  - Buyer's mortgage interest
  - Upfront MIP
- Seller contributions are limited to 6% of sales price
- Excess contributions are treated as inducements to purchase
  - Deducted from sales price in loan amount calculations
- 6% limit only applies to contributions paid for by seller or another interested party
- Example:

  The Johnson's are buying a home for $254,000 and financing the purchase with an FHA loan. The seller has agreed to pay the lender $16,000 to buy down the interest rate on the Johnson's loan. Six percent of the sales price is $15,240, so the buydown is $760 over the 6% limit on seller contributions ($16,000 - $15,240 = $760). The $760 excess seller contribution will be treated as an inducement to purchase.

Inducements to Purchase

- FHA considers it to be an inducement to purchase if seller (or other interested party):
  - Gives buyer a decorating allowance
  - Gives buyer a repair allowance
  - Pays for buyer's moving expenses
  - Pay real estate agent's sales commission on sale of buyer's current home
  - Pays the buyer's agent a larger sales commission than is customary in the local area
  - Gives buyer personal property not customarily included in sale of home
- Value of inducements are subtracted from property's sale price before LTV ratio is applied
  - Reduces amount of mortgage available to FHA borrower
- Example:

  Returning to the previous example, suppose that the seller has also agreed to give the Johanssons $1,000 towards their moving costs. This $1,000 and the $760 excess in seller contributions are considered inducements to purchase, and they're subtracted from the property's sales price before the maximum loan amount is calculated.

$ 254,000	Sales Price
- 1,760	Inducements to Purchase
$ 252,240	Adjusted Sales Price
x .965	Maximum Loan-to-Value Ratio (96.5%)
$ 243,411	Maximum Loan Amount

Secondary Financing

FHA rules regarding use of secondary financing depend on whether financing is being used for minimum cash investment or as supplement to make up permitted base loan amount

Cash Investment

- Generally, borrower not allowed to use secondary financing from seller, another interested party, or institutional lender to pay:
  - Minimum cash investment
  - Closing costs
  - Other expenses
- If secondary financing is a family member, total financing can't exceed property's value or sales price plus closing costs, prepaids, and discount points
- Combined payments can't exceed buyer's ability to pay
- FHA borrower who is 60 years or older may borrow money from:
  - Relative
  - Close friend with clearly defined interest in borrower
  - Employer
  - Charitable organization
- Same value requirements as with family and agencies

Base Loan

FHA allows second mortgages from anyone with FHA-insured loan. Following conditions must be met:

- Both loans together can't exceed FHA maximum mortgage amount
- Combined total of payments may not exceed borrower's ability to pay
- If second loan has periodic installment payments, they must be collected on a monthly basis. Payment amounts should be substantially the same
- Second mortgage may not have balloon payment due less than 10 years after closing
- Second mortgage may not impose prepayment penalty

Assumption of FHA Loans

- FHA loans closed before December 15, 1989 can be assumed:
  - By any buyer
  - Without FHA or lender approval
  - By an investor (non-occupant)
- For FHA loans closed after December 15, 1989, buyer assuming loan must:
  - Pass creditworthiness review
  - Occupy home
- For FHA loans closed on or after January 27, 1991,
  - Home must be buyer's primary residence
  - May not be a second home
- For FHA loans closed between February 5, 1988 and January 27, 1991, if:
  - Original borrower was owner occupant
  - Buyer is purchasing property as a second home
  - Then loan must be paid down to 85% LTV ratio

Assumption Charges

- Interest rate on fixed-rate FHA-insured loan normally isn't raised after assumption
- Lender allowed to charge $500 assumption fee if loan originated after December 15, 1989

FHA Underwriting

FHA underwriting standards aren't as strict as Fannie Mae/Freddie Mac standards

- Involves analysis of applicant's income, net worth, and credit history

Income Analysis

- FHA underwriter determines applicant's monthly effective income
- Effective income - gross income from all sources expected to continue for first 3 years of loan term
- Underwriter also applies income ratios to determine adequacy of effective income:
  - Fixed payment to income ratio (generally 43%)
  - Housing expense to income ratio (generally 31%)
- Fixed payments include proposed monthly housing expense and all recurring charges
- Housing expense:
  - Principal and interest
  - Property taxes
  - Hazard insurance
  - One-twelfth of FHA annual premium
  - Any homeowners' dues
  - Flood insurance or additional insurances
- Recurring charges:
  - Monthly payments on debt with 10 or more remaining payments
  - Alimony and child support payments
  - Installment debt payments
  - Payments on revolving credit accounts
  - Calculating Recurring Charges – Example

    Helen Crowder wants to buy a home using FHA financing. In the area where she lives, the maximum FHA loan amount is $271,050 and lenders are generally charging about 5.5% interest for 30-year fixed rate FHA loans. She'd like to get preapproved for the maximum loan amount. The monthly payment (including principal, interest, taxes, hazard insurance, and mortgage insurance) for a loan that size would be approximately $1,693. Crowder's monthly salary is $4,500. Her ex-husband reliably sends her a child support payment each month for their four-year-old daughter. The child support is tax-exempt, so the lender "grosses up" the payment, and concludes that it's the equivalent of $650 in taxable income. Thus, Crowder's effective income is $5,150.

Crowder has to pay the following recurring charges every month:

$ 253	Car Payment (11 payments remaining)
65	Furniture store payment (15 payments remaining)
55	Minimum Visa payment
29	Minimum MasterCard payment
125	Student loan (63 payments remaining)
+ 60	Average payment on Texaco credit card
$587	Total Recurring Charges

Calculating Debt to Income Ratio Example

To calculate Crowder's debt to income ratio, first add the proposed housing expense to her recurring charges to determine her total fixed payments. Then divide that figure by her effective income.

$1,693	Proposed housing expense
+ 587	Recurring charges
$2,280	Total Fixed Payments

$ 2,280	Total Fixed Payments
5,150 (÷)	Effective income
0.4427	Debt to Income Ratio (44%)

With the $1,693 proposed monthly payment, Crowder's housing expense to income ratio would be approximately 33%:

$ 1,693	Proposed housing expense
5,150 (÷)	Effective income
0.3287	Housing expense to income ratio (33%)

- If income ratios exceed 43% and/or 31% limits, applicant won't qualify for loan unless there are compensating factors that reduce risk of default
- Compensating factors include:
  - Paid housing expenses at least equal to proposed expenses for last 12-24 months
  - Plans to make large down payment (10%)
  - Demonstrated ability to accumulate savings and conservative attitude toward use of credit
  - Able to devote greater portion of income to housing expenses
  - Receives income not counted as effective income, but directly affects ability to pay
  - Proposed housing expense only a small increase (10% or less) of current housing expense
  - Will have substantial reserves after closing (at least 3 mortgage payments)
  - Job training or professional education indicate potential for increased earnings

- If home is an energy-efficient home, income ratios can be exceeded by 2%
- Temporary buydowns are allowed if buyer qualifies at note rate. If buydown brings interest rate down from 9% to 7%, buyer must qualify for loan at 9%

Assets for Closing

- At closing, borrower needs enough cash to cover:
    - Minimum cash investment
    - Prepaids
    - Any discount points
    - Upfront MIP (if not financed)
    - Any closing costs, repair costs, or other expenses not financed
- Generally, borrower not required to have reserves for FHA loan, but reserves may be a compensating factor if income ratios exceed limits
- May also borrow money required for closing from someone other than relative, if loan is secured by collateral other than home being purchased

Other Closing Requirements

- FHA has several requirements related to inspection of properties used to secure FHA-insured loans
- First, buyers must receive HUD-provided disclosure form titled "For Your Protection: Get a Home Inspection"
    - Explains importance of home inspections
    - Distinguishes them from appraisals
- By signing form, buyers acknowledge that FHA will not perform home inspection or guarantee property's price or condition
- Second, buyers must receive disclosure form titled "Notice to the Homebuyer"
    - Summarizes conditions noted by FHA-approved appraiser preventing approval of property
    - Part of disclosure package
    - Must be disclosed within 3 days of loan application

FHA Insurance Premiums

- Insurance premiums for FHA loans are either:
- MMI (mutual mortgage insurance premiums)
- MIP (mortgage insurance premiums)
- For most programs, borrowers pay an upfront premium and annual premiums

Upfront MIP

- Upfront premium (UFMIP) is also called "one-time premium" (OTMIP)
- Paid in cash, or financed
- Percentage of base loan amount (currently 1.75%)

- Example: John Rubino is buying a house with a $350,280 FHA loan. His upfront premium will be $6,129.90.

$ 350,280	Loan Amount
x 1.75%	Premium Percentage
$6,129.90	UFMIP

- Either borrower or seller can pay UFMIP in cash at closing
- May also be financed over loan term; Added to base loan amount
- Borrower can borrow maximum loan amount plus UFMIP
  Example: Rubino has chosen to finance his upfront MIP instead of paying it in cash at closing.

$ 350,280.00	Loan Amount
+ 6,129.90	UFMIP
$ 356,409.90	Total Amount Financed

- Loan origination fee is based only on base loan amount, not including UFMIP
  Example: 1% origination with loan amount @ $350,280
  $350,280 x .01 = $3,502.80
- Discount points are based on total amount financed, including upfront MIP
  Example: 1% discount with a loan amount @ $350,280 plus $3,520.80 (UFMIP) = $353,782.80
  $353,782.80 x .01 = $3,573.83
- FHA buyer may be entitled to refund of part of UFMIP if loan is paid off early. FHA “earns” premium under a schedule
- Borrower gets refund whether UFMIP was paid in cash or financed
- But borrower not entitled to refund if:
  - Selling property and allowing buyer to assume FHA loan
  - Loan made after December 8, 2004 (unless loan is to refinance another FHA loan)

Annual Premiums

Exceptions: 15 year term with an LTV of 78% or less

Most FHA buyers are required to pay annual renewal premiums in addition to UFMIP. Annual premiums will be a percentage of the loan balance.

- 15-year loan term
  - LTV less than or equal to 78 percent - 0.45% annually
  - LTV greater than 78 percent, less than 90 percent - 0.45% annually
  - LTV greater than 90 percent - 0.70% annually
- 30-year loan term
  - LTV less than or equal to 95 percent: 1.30% annually
  - LTV greater than 95 percent - 1.35% annually

Annual MIP Chart

LTV Ratio	Annual Premium for over 15 Years and up to 30 Years	LTV Ratio	Annual Premium for Loans 15 Years and Under
95.00% and Under	1.30%	78% and under	0.45%
95.01% and Over	1.35%	90.00% to 78.01%	0.45%
		90.01% and Over	0.70

Note: FHA mortgages for which the loan size exceeds $625,500 are subject to additional MIP.

Annual Premium Cancellation

FHA will remove annual MIP after 11 years for homeowners whose beginning LTV is 90% or less. For everyone else, including those making a 3.5% down payment, the FHA will charge MIP for the remainder of the loan's term.

CANCELLATION OF MIP

TERM	LTV	PREVIOUS FHA GUIDELINES	EFFECTIVE 04/01/13
≤ 15 yrs	≤ 78	No annual MIP	11 years
≤ 15 yrs	> 78 – 90	Cancelled at 78% LTV	11 years
≤ 15 yrs	> 90	Cancelled at 78% LTV	Loan term
> 15 yrs	≤ 78	5 years	11 years
> 15 yrs	> 78 – 90	Cancelled at 78% LTV & 5 yrs	11 years
> 15 yrs	> 90	Cancelled at 78% LTV & 5 yrs	Loan term

SUMMARY:

- Two federal home financing programs are the FHA-insured loan program and the VA-guaranteed loan program
- Federal Housing Administration (FHA) was created in 1934 as part of National Housing Act
- The purpose of this act was to generate new jobs by increasing construction activity, stabilize the mortgage market, and promote financing, repair, improvement, and sale of real estate
- Mutual Mortgage Insurance Plan is FHA insurance program funded by premiums paid by FHA borrowers
- Direct endorsers are lenders authorized to handle entire underwriting process for FHA loans
- A typical FHA loan has a 30-year term, but borrower may have option for shorter term.
- FHA has many different programs to fit different needs. Each is funded annually on a national basis
- These programs are of the greatest interest to home buyers:
  - Section 203(b) – fixed-rate mortgages on owner-occupied residences with up to four units
  - Section 203(k) – mortgages used to purchase/refinance and rehabilitate a residence with up to four units
  - Section 223(e) – loans in older, declining urban areas

    - Section 234(c) – loans on owner-occupied condominium units
    - Section 245 and Section 245(a) – graduated payment mortgages and growing equity mortgages
    - Section 251 – adjustable-rate mortgages
- Most FHA loans are 203(b) loans
- The 203 (b) program can be used for purchase loans or refinancing for residences with up to four units
- Most FHA loans are 203(b) loans
- Instead of one national mortgage limit like Fannie Mae, loan limits will depend on whether a property is in a general or high-cost area
- Seller contributions are limited to 6% of sales price
- FHA rules regarding use of secondary financing depend on whether financing is being used for minimum cash investment or as supplement to make up permitted base loan amount
- FHA underwriting standards aren't as strict as Fannie Mae/Freddie Mac standards
- Insurance premiums for FHA loans are either MMI (mutual mortgage insurance premiums) or MIP (mortgage insurance premiums)
- Upfront premium (UFMIP) is also called "one-time premium" (OTMIP)

Lesson 5: Adjustable Rate Mortgages (Non-Traditional Mortgage Products)

OVERVIEW

The following material will be covered in this lesson:

- The difference between a qualified mortgage and a non-qualified mortgages
- Adjustable Rate Mortgages
- Terminology regarding Adjustable Rate Mortgages
- Different types of Adjustable Rate Mortgages available

LESSON OBJECTIVES

By the end of this lesson students should:

1. Recognize the difference between a qualified mortgage and a non-qualified mortgage
2. Be familiar with what non-traditional mortgage product Adjustable Rate Mortgages are
3. Be familiar with the different terminology used for Adjustable Rate Mortgages
4. Be familiar with the various types of Adjustable Rate Mortgages

Qualified Mortgages vs. Non-Qualified Mortgages

After the housing crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act set minimum standards for mortgages. These standards included the ability to repay rule. The ability to repay rule specifies certain requirements that evidence the borrower will be able to repay the debt incurred from the mortgage loan. Mortgages will be classified under two categories: Qualified Mortgages and Non-Qualified Mortgages.

Those mortgages that meet the various requirements set forth for purchase, guarantee, or insurance by Fannie Mae, Freddie Mac, FHA, VA, or USDA are considered Qualified Mortgages.

The mandatory requirements for all Qualified Mortgages is as follows:

- points and fees less than or equal to 3% of the loan amount (for less than $100,000, higher percentage thresholds are allowed),
- no risky features like negative amortization, interest-only, or balloon loans,
- maximum loan term is less than or equal to 30 years.

Therefore, a qualified mortgage is one that includes a thorough investigation evidencing that the borrower has the ability-to-repay the loan, a limit on debt-to-income ratios, no upfront fees, and no risky features, and no more than 30 years.

As you can see, qualified mortgages are very neat packages, however, not everyone can meet the several requirements necessary for qualified mortgages such as the traditional conventional mortgage loan program. Therefore, as a mortgage loan originator, you must look elsewhere for other mortgage options for your borrowers. These types of loans would fall under the second classification as Non-Qualified mortgages.
Non-qualified mortgages are mortgages that do not fit the qualified mortgage criteria. Non-qualified mortgages do not necessarily have to be high-risk mortgages. These mortgages are simply ones that do not fit the mold of a qualified mortgage.

Most non-qualified mortgages will require non-traditional mortgage products, which we will review in this lesson.

Non-Traditional Mortgage Products

According to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), Non-traditional mortgage products are defined as any mortgage products that are not 30 year fixed rate mortgages.

The most popular of these non-traditional mortgage products is the Adjustable Rate Mortgage (ARM). Unlike Fixed Rate Mortgages where the interest rate does not fluctuate throughout the life of the loan, Adjustable Rate Mortgages involve mortgages in which interest rates change over time. The interest rates for these mortgages change periodically to reflect market conditions. The rate itself can move up or down.

Consumers will choose an adjustable rate mortgage product in order to have smaller payments, initially, than those offered by the traditional fixed rate mortgage products. Usually, consumers that are not making enough money to afford a larger payment will chose an adjustable rate mortgage with the hopes that once the rate adjusts in the future, they will be making more income and therefore be able to afford the payments. Alternatively, consumers may want an adjustable rate mortgage because they plan on only living therefore, a short amount of time and therefore take advantage of the lower initial rate.

With Adjustable Rate Mortgages, an initial interest rate is set for a certain amount of time. Once that time has passed, the interest rate will start adjusting and will continue to do so for the life of the loan. Caps are placed on the rate in order to protect the consumer, however, changes in the interest rate will reflect different monthly payments for the borrower, therefore, it is often impossible to predict what the borrower's monthly payments will be in the future. That said, lifetime caps do exist and prevent the interest rate from increasing past a certain limit.

Adjustable Rate Mortgages

The way that adjustable rate mortgages work is through an index. Adjustable rate mortgages are linked to one of the many indices.

The following is a list of some of the possible indices that an adjustable mortgage is linked to:

- The London Interbank Offered Rate, or LIBOR
    - The LIBOR references a daily rate based on the interest rate which one bank believes it will be offered were it to borrow funds from another bank.
    - These rates usually vary throughout the day.
- The 11th District Cost of Funds Index
    - The 11th District Cost of Funds Index, or COFI, reflects the weighted average interest rate paid by the 11th Federal Home Loan Bank District for savings and checking accounts and the weighted average of the cost of borrowings to member banking institutions of the Federal Home Loan Bank of San Francisco.
    - With this index, interest rates usually lag as they are usually published on the last day of the month and reflect the cost of funds for the prior month.

- Constant Maturity Treasury
    - The Constant Maturity Treasury, or CMT, are the weekly or monthly average yields on United States Treasury securities adjusted to constant maturities of one year.
    - Because these indices move with the market, they are volatile and are very responsive to economic changes.
- The 12 Month Treasury Average Index
    - This index is also known as the 12MTA,
    - This index is calculated by adding the 12 most recently published yields together and dividing the result by 12 and rounding to the nearest 100,000th of one percentage point.
- Certificate of Deposit Index
    - The Certificate of Deposit Index, or CODI, is the 12 month average of the monthly average yields on the nationally published 3-month certificate deposit rates.
    - The index is an annual average; therefore, it is steadier than other indices, particularly the CMT.

Though any of these and other indices are used for Adjustable Rate Mortgages, the London Interbank Offered Rate, the 11th District Cost of Funds Index, and the Constant Maturity Treasury are the most frequently used indices for Adjustable Rate Mortgages.

How Adjustable Rate Mortgages Work

As discussed above, adjustable rate mortgages are attached to an **index.** The index works as the benchmark interest rate that reflects the conditions of the market. The index amount will change based on the market. But, it is not only the index that is at work when determining the borrower's interest rate. Aside from the index, a **margin** is used to calculate the interest rate.

The lender decides which index will be used for the particular mortgages and it is also the lender that sets the margin. The margin will generally not change after the loan is closed. While the margin remains steady, it is the index that changes periodically.

Therefore, the interest rate on an adjustable rate mortgage is set by adding the index and the margin together.

Interest rate = index + margin

For example:

> The index at the time of calculation from the LIBOR index is 2.25%. The lender's margin is 3.00%.
>
> 2.25% + 3.00%= 5.25%
>
> The interest rate at the time is 5.25%.

That said, there are different kinds of adjustable rate mortgages and the adjustment period depends on the terms that are agreed upon with the borrower when getting a mortgage.
The adjustment period is the amount of time where the interest rate will remain the same for an adjustable rate mortgage. These can vary. You can have a 1 year adjustable rate mortgage. This means that the interest rate will remain the same for a year, after which it will change yearly.

You can also have a 3 year adjustable rate mortgage, which means that the interest rate will remain the same for 3 years and after that will adjust yearly. You could also have 5/1 adjustable rate mortgage. This means that for the first five years the rate will remain and starting on the 6 year the interest rate will adjust.

Here is an example of a 5/1 adjustable rate mortgage and how it would work.

You have a 5/1 adjustable rate mortgage. The mortgage has an initial rate of 2.25% and an adjustable rate LIBOR plus 2.5% margin.

This means that for the first 5 years of your mortgage loan, your interest rate, or initial rate, will be 2.25% for the first 5 years. The rate will then adjust starting on the 6th year. When year 6 comes around, the rate will adjust. For this example, let's say that the LIBOR index is 2.5% during this time. That means that your new rate for the mortgage on year 6 is 4.75%.

2.5% (index) + 2.25% (margin) = 4.75%

The mortgage will then adjust again at the beginning of the 7th year. If the LIBOR at this time is 2.75% then the new rate will be 5%.

2.75% (index) + 2.25% (margin) = 5%

This loan will continue to adjust yearly. However, in order to prevent the interest rate to increase too much, there are certain caps put in place to protect the borrower.

Caps and ARMs

Most adjustable rate mortgages include some sort of **cap**. This cap will limit how much a rate can go up in a given time. There are different types of caps. There are lifetime caps, periodic caps, and payment caps.

- The lifetime cap is a cap that limits the amount the interest rate can change during the life of the loan. If a lifetime cap is set, the interest rate cannot exceed the amount of the cap.
  For example: if the initial rate starts out at 3.5% with a lifetime cap of 6%, the rate can never exceed 9.5% over the life of the loan.
- The periodic cap is the cap that limits the amount the interest rate can change during each adjustment period.
  For example: if the current rate is 3.5% and the periodic cap is set at 2%. During the adjustment period, the rate goes up 3%. That means the new rate would be 6.5%, however, this cannot be the case because the periodic cap does not allow an interest rate increase above 2%. Therefore, the interest rate must be 4% or less for it to comply with the cap.
- The payment cap is the cap that limits the amount the monthly payment increases during each adjustment period.
  For example: if you are paying $1500 for your monthly note and your mortgage has a payment cap of 5.5%, your monthly payment can only go up by 5.5% or $82.50. If the payment cap is 5.5%, you multiply your current monthly note of $1500 by 5.5%, which amounts to $82.50. Therefore, your new monthly note can only go as high as $1582.50. Because of the payment cap, the monthly payment can only increase by $82.50 no matter what the index/market conditions are at the time.

ARMs have three identifying numbers. Each of the numbers denote what type of cap the mortgage has. Therefore, if you have a 1/1/6 ARM, the first number means that the initial rate is 1%; the second number means that the adjustment cap for the loan is 1%; and the third number means that there is a 6% lifetime cap on the loan.

Why choose an Adjustable Rate Mortgage?

Many believe that getting an Adjustable Rate Mortgage is not the best choice considering that a borrower's payment will not be consistent throughout the life of the loan, however, there are various benefits to getting a non-traditional mortgage product like the adjustable rate mortgage.

For example, if a borrower intends to stay in their home for a period of 5 years, they can take advantage of the lower initial rate and not worry about the adjustment period. At that point they can sell the house.

Or, if a borrower does not have enough income to make the regular monthly payments from a fixed interest rate, he or she could benefit from the initial lower rate and eventually, during the adjustment period, they will have the income to cover an increased monthly payment.

By that time, the borrower could also refinance into a loan with a fixed rate or another adjustable rate mortgage. Some borrowers may choose to get an adjustable rate mortgage if the property is a short term investment property.

There are various reasons why a nontraditional product like an adjustable rate mortgage may be the best type of mortgage for your client. It is up to you as the mortgage loan originator to figure out which program best suits him or her and there are various different types of adjustable rate mortgages to choose from.

Types of Adjustable Rate Mortgages - Option ARMs

Hybrid Adjustable Rate Mortgages:

Hybrid ARMs are, as the name suggests, a mix or hybrid between a fixed-rate mortgage and an adjustable rate mortgage. Generally, hybrid ARMs involve a fixed interest rate for the first few years of the mortgage followed by a rate that adjust periodically until for the rest of the life of the loan.

For example: a 7/1 ARM means that for the first 7 years of the loan, the interest rate is fixed, while every year after that, the interest rate will adjust. The first number (number 7) denotes the years in which the interest rate will be fixed. The second number (1) denotes how often the interest rate will adjust after the initial fixed rate period.

There are different types of hybrid ARMs. For example, there are 3/1 ARMs where the first three years of the loan the interest rate will remain the same and after that the adjustment in interest rate will occur annually. There are 5/1 ARMs, where for the first five years the interest rate will remain the same, and on the sixth year, adjustments will start taking place annually. There are also 10/1 ARMs, where the interests rate starts adjusting after the tenth year.

Some ARMs you may also see are 2/28 or 3/27 ARMs. Similar to the above, the first number denotes how many years the fixed interest rate period will be, while the second number indicates the number of years left on the loan where the interest rate will be adjustable. Some of these types of hybrid ARMs adjust every 6 months rather than only annually.

Interest-Only Adjustable Rate Mortgages:

Interest-only ARMs have payment plans that enable the borrower to pay only the interest on the mortgage loan for a specified number of years. Usually, the borrower can pay only interest for three to ten years.

The obvious advantage of this non-traditional mortgage product is the fact that the borrower will have smaller monthly payments during the initial period of the mortgage loan.

However, once the initial interest only period expires, the borrower will have an increased monthly payment. Even if the interest rate remains the same, the monthly payments will be larger because the borrower must start paying back the principal and the interest on the mortgage loan each month. It is important to note that the interest rate can change multiple times during the life of an interest-only adjustable rate mortgage loan and that the longer the interest only period lasts, the larger the monthly payment will be after the interest only period ends. It is up to the terms of the particular loan how often the interest rate will adjust.

Though there are obvious advantages for the borrower with an interest-only adjustable rate mortgage, there are some drawbacks. Due to the fact that for the first few years the borrower is only paying for interest, the borrower should be careful and be prepared for payment shock. Payment shock can occur if the mortgage payment increases significantly in a rate adjustment.

In this case, payment shock is likely because once the initial interest only period is over the borrower will have to not only pay for principal and interest but will also have to pay a larger portion of the principal to catch up to what he or she would have paid on the principal had it not only been interest only payments. Additionally, while having to catch up with the principal payments, the interest rates will be adjusting at the same time.

Payment-Option Adjustable Rate Mortgages:

Payment-option ARMs are mortgages that enable the borrower to choose among various payment options monthly. Generally speaking, the interest rate on a payment-option ARM is low for the first few months, after which the rate increases. These types of loans have a recalculation period built-in. These recalculation periods are usually five years where the payment will be recalculated based on the remaining term of the loan.

This way, whatever consequences with regards to loan balance that results from the options the borrower has chosen for their monthly payment will be considered for the mortgage. This will make a little more sense after we review the different options available. There are three options the borrower can choose from: a traditional payment of principal and interest, an interest-only payment, and a minimum payment.

The traditional payment of principal and interest payment option reduces the amount the borrower owes on the mortgage itself. The payment is based on the set loan term, whether it is a 15, 20, 30, or 40 year loan term. In other words, if you have a 15-year loan term the payment will be based on the 15 year fully amortized loan payment. If you have a 30-year loan term the payment will be based on the 30 year fully amortized loan payment.

The interest-only payment option is one where the borrower only pays interest, however, this payment will not reduce the amount the borrower owes on the mortgage.

The minimum payment option enables the borrower to pay less than the amount of interest owed for the month. When choosing this option negative amortization will occur. Negative amortization occurs when payments do not cover the full cost of the interest due for a month and therefore are added to the loan balance, resulting in more debt for the borrower. In other words, when the borrower owes more money than what he or she borrowed.

In the case of the minimum payment option, interest that is not paid during that month has to be paid somehow, therefore it will be added to the principal of the loan, therefore increasing the amount that you owe on the loan. This will also increase the amount of interest you will pay over the life of the loan. With this option, the borrower runs the risk of having to pay a balloon payment. In other words, at the end of the loan term, he or she will have to pay a large extra payment to catch up with what was not paid throughout the life of the loan.

Cash Flow Adjustable Rate Mortgage:

A cash flow ARM is a type of minimum payment option loan. Much like payment-option ARMs, the cash flow ARM enables the borrower to choose their monthly payments from different options. This product is great for borrowers who do not have a large budget monthly but believe they will in the future. This product allows for flexibility in the payment of the monthly mortgage note.

The options for cash flow adjustable rate mortgages are the traditional payment of principal and interest (15 year amortization payment and 30 year amortization payment), the interest-only payment, and the minimum payment. The major difference between cash flow ARMs and payment-option ARMs is that cash flow ARMs do not necessarily adjust.

The minimum payment on a cash flow ARM is generally lower than that of the interest only option, but this can eventually lead to negative amortization as discussed before. Sometimes, lenders will offer discounted rates or teaser rates. These rates are significantly lower than the indexed rate.

The borrower must proceed with caution, as these products usually have these lower rates initially, but have significantly higher rates later as well as fees and points.

It is important, particularly with these types of mortgage loans that you, as the mortgage loan originator, explain the many consequences that these loans can have for the borrower. This includes the possibility of payment shock, balloon payments, and negative amortization.

Convertible Adjustable Rate Mortgages:

Convertible ARMs are adjustable rate mortgages that can essentially be converted, as the name suggests, into fixed rate mortgages.

Convertible ARMs will have certain points in time where the borrower can decide to turn their adjustable interest rate into a fixed interest rate for the rest of the term of the mortgage loan. If the borrower decides to convert their adjustable rate into a fixed one, the original loan documentation provides the formula to set the new rate.

It is important to note that though this product is useful for certain borrowers, they should be aware that the initial rate and upfront fees for a convertible adjustable rate mortgage are higher than those for other types of adjustable rate mortgages. Since this is the case, it may not be the best product for applicants that need an adjustable rate mortgage because they want a smaller monthly mortgage until they are more financially stable.

Terms Related to Adjustable Rate Mortgages

Considering the many consequences attached to the different adjustable rate mortgage products available, certain precautions have been set in place by the industry. We already discussed the availability of payment caps that limit how much the monthly payment can be monthly, periodic caps that limits the amount the interest rate can increase during the adjustment period, and lifetime caps that limit the amount the interest rate can increase during the life of the loan; but there is also what is called an amortization cap.

An amortization cap is a cap on negative amortization. This particular cap limits the total amount the borrower owes on the original loan amount. In other words, the borrower cannot owe more than the amortization cap percentage despite the method chosen on option adjustable rate mortgages.

Usually, the amortization cap limits how much the borrower will owe to 125% of the original mortgage loan. Therefore, if the borrower choses an option ARM and his interest or principal are added to the amount he or she owes, this can only occur and result in 125% of the original loan amount. If the cap has been placed, to be safe, the borrower should pay more on the monthly note in order to not surpass the limit placed by the cap.

Aside from the possibility of negative amortization, possible balloon payments, and payment shock, you should also inform applicants looking into adjustable rate mortgages about possible prepayment penalties.

Prepayment penalties are penalties that may apply to borrowers who pay their mortgage loan balance in full before the term of the loan is over or if they refinance in a short period of time.

A prepayment penalty clause will usually be included in a mortgage loan in order to deter the loss of fees the lender will collect from interest that accrues on the loan. Paying a loan in full prior to the end of the loan term prevents the investor from getting a good return on their investment. Usually the penalty is placed for the first five years of the loan, depending on the type of mortgage loan.

There are two different types of prepayment penalty clauses. The first is a hard prepayment penalty and the second is a soft prepayment penalty.

A hard prepayment penalty means that the borrower will have to pay a penalty if he or she sells or refinances the home before the time frame that was set on the loan documentation.

A soft prepayment penalty means that the borrower will have to pay a penalty if he or she refinances the loan within the time frame set on the loan documentation. However, there will be no extra fees incurred if the home is sold.

You should inform applicants that prepayment penalties are not mandatory. The borrower, with your help and together with the lender, what time frame will be set on the loan documentation. The borrower could set a 1 year term, 2 year term, 3 year term, 4 year term, or 5 year term for the prepayment penalty to be administered. If the borrower intends to stay in the property for a long period of time, a prepayment penalty will have no negative effect for the borrower, however, those expecting to remain in the home for a short period of time should prefer a soft prepayment penalty or none at all.

CONCLUSION

Not all borrowers fit the criteria necessary to get a fixed rate mortgage. For those borrowers that need a different kind of product, adjustable rate mortgages come in various shapes and sizes.

It is up to you as the mortgage loan officer to disclose as much information as you can regarding the options available to them. Adjustable rate mortgages can be a great benefit to the consumer, however, as we discussed, there are various different consequences that the consumer must be made aware.

Now that we can discussed adjustable rate mortgages we can move on to discuss other nontraditional mortgage products available in the mortgage lending industry.

SUMMARY

After the housing crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act set minimum standards for mortgages.
The new regulatory reform also states that as of January 1, 2014, mortgages will be classified under two categories: Qualified Mortgages and Non-Qualified Mortgages.

The mandatory requirements for all Qualified Mortgages is as follows:
- points and fees less than or equal to 3% of the loan amount (for less than $100,000, higher percentage thresholds are allowed),
- no risky features like negative amortization, interest-only, or balloon loans,
- maximum loan term is less than or equal to 30 years.

Qualified mortgages are delivered in very neat packages, however, not everyone can meet the several requirements necessary for qualified mortgages such as the traditional conventional mortgage loan program.

Those that do not fit the qualified mortgage criteria are categorized under the Non-Qualified Mortgage criteria. Non-qualified mortgages do not necessarily have to be high-risk mortgages. These mortgages are simply ones that do not fit the mold of a qualified mortgage.

Most non-qualified mortgages will require nontraditional mortgage products.

Non-Traditional Mortgage Products:

- According to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), Non-traditional mortgage products are defined as any mortgage products that are not 30 year fixed rate mortgages.
- The most popular of these non-traditional mortgage products is the Adjustable Rate Mortgage (ARM).
- Unlike Fixed Rate Mortgages where the interest rate does not fluctuate throughout the life of the loan, Adjustable Rate Mortgages involve mortgages in which interest rates change over time. The interest rates for these mortgages change periodically to reflect market conditions. The rate itself can move up or down.

With Adjustable Rate Mortgages, an initial interest rate is set for a certain amount of time. Once that time has passed, the interest rate will start adjusting and will continue to do so for the life of the loan. Caps are placed on the rate in order to protect the consumer, however, changes in the interest rate will reflect different monthly payments for the borrower, therefore, it is often impossible to predict what the borrower's monthly payments will be in the future.

Adjustable Rate Mortgages- How they work

- Adjustable rate mortgages are linked to one of the many indices.
- The following is a list of some of these indices:
  - The London Interbank Offered Rate, or LIBOR
  - The 11th District Cost of Funds Index
  - Constant Maturity Treasury
  - The 12 Month Treasury Average Index
  - Certificate of Deposit Index

The most popular of these indices are the London Interbank Offered Rate, the 11th District Cost of Funds Index and the Constant Maturity Treasury.

The index works as the benchmark interest rate that reflects the conditions of the market. The index amount will change based on the market. But, it is not only the index that is at work when determining the borrower's interest rate. Aside from the index, a **margin** is used to calculate the interest rate.

The lender decides which index will be used for the particular mortgages and it is also the lender that sets the margin. The margin will generally not change after the loan is closed. While the margin remains steady, it is the index that changes periodically.

To calculate the interest rate on an adjustable rate mortgage, you add the interest and the margin together.

Interest rate = index + margin

The interest rate will be recalculated when the loan's interest rate is adjusted.

The adjustment period is the amount of time where the interest rate will remain the same for an adjustable rate mortgage. These can vary. It will depend on the type of ARM what the adjustment period will be. For example, if it is a 5/1 ARM, the interest rate will adjust annually after the initial five years on the mortgage loan. If it is a 7/1 ARM the interest rate will adjust annually after the first seven years on the mortgage loan.

During the term of mortgage loan, the margin will remain the same, while the index changes with the market conditions.

Caps and ARMs

- Most adjustable rate mortgages include some sort of **cap**. This cap will limit how much a rate can go up in a given time. There are different types of caps. There are lifetime caps, periodic caps, and payment caps.
- The lifetime cap is a cap that limits the amount the interest rate can change during the life of the loan.
- The periodic cap is the cap that limits the amount the interest rate can change during each adjustment period.
- The payment cap is the cap that limits the amount the monthly mortgage payment increases during each adjustment period.
- Adjustable Rate Mortgages can have three identifying numbers:
  - the first signifies the initial rate
  - the second signifies the adjustment cap
  - the third signifies the lifetime cap
- For example: if you have a 1/1/6 ARM, the initial rate is 1%, the adjustment cap is 1%, and the lifetime cap is 6%.

Different Types of ARMs: There are various reasons why an adjustable rate mortgage is a good product for a borrower. Some borrowers need a product that will allow them to have flexible monthly payments. Some borrowers may need a product that allows them to pay less with the hopes that their income will increase by the time the interest rate adjusts. Some borrowers may want to take advantage of the lower initial rate because they know that they will sell the house or refinance eventually. For whatever the case may be, there are various different kinds of adjustable rate mortgages.

Hybrid ARMs

- these adjustable rate mortgages are a mix between adjustable rate mortgages and fixed rate mortgages.
- these mortgages usually involve a fixed interest rate for the first few years of the mortgage loan followed by a rate that adjust periodically for the rest of the life of the loan.

Examples of hybrid ARMs are 7/1 ARM, 2/28 ARM, 3/27 ARM.

- for a 7/1 ARM, the first seven years carry a fixed interest rate and starting the 8th year the interest rate adjust annually.
- for the 2/28 ARM, the first two years carry a fixed interest rate and the following 28 years the rate will adjust periodically.
- for the 3/27 ARM, the first three years of the loan will carry a fixed interest rate while the 27 years thereafter will carry an interest rate that will adjust periodically.

Some hybrid ARMs adjust every 6 months rather than only annually.

Interest-Only ARMs

- these mortgages enable the borrower to pay only the interest on the mortgage loan for a specified number of years
- usually the borrower can pay just the interest rather than the principal for three to ten years

The obvious advantage of this nontraditional mortgage product is the fact that the borrower will have smaller monthly payments during the initial period of the mortgage loan. However, once the initial interest only period expires, the borrower will have an increased monthly payment.

It is important to note that the interest rate can change multiple times during the life of an interest-only adjustable rate mortgage loan and that the longer the interest only period lasts, the larger the monthly payment will be after the interest only period ends. It is up to the terms of the particular loan how often the interest rate will adjust.

It is also important to note that the borrower runs the risk of payment shock because the borrower will have to not only pay for principal and interest but will also have to pay a larger portion of the principal to catch up to what he or she would have paid on the principal had it not only been interest only payments. Additionally, while having to catch up with the principal payments, the interest rates will be adjusting at the same time.

Payment-Option Adjustable Rate Mortgages

- these mortgages enable the borrower to choose among various payment options monthly
- there are three different options to choose from
    - the traditional payment of principal and interest (15 year term or 30 year term)
    - the interest only payment
    - the minimum payment

The minimum payment option enables the borrower to pay less than the amount of interest owed for the month. When choosing this option negative amortization could occur.

Negative amortization occurs when payments do not cover the full cost of the interest due for a month and therefore are added to the loan balance, resulting in more debt for the borrower. In other words, when the borrower owes more money than what he or she borrowed.

Cash Flow Adjustable Rate Mortgage

- this type of mortgage is a type of minimum payment option loan
- like payment-option ARMs, the cash flow ARM enables the borrower to choose their monthly payments from different options (minimum payment, traditional principal and interest payment, and interest only)
- the major difference between the payment option ARM and the cash flow ARM is that the cash flow ARM does not necessarily adjust.

It is important, particularly with these types of mortgage loans that you, as the mortgage loan originator, explain the many consequences that these loans can have for the borrower. This includes the possibility of payment shock, balloon payments, and negative amortization.

Convertible Adjustable Rate Mortgages

- these mortgages are adjustable rate mortgages that can essentially be converted, as the name suggests, into fixed rate mortgages
- these mortgages will have set certain points in time where the borrower can decide to turn their adjustable interest rate into a fixed interest rate for the rest of the term of the mortgage loan

It is important to note that though this product is useful for certain borrowers, they should be aware that the initial rate and upfront fees for a convertible adjustable rate mortgage are higher than those for other types of adjustable rate mortgages.

Terms Related to Adjustable Rate Mortgages

- payment caps- limit how much the monthly payment can increase per month
- periodic caps- limit how much the interest rate can increase during adjustment periods
- lifetime caps- limit how much the interest rate can increase over the entire term of the mortgage loan
- amortization cap
    - limits how much the borrower will owe over the original loan mount
    - will prevent the amount of negative amortization

These caps exist to protect the borrower.

MLOs should make sure to explain these to their customers.

- prepayment penalties- penalties in place in case the borrower pays his or her loan balance in significantly less time than the term of the loan. Two types of prepayment penalties:
    - Hard prepayment penalties penalize the borrower if he or she sells or refinances the home prior to the time frame allotted in the initial documentation.
    - Soft prepayment penalties penalize the borrower if he she refinances the home within the time allotted on the documentation. However, if the borrower sells the home, he or she will not incur extra fees.

Lesson 6: Ethics and Fraud in Real Estate Finance I

OVERVIEW

In this section of the course we will go over ethics, fraud, and consumer protection laws pertaining to the real estate industry. We will begin by defining ethics and discussing what constitutes ethical behavior in general and in business. We will also define fraud and review different types of fraud one can encounter in the mortgage industry. Lastly, we will review some of the laws that are in place to prevent fraudulent behavior and provide consumer protection.

LESSON OBJECTIVES

By the end of this lesson, students should:

- Know the definition of ethics and what constitutes ethical behavior
- Recognize different types of fraud in the industry
- Understands why the Identity Theft Rules and the Telemarketing Rules are important

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.

ETHICS

What is ethics?

The meaning of ethics is difficult to describe. People have different ideas of what ethics are. For instance, someone may say that ethics has to do with feelings of right or wrong. Others believe that ethics has to do with what the law requires us to do. And, other, believe that ethics has to do with religion and religious beliefs.

According to Merriam-Webster Dictionary, Ethics are the rules of behavior based on ideas about what is morally good and bad. Furthermore, ethics are a set of moral principles that, individually or as part of a larger group, we use to determine what we believe is good or bad. Therefore, ethics addresses questions about what we believe to be moral and what we believe is not moral.

You may think of these as the rules of conduct that are recognized in society. If you lie to someone in order to gain something for yourself, you may think of this as unethical. In other words, lying for self-gain would be viewed as unethical because in society, the standards of behavior that are most widely accepted denote that truth is morally good and lying as morally bad or wrong.

I suppose we really should define what moral is before we can truly understand what ethics means, as usually these two words go hand in hand. Going back to the Merriam-Webster dictionary, moral is defined as relating to principles of right and wrong behavior or conforming to a standard of right behavior. Therefore, whether we are talking about ethics or morals, we are dealing with the difference between right and wrong or good and evil.

From either definition, we can denote that, despite the fact that there are no written rules stating exactly what is ethical or moral and what is unethical and immoral, there are common standards and principles in society that allow us to come to a conclusion regarding what behavior is ethical and what behavior is unethical.

How to recognize ethical behavior vs. unethical behavior…

From the definitions we just went over, we know that ethics has to do with right and wrong or good and evil.

A good rule of thumb is to determine whether a behavior is unethical or ethical is to ask yourself some questions. First and foremost, you should ask yourself how you would feel if the action you are taking where taken by someone else to you? In other words, if someone were doing this to you, would you be ok with it? Would you think that this particular behavior is right or wrong? Would you think this action was the "right thing" to do?

If you answer yes to these questions, then chances are that you are behaving ethically. If you answered no to these questions, then you are most likely behaving unethically.
Example:

> Samantha comes to your office and states that she would like to know about the mortgage lending process but does not intend to purchase a house for another year.

Scenario 1:

> You are swamped and really don't have much time on your hands, so you tell her that there is no need to find out about the process until she intends to purchase a home.

Scenario 2:

> You explain to her that you would be more than happy to assist and educate her of the process but ask whether she can set an appointment on another day because you are swamped. You also let her know that if she would like to see someone right away, she is more than welcome to ask one of your co-workers.

In which scenario do you think you behaved the most ethically?

If you said scenario 2, you are correct. Scenario 1 was a rather selfish way to behave. You should always think about what is best for the consumer. Again, if you were to put yourself in her position, you would want someone to help you and not act in accordance to what is best for them.
In the mortgage lending business, you should always strive to behave ethically.

Ethics and Business

In order to run a business ethically, most have a code of ethics or guidelines that ensure employees and those working within the business are behaving ethically.

Generally, a handbook or code of ethics or conduct book will be available to employees and should be reviewed by employees. This will guarantee that consumers will be treated fairly and that employees will work in the best interest of the consumers.

Following the law and abiding by the business' code of ethics will enable a good working environment and growth in business. Furthermore, behaving ethically and in the best interest of the consumer will build your own reputation, which is something only you can do for yourself.

Your job as a mortgage loan originator is to inform consumers on the mortgage loan process and always treat consumers fairly in a non-discriminating fashion. Your duty is to act in the best interest of the consumer. Behaving ethically will enable you to do just that.

Part of behaving ethically is to make sure that the consumer knows that his/her information is confidential and, therefore, you will not be sharing that information with anyone outside of what you disclose to your consumer. For example, you will certainly have to share their information with an underwriter or investor, however, you should not be sharing their information with anyone else, including their real estate agent. The consumer should be the only party deciding with whom their information can be shared.

If, at any point in the mortgage lending process, a third party asks you for information on a consumer, you should direct them to the consumer directly rather than providing their information.

FRAUD

Now that we are clear on what ethical behavior entails, we should talk about what unethical behavior can end up becoming. If one is not behaving ethically in the mortgage lending business, one runs the risk of committing fraud. Fraud, in the mortgage lending industry, is, unfortunately, a common occurrence.

Fraud, according to Merriam-Webster, is defined as intentional perversion of truth in order to induce another part with something of value or to surrender a legal right. Fraud can also be defined as an act of deceiving or misrepresenting, which includes a person pretending to be someone he/she is not. Therefore, fraud includes any type of deceit or misrepresentation that is done on purpose and sometimes, as we will discuss later, even when not done purposefully.

Fraud in the Mortgage Lending Industry

Let's take a look at what fraud looks like in the mortgage lending business.
Fraud is a very serious offence in the mortgage lending industry. In fact, in some cases it can be considered a felony and will include penalties such as fines, financial restitution, suspension of your mortgage origination license, or even the loss of your mortgage origination license.

There are various Federal laws put in place in order to prevent unethical behavior in lending. Below is a list of some of these laws.

- The Home Mortgage Disclosure Act, or HMDA [Regulation C 12 CFR, Part 1003] requires financial institutions to maintain, report, and publicly disclose information about mortgages in order to show that lenders are serving the housing needs of their communities.
- The Real Estate Settlement and Procedures Act, or RESPA [FDIC Law, Regulations, Related Acts, 6500 – Consumer Protection, Part 1024 – Real Estate Settlement Procedures, RESPA, Regulation X, 12 CFR, Part 1024] requires lenders and mortgage brokers to provide borrowers with pertinent and timely disclosure regarding the costs of the settlement process.

- The Home Ownership and Equity Protection Act, or HOEPA [Section 32] was enacted as an amendment to TILA to address abusive practices in refinances and closed-end home equity loans with high interest rates or high fees.
- The Equal Credit Opportunity Act, or ECOA [Regulation B 12 CFR §1002.1(b)] was enacted to prohibit by law the discrimination of any applicant based on race, color, religion, national origin, sex, marital status, or age from the part of a creditor.
- The Truth in Lending Act, or TILA [Bureau of Consumer Financial Protection – 12 CFR Chapter X, Part 1026 – Truth in Lending – Regulation Z)] requires full disclosure of the terms and conditions of finance charges in credit transactions or offers to extend credit and also gives consumers the right of rescission.
- The Gramm-Leach-Bliley Act, or the GLBA or Modernization Act [Gramm-Leach-Bliley Act, Regulation P 15 USC, Subchapter I Sec.6801-6809, Disclosure of Nonpublic Personal Information] requires financial institutions to safeguard private/personal data as well as explain their information-sharing practices to consumers.

All of these laws are in place to prevent unethical and fraudulent behavior.

Aside from these laws, Fannie Mae and Freddie Mac have established practices for fraud prevention that are available to the public. In an effort to create quality control strategies, they suggest training employees to detect and prevent fraud, run regular updates on compliance, updates on fraud detection practices, and updates on the most recent red flag situations. It is imperative to continue to educate oneself of the newest fraud cases in order to remain aware of what to look for when conducting a mortgage loan transaction. Fraud prevention education should be present for all persons involved in the loan process in order to ensure the most ethical behavior.

Different Types of Fraud in the Mortgage Lending Industry

As stated earlier, fraud can be defined as behavior that is deceptive or misleading. People can be deceptive and misleading in a number of areas when it comes to the loan process. This is why there are several different types of fraud that loan originators and everyone else involved in the loan process must become aware of.

A particular type of fraud within the mortgage lending industry involves a person acting as though he/she is the consumer or borrower, when in reality the homeowner will be somebody else. This is called a **Straw Borrower**. Usually, a mortgage loan originator will experience this because the real consumer does not qualify for a mortgage loan. In order to receive a mortgage loan, he/she asks someone else who has good credit and a proper income-to-debt ratio in order to qualify for a mortgage loan. Therefore, someone else is purchasing a property on behalf of a different person.

A straw borrower is considered fraud when the real borrower or consumer does not have the income or credit history needed, does not occupy the subject property as a principal residence, is not a legal alien, is not eligible for a special purpose loan, and/or intends to use the subject property to flip and profit.

Fraud can also occur when a builder is having trouble moving property and use different tactics in order to move the property. They may use a relative to secure a “fake sale” or even offer fake bargains such as no money down. This particular type of fraud is called **builder bailout**. Generally, one can assume that there is builder bailout occurring when the consumer’s source of funds is questionable or if the consumer and builder are related or affiliated in some way. In order to prevent this type of fraud, one should review all documents thoroughly with the purpose of finding any kind of deception or misrepresentation.

There can also be fraud in property flipping. Though flipping a property is not illegal, when a flip occurs multiple times in a short span of time, illegal flipping is most likely occurring. This is called **flips fraud**. Flipping as well as Illegal flipping happens when a home is purchased at an inflated appraised value.

Fraud within the property flip occurs when the seller and appraiser inflate the value of the home, therefore convincing the borrower that the house is worth more money. This will ensure profit for the sellers and negative equity for the new homeowners. Fraud within the property flip can also occur when renovations that have not been made are listed as having been made, therefore adding value to the property that really does not exist. Here, too, the borrower believes the property is worth more than its real value.

Mortgage loan originators and lenders should be aware of whether multiple changes of ownership in a short period of time have occurred with a single property, if the appraised value increases every time there is an appraisal, if the seller is not actually listed on the property title, if the seller has only own the property for a very short time, and/or if the seller and borrower are affiliated or related. Any of the above could be signs that flips fraud is present.

When loans have no underlying collateral for loan security, and therefore the only thing securing a loan is “air” then **air loan fraud** is being committed. In this case, the property and the borrower are both made up. Once the loan goes into default, the lender will have no recourse as they will have lost everything. This mortgage fraud scheme is usually made by a mortgage broker in order to ear profit from a completed loan transaction.

In order to prevent air loan fraud, the lender or other mortgage loan personnel should pay attention to whether or not there is a chain on the title on the property that cannot be validated, whether or not there is a real estate agent involved, or whether mortgage payments are not made the supposed borrower.

Another, unfortunately common, form of fraud is **Identity Theft**. This particular type of fraud is widely known across multiple industries as it occurs all the time. Identity fraud occurs when a person steals someone else’s identity, including social security number, bank account numbers, credit card numbers, and other private and sensitive information, for personal gain.

One of the reasons why identity fraud or theft is very common is the fact that financial information is very easy to obtain. Due to the ease at which people can steal other people’s sensitive information, there are several laws in place in the mortgage loan industry that make it mandatory to take the proper precautions to safeguard consumer’s sensitive information.

Other areas that are subject to fraud also include **credit fraud**. In the mortgage lending industry, credit fraud comes into play with the credit report. There are times where personal information will not be consistent on the original mortgage loan application and the credit report itself. One should always make sure that the social security, name, and other pertinent information matches on the various documents, including the credit report. Also, always check to see that the consumer's credit history is consistent with the consumer's income, employment and age.

Another type of fraud is **affinity fraud**. Affinity frau occurs when members of a group are involved in activities such as foreclosure rescues or investment property schemes. Unfortunately, these groups are able to get away with this type of fraud because they develop a level of trust amongst the membership.

There are certain times where fraud can be committed in the sales contract. This is called **sales contract fraud**. The sales contract is a binding agreement made by all parties involved in the sale and purchase of a property. Within the sales contract, you will find the conditions stipulated by each party, the amount of the deposit placed (otherwise known as the earnest money deposit), the sales price, the closing date, the closing costs to be paid by each party, and the acceptance of the offer made by the purchaser to the seller.

When reviewing a sales contract, you should check to make sure that the borrower' name is the same as the purchaser, the sales price is around that of market value, that realtors are involved (though sometimes this is not the case, for instance with a for sale by owner), or that a second mortgage is shown. If either of these is found, it would raise some red flags.

Fraud can also be committed during the process of taking application. **Application Fraud** denotes that at somewhere in the application there is erroneous information. One should review the application along with accompanying documents to make sure that all information matches and that no red flags are raised.

Application Fraud can include any type of information on the loan application. For instance, employment information, income information, name, social security number, date of birth, subject property sales price, assets, bank account information, etc.… A good rule of thumb is to double-check what the client mentioned during application with all of the supporting documents provided.

More Types of Fraud

Fraud in the form of expression, omission, concealment or misrepresentation can be considered a felony. The Federal Bureau of Investigation lists two main categories of mortgage fraud. The first category is **Fraud for Profit**. Fraud for profit is generally committed by people in the mortgage lending industry, as they have more to gain in the context of profit. The second is category is **Fraud for Housing**. Fraud for housing is generally committed by the consumer as it involves acquiring a house under false pretenses.

Fraud for Profit

Fraud for profit is as it sounds. It involves an individual or individuals that deceive or misrepresent in order to gain something. Among other things, fraud for profit entails an individual committing fraud in order to inflate the value of a property, an individual that intends to remove the equity in the property, an individual that intends to abandon the property as well as the mortgage payments, or individuals that provide false income and credit information in order to obtain a mortgage loan.

Generally, fraud for profit may be committed by an appraiser, mortgage loan originator, a real estate agent, an underwriter, or a processor. It is also possible that the consumer is aware of the fraudulent behavior.

Fraud for Housing

Fraud for housing involves a consumer getting a mortgage loan under false pretenses or by falsifying one or some of the many documents needed to get a mortgage loan.

Within this type of fraud, there are four categories. The first category is **occupancy fraud,** which entails a consumer that tries to get a mortgage loan for an investment property, but states that the property will be their primary residence.

The second category is **asset or down payment fraud**, which entails the consumer falsifying or omitting information regarding the funds for closing or for their down payment. The third category is **income fraud**, which entails a consumer falsifying or misrepresenting his/her income or employment. The fourth category is **appraisal fraud**, which entails any misrepresentation of an appraisal.
We will now discuss these in more detail.

Occupancy Fraud

As stated before, generally occupancy fraud involves an individual who acquires a mortgage loan for a property under false pretenses. The individual may tell the mortgage loan originator that the intention for the mortgage is to have a primary residence. However, the true intention for obtaining a mortgage is to acquire an investment property, which will allow the consumer to get lower rates, as rates for investment property are higher than those for primary residences or second homes.

Investment properties also have capital gains taxes and by stating that the property is a primary residence will prevent the consumer from having to pay these.

Therefore, occupancy fraud is committed when a borrower attempts to get a mortgage loan and purposely provides false information in order to obtain the mortgage loan.

Asset or Down Payment Fraud

Asset or down payment fraud is committed when the consumer misrepresents where the funds come from for the down payment or closing costs.

In order to avoid asset or down payment fraud, a Verification of Deposits and the most recent 60 day bank statements should be used. A Verification of Deposits will enable the lender to determine if there are any large increases in the statement or a new account opened.

If this is the case, the consumer will have to explain why there are large increases in their bank statements or why there was a new account that was opened. It is important to note that no information on the statement is crossed out, that the name of the consumer is on the statement, that fees have not been collected for insufficient funds, and that white-out has not been used. Generally, if one of these is present, the consumer could be committing asset or down payment fraud.
The rule of thumb in all matters during the mortgage loan process is “verification is key.”

Income Fraud

Income fraud occurs when a borrower has misrepresented his or her income in some way. For example, he/she may state that their gross monthly income is higher than it actually is, or he/she may say that he/she is not self-employed, but rather a salaried or hourly wage employee, etc.… There are several stages in the income verification process where income fraud could occur.

In order to determine the consumer's true income, the mortgage loan originator must collect the most recent two years tax returns, W2s and/or 1099s. Not only will these tax returns serve as proof of income, but additionally, an IRS tax transcript will be ordered to verify that the consumer has not omitted or changed anything on his/her tax returns. Furthermore, information on the last two years of employment history will be gathered as well as the consumers 30 day pay check stubs.

If there are any gaps in employment history, these will have to be explained by the consumer in a letter of explanation. Their employment history will be verified with an Verification of Employment, which will be mailed to the consumer's employer. The pay check stubs will also indicate the fact that the consumer is employed and how much he/she makes during a pay period.

Despite the verifications involved, the mortgage loan originator should make sure to review all paperwork gathered for items that are crossed out, hand written, whited out, etc., in order to prevent income fraud. The loan originator can also conduct research online to determine whether the employer or business does exist and that the information online matches that provided by the consumer.

Appraisal Fraud

Appraisal Fraud occurs when there is a misrepresentation of an appraisal. Generally, this will entail a misrepresentation of value for a particular property. An appraiser may feel pressured by a loan officer to add value to a property in order to later collect some form of profit.

In order to avoid appraisal fraud, mortgage loan originators or lenders should review the appraisal content thoroughly. One should look for differences in pricing between the subject property and the surrounding properties, or differences in the subject property and its comparables.

As with any type of fraud, again, verification is key for prevention.

As you can see, there exists many types of fraud. The previous examples are of fraud in activities involved in mortgage lending. There are various other types of fraud that exist that were not mentioned here. Now, more than ever, government and financial institutions are coming together to determine new ways in which they can protect customers from fraud, specifically identity theft. We will next discuss some of the provisions in federal laws that pertain to the issue of identity theft.

THE FAIR CREDIT REPORTING ACT

Let's review some of the laws that are in place to prevent the incidence of fraud in this industry.

Identity theft, or the fraudulent use of a person's private identifying information for financial gain, is a prevalent problem. As our technology becomes more advanced as well as more accessible, the problem appears to become worse. It is part of a mortgage loan originator's duty to try to verify that the information given is truthful. There are various laws in place to help us do so.

The Fair Credit Reporting Act (FCRA) is meant to promote the accuracy, fairness, and privacy of consumer information pertaining to consumer reporting agencies. Part 681 of the Act lists the Identity Theft Rules. This section of the law delineates the duties regarding the detection, prevention, and mitigation of identity theft. [16 C.F.R. §681.1].

The law requires that financial institutions or creditors that offer or maintain one or more covered accounts must develop and implement a written Identity Theft Prevention Program. [16 C.F.R. §681.1(d)] The program should be designed to combine existing policies and procedures and other arrangements to control foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft.

The Identity Theft Prevention Program itself must include reasonable policies and procedures to do the following: [16 C.F.R. §681.1(2)(i)(ii)(iii)(iv)]

- Identify relevant Red Flags for the covered accounts that the financial institution or creditor offers or maintains or incorporate those Red Flags into its Identity Theft Prevention Program.
- For the purposes of these provisions, "covered account" means: [16 C.F.R. 681.1 (3)(i)(ii)]
    - An account that a financial institution or creditor offers or maintains, primarily for personal, family or household purposes, that involves or is designated to permit multiple payments or transactions, such as a credit card account, mortgage loan, automobile loan, margin account, cell phone account, utility account, checking account, or savings account.
    - This also includes any other account that financial institutions or creditors offers or maintains for which there is reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.
- Detect Red Flags that have been incorporated into the Identity Theft Prevention Program of the financial institution or creditor.
- Respond appropriately to any Red Flags that are detected to prevent and mitigate identity theft.
- Ensure the Identity Theft Prevention Program is updated periodically in order to reflect changes in the risk to customers and the safety and soundness of the financial institution or creditor from identity theft.

The law also requires that financial institutions and creditors that must have an Identity Theft Prevention Program must also have continued administration of the program and should obtain approval of the initial written program from either the board of directors or an appropriate committee of the board of directors.

> For the purposes of this legal requirement, board of directors means the managing official in charge of the branch or agency of a foreign bank or the board of directors of a creditor. If there is no board of directors, there should be a designated employee at the level of senior management. [16 C.F.R. 681.1(2)(i)(ii)]

The board of directors, appropriate committee of the board of directors, or designated employee must become involved in the oversight, development, implementation and administration of the program. They must also train staff, as necessary, to implement the Identity Theft Prevention Program. Furthermore, the administration of the program must exercise appropriate and effective oversight of service provider arrangements.

<u>How should the Identity Theft Prevention Program operate?</u>

With regards to what the Identity Theft Prevention Program actually does in order to prevent identity theft, Appendix A of Part 681 of the Fair Credit Reporting Act provides specific guidelines intended to aid in the formulation of an appropriate Identity Theft Prevention Program. The Appendix denotes how these Programs should identify relevant red flags, detect red flags, prevent and mitigate identity theft, continually provide updates for the programs in place, and how the programs should be administered. We will review what the guideline provides below.

The guideline states the following:

- Identifying Relevant Red Flags:
    - Risk Factors: A financial institution or creditor should consider the following factors in identifying relevant Red Flags for covered accounts:
        - The types of covered accounts it offers or maintains
        - The methods it provides to open its covered accounts
        - The methods it provides to access its covered accounts
        - Its previous experiences with identity theft
    - Sources of Red Flags: Financial institutions and creditors should incorporate relevant Red Flags from sources such as:
        - Incidents of identity theft that the financial institution or creditor has experienced.
        - Methods of identity theft that the financial institution or creditor has identified that reflect changes in identity theft risks.
        - Applicable supervisory guidance.
    - Categories of Red Flags: The Identity Theft Prevention Program should include relevant Red Flags from the following categories:
        - Alerts, notifications, or other warnings received from consumer reporting agencies or service providers, such as fraud detection services
        - The presentation of suspicious documents
        - The presentation of suspicious personal identifying information, such as a suspicious address change
        - The unusual use of, or other suspicious activity related to, a covered account
        - Notice from customers, victims of identity theft, law enforcement authorities, or other persons regarding possible identity theft in connection with covered accounts held by the financial institution or creditor

- Detecting Red Flags:
    - The Identity Theft Prevention Program should have policies and procedures that address the detection of Red Flags by:
    - Obtaining identifying information about, and verifying the identity of, a person opening a covered account.
    - Authenticating customers, monitoring transactions, and verifying the validity of change of address requests, in the case of existing covered accounts.
- Preventing and Mitigating Identity Theft
    - Policies and procedures in the Identity Theft Prevention Program should provide for responses to Red Flags that are detected.
        - In order to determine what the response should be, the financial institution or creditor should consider aggravating factors that may heighten the risk of identity theft, such as data security incident that results in unauthorized access to a customer's account records, or notice that a customer has provided information related to a covered account to someone fraudulently claiming to represent the financial institution or creditor or to a fraudulent website.
        - Appropriate responses include the following:
            - Monitoring a covered account for evidence of identity theft;
            - Contacting the customer;
            - Changing any passwords, security codes, or other security devices that permit access to a covered account;
            - Reopening a covered account with a new account number;
            - Not opening a new covered account;
            - Closing an existing covered account;
            - Not attempting to collect on a covered account or not selling a covered account to a debt collector;
            - Notifying law enforcement; or
            - Determining that no response is warranted under the particular circumstances.
- Updating the Program
    - Financial Institutions and creditors must update their Identity Theft Prevention Program periodically.
    - The updates are meant to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft, based on factors such as:
        - The experiences of the financial institution or creditor with identity theft;
        - Changes in methods of identity theft;
        - Changes in methods to detect, prevent, and mitigate identity theft;
        - Changes in the types of accounts that the financial institutions or creditor offers or maintains; and
        - Changes in the business arrangements of the financial institution or creditor, including mergers, acquisitions, alliances, joint ventures, and service provider arrangements.

With regards to administering the program, Appendix A also provides specific guidelines on how to do so.

- Oversight of Program: Oversight of the Program is the responsibility of the board of directors, an appropriate committee of the board of directors, or a designated senior-level employee. Oversight should include:

  - Assigning specific responsibility for the Program's implementation;
  - Reviewing reports prepared by staff regarding compliance by the financial institution or creditor with the provisions found in §681.1.
  - Approving material changes to the Program as necessary to address changing identity theft risks.

- Reports:
  - The staff of the financial institution must provide the board of directors or those responsible for oversight of the Program a report at least once a year regarding compliance by the institution or creditor with the provisions found in §681.1.
  - The report should address material matters related to the Program and evaluate issues such as:
    - The effectiveness of the policies and procedures in place addressing the risk of identity theft in connection with opening covered accounts and with respect to existing covered accounts
    - The service provider arrangements
    - Significant incidents involving identity theft and management's response
    - Recommendation for material changes to the program
- Oversight of Service Provider Arrangements. Whenever a financial institution or creditor engages a service provider to perform an activity in connection with one or more covered accounts the financial institution or creditor should take steps to ensure that the activity of the service provider is conducted in accordance with reasonable procedures designed to detect, prevent, and mitigate risk of identity theft.

  For example, a financial institution or creditor could require that the service provider by contract have policies and procedures to detect relevant Red Flags that may arise in the performance of the service provider's activities, and either report the Red Flags to the financial institution or creditor or take the appropriate steps to prevent or mitigate identity theft.

Examples of Red Flags

Appendix A guidelines also include a supplement that lists some examples of the types of Red Flags that financial institutions and creditors might encounter and should become aware of. Let's go over that list now, as it is useful to know some of the scenarios we should equate as Red Flags.

You can find all of the following information under Title 16, Chapter I, Subchapter F, Appendix A to Part 681 on the government publishing office website at www.ecfr.gov.

Financial institutions or creditors might encounter the following and should note it as a Red Flag:
- A fraud or active duty alert is included with a consumer report.
- A consumer reporting agency provides a notice of credit freeze in response to a request for a consumer report.
- A consumer reporting agency provides a notice of address discrepancy.
- A consumer report indicates a pattern of activity that is inconsistent with the history and unusual pattern of an applicant or consumer, such as:
  - a recent and significant increase in the volume of inquiries
  - an unusual number of recently established credit relationships

    - a material change in the use of credit, especially with respect to recently established credit relationships
    - an account that was closed for cause or identified for abuse of account privileges by a financial institution or creditor

With regards to examples of possible suspicious documents financial institutions or creditors might encounter and should mark as a Red Flag, the supplement states the following:

- Documents provided for identification appear to have been altered or forged.
- The photograph or physical description on the identification is not consistent with the appearance of the applicant or customer presenting the identification.
- Other information on the identification is not consistent with information provided by the person opening a new covered account or customer presenting the identification.
- Other information on the identification is not consistent with readily accessible information that is on file with the financial institution or creditor, such as a signature card or a recent check.
- An application appears to have been altered or forged or gives the appearance of having been destroyed and reassembled.

With regards to examples of suspicious personal identifying information financial institutions or creditors might encounter and should mark as a Red Flag, the supplement states the following:

- Personal identifying information provided is inconsistent when compared against external information sources used by the financial institution or creditor. For example:
    - the address does not match any address in the consumer report; or
    - the Social Security Number has not been issued, or is listed on the Social Security Administration's Death Master File
- Personal identifying information provided by the customer is not consistent with other personal identifying information provided by the customer. For example: there is a lack of correlation between the Social Security Number range and the date of birth.
- Personal identifying information provided is associated with known fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:
    - the address on an application is the same as the address provided on a fraudulent application; or
    - the phone number on an application is the same as the number provided on a fraudulent application.
- Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:
    - the address on an application is fictitious, a mail drop, or a prison; or
    - the phone number is invalid, or is associated with a pager or answering service
- The Social Security Number provided is the same as submitted by other persons opening an account or other customers.
- The address or telephone number provided is the same as or similar to the address or telephone number submitted by an unusually large number of other persons opening accounts or by other customers.
- The person opening the covered account, or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.

- The personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.
- For financial institutions and creditors that use challenge questions, the person opening the covered account, or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.

With regards to possible examples of unusual use of, or suspicious activity related to, the covered account that financial institutions or creditors might encounter and should mark as a Red Flag, the supplement states the following:

- Shortly following the notice of a change of address for a covered account, the financial institution or creditor receives a request for a new, additional, or replacement card or cell phone, or for the addition of authorized users on the account.
- A new revolving credit account is used in a manner commonly associated with known patterns of fraud. For example: the majority of available credit is used for cash advances or merchandise that is easily convertible into cash
- A covered account is used in a manner that is not consistent with established patterns of activity on the account.
- A covered account that has been inactive for a reasonably lengthy period of time is used.
- Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection to the account.
- The financial institution or creditor is notified that the customer is not receiving paper account statements
- The financial institution or creditor is notified of unauthorized charges or transactions in connection with a customer's covered account.

The above are only a few of the many different scenarios that should be flagged by financial institutions and creditors that can be encountered during routine work activities. The Real Estate industry has become a target for identity theft as we continue to adapt to technology and move forward with electronic contracts and other documents. Due to how prevalent identity theft has become, it is crucial that financial institutions and creditors follow the provisions of the law and create efficient Identity Theft Prevention Programs as well as other programs in an effort to prevent fraud in the industry and protect consumers.

Telemarketing and Consumer Fraud and Abuse Prevention Act

Aside from the provisions on Identity Theft Rules, there are other federal laws that aim at protecting consumers and their private information. Interstate telemarketing fraud has become prevalent in the last couple of decades. It has become very easy for a telemarketer to deceive a person and attain their personal information. The Telemarketing and Consumer Fraud and Abuse Prevention Act [15 USC 6101 et seq.] is a law aimed at protecting consumers from telemarketing deception and abuse.

According to Congress telemarketing differs from other sales activities because it can be done across state lines without any direct contact with the consumer. Due to its ease, interstate telemarketing fraud has become popular. In Chapter 87 Section 6101 of Title 15 USC, Congress states that consumers and others are estimated to lose $40 billion a year in telemarketing fraud.

Congress also finds that senior citizens are often the target of this type of fraud. Since older Americans are amongst the most rapidly growing segments of society, a solution must become a priority. According to Congress' findings, 56 percent of the people telemarketers list as persons vulnerable to fraud are 50 years of age or older. In the U.S.A. the elderly are often victims of violent crime, property crime, and consumer and telemarketing fraud. The TRIAD program is in place to aid in the prevention of criminal victimization of the elderly.

The Federal Bureau of Investigation and Federal Trade Commission have also provided resources to assists private-sector organizations to operate outreach programs to warn senior citizens whose names appear on telemarketing lists of those most vulnerable, and the Administration on Aging has a system in place to inform senior citizens of the dangers of telemarketing fraud. However, though these entities are aiding in the protection of the elderly with regards to this type of fraud, Congress has found that more is necessary. In an effort to provide more help in the protection of the elderly, the Senior Fraud Prevention Program was created. Through this program the Secretary of Health and Human Services, acting through the Assistant Secretary of Health and Human Services for Aging, provides to the Attorney General for each State information designed to educate senior citizens and raise awareness about the dangers of fraud, including telemarketing and sweepstakes fraud.
[15 USC Ch. 87 §6101]

Due to the extent of telemarketing fraud and the above findings, Congress gave the Federal Trade Commission the authority to prescribe rules prohibiting deceptive and abusive telemarketing practices in general.

In creating rules prohibiting deceptive and abusive telemarketing practices, by law the Federal Trade Commission must include: [15 USC Ch. 87 §6102(1)(2)(3)(A)(B)(C)(D)]

- A definition of what deceptive telemarketing acts and practices are. This definition should include fraudulent charitable solicitations, as well as acts or practices of entities or individuals that assist or facilitate deceptive telemarketing.
- A requirement that telemarketers may not undertake a pattern of unsolicited telephone calls which the reasonable consumer would consider coercive or abusive of such consumer's right to privacy.
- A requirement that any person engaged in telemarketing for the sale of goods or services shall promptly and clearly disclose to the person receiving the call that the purpose of the call is to sell goods or services and make such other disclosures as the Commission deems appropriate.
    - Restrictions on the hours of the day and night when unsolicited telephone calls can be made to consumers.
    - A requirement that any person engaged in telemarketing for the solicitation of charitable contributions, donations, or gifts of money or any other thing of value, shall promptly and clearly disclose to the person receiving the call that the purpose of the call is to solicit charitable contributions, donations, or gifts, and make such other disclosures as the Commission considers appropriate, including the name and mailing address of the charitable organization on behalf of which the solicitation is made.

As mentioned before, what is “tricky” about telemarketing is the fact that it can be conducted across state lines. This makes it difficult to determine the jurisdiction were there to be any legal action taken against a telemarketer for deceptive practices. To clarify, the law states that whenever an attorney general of any State has reason to believe that the interests of the residents of that State have been or are being threatened by someone engaging in a pattern or practice of telemarketing which violates the Commission’s rules, the State, can bring civil action on behalf of its residents in an appropriate district court of the United States to enjoin such telemarketing, to enforce compliance with the legal rules and to obtain damages, restitution, or other compensation on behalf of the residents of the State, or to obtain such further and other relief as the court deems appropriate.
[15 USC Ch. 87 §6103(a)]

If a person is affected by any pattern or practice of telemarketing which violates any rule of the Commission, or an authorized person acting on such person’s behalf, within 3 years after discovering the violation, they may bring a civil action in an appropriate district court of the United States against a person who has engaged or is engaging in a pattern or practice of telemarketing that is in violation of the rules if the amount in controversy exceeds $50,000 in actual damages for each person adversely affected by such telemarketing. [15 USC, Ch. 87 §6104(a)]

With the above telemarketing rules, Congress hoped to further protect those most vulnerable to identity fraud and enable them to take action against those committing deceptive and abusing practices. In the next hour we will go over some of the other laws in place that also aim at providing consumer protection.

Summary

Ethics is defined as the rules of behavior based on ideas about what is morally good or bad. Ethics are a set of moral principles that we use to determine what is good or what is bad.

A code for ethics ensures a business runs ethically. The code of ethics should serve as a guideline to employees of how they should behave.

Unethical behavior can lead to fraud. Fraud is defined as an intentional perversion of the truth in order to induce another part with something of value or to surrender that legal right.

Types of fraud in the mortgage industry include:
- Straw Borrower
- Identity Theft/Fraud
- Credit Fraud
- Application Fraud
- Builder Bailout
- Flips Fraud
- Sales Contract Fraud
- Affinity Fraud
- Air loan Fraud

The FBI places different types of fraud into two categories - Fraud for Profit & Fraud for Housing

There are various types of fraud, but identity theft seems to be the most prevalent in the industry. Identity theft is the fraudulent use of a person’s private identifying information for financial gain.

All financial institutions or creditors that offer or maintain one or more covered accounts must develop and implement a written Identity Theft Prevention Program.

The Program must:

- Identify relevant Red Flags for covered accounts
- Detect Red Flags that are incorporated into the Program
- Respond appropriately to any Red Flags that are detected
- Ensure the Program is updated periodically to reflect changes in the risk to customers and the safety and soundness of the financial institution or creditor

The Program must also be administrated by the board of directors or an appropriate committee of the board of directors or designated senior level employee. There must also be oversight of any service provider arrangements.

The Telemarketing and Consumer Fraud and Abuse Prevention Act is a law aimed at protecting consumers from telemarketing deception and abuse. According to Congress, telemarketing differs from other sales activities because it is done across state lines without any direct contact with the consumer.

The elderly are disproportionately affected by telemarketers. Though other entities try to help the elderly avoid being taken advantage of, Congress set up the Senior Fraud Prevention Program, which is designed to education senior citizens and raise awareness about the dangers of fraud in all states.

The law does state that the attorney general can bring civil action on behalf of the residents of the state against a telemarketer for deceptive practices. The law also allows for an individual to bring civil action against a telemarketer for violations of the law up to three years after the discovery of the violation.

Lesson 7: Ethics and Fraud in Real Estate Financing – Part II (Ethics)

OVERVIEW

In this section of the course we will continue going over laws pertaining to ethics and fraud in the real estate industry. We will begin by discussing consumer protection law regarding advertising. We will then move on to the Bank Secrecy Act and its Anti-Money Laundering Program requirements. Lastly, we will discuss what Suspicious Activity Reports are and why they are important.

Learning Objectives

By the end of this lesson, students should:

- Know what is prohibited in advertising
- Understand the provisions found in the Bank Secrecy Act and its Anti-Money Laundering requirements
- Recognize when a Suspicious Activity Report should be filed

There was a time where there was a lot of fraud in advertising. People were flexible in what was said in advertisements and were not very clear as to what the product or service they were offering really entailed. Unfortunately, consumers tend not to be very knowledgeable about mortgage products and they are likely to believe what the "experts" tell them. This makes consumers vulnerable, particularly to scams. In order to protect vulnerable consumers, laws must be created that target those that are in the best position to take advantage of consumers.

Regulation N, Mortgage Acts and Practices-Advertising Rule, was created by the Consumer Financial Protection Bureau in an effort to enforce Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This particular regulation has to do with advertising any mortgage credit product and applies to those over which the Federal Trade Commission has jurisdiction over under the Federal Trade Commission Act.

Regulation N defines commercial communication as any written or oral statement, illustration, or depiction, whether in English or any other language, that is designed to effect a sale or create interest in purchasing goods or services, whether it appears on or in a label, package, package insert, radio, television, cable television, brochure, newspaper, magazine, pamphlet, leaflet, circular, mailer, book insert, free standing insert, letter, catalogue, poster, chart billboard, public transit card, point of purchase display, film, slide, audio program transmitted over a telephone system, telemarketing script, on-hold script, upsell script, training materials provided to telemarketing firms, program-length commercial ("infomercial"), the internet, cellular network, or any other medium. The term commercial communication also includes promotional materials and Web pages. [Regulation N, 12 CFR §1014.2]

As you can see, this definition is all encompassing. The term commercial communication is meant to cover any form of advertising. Regulation N states that it is a violation of the law for any person to make any material misrepresentation, expressly or by implication, in any commercial communication regarding any term of any mortgage credit product. [Regulation N,12 CFR §1014.3]

For the purposes of this regulation, *term* is defined as any of the fees, costs, obligations, or characteristics of or associated with the product. Term also includes any conditions on or related to the availability of the product. [Regulation N,12 CFR §1014.2]

Material misrepresentation of any term for any mortgage credit product also includes all of the following: [Regulation N,12 CFR §1014.3(a-s)]

- The interest charged for the mortgage credit product, including but not limited to:
  - The amount of interest that the consumer owes each month that is included in the consumer's payments, loan amount, or total amount due or
  - Whether the difference between the interest owed and the interest paid is added to the total amount due from the consumer
- The annual percentage rate, simple annual rate, periodic rate, or any other rate;
- The existence, nature, or amount of fees or costs to the consumer associated with the mortgage credit product, including but not limited to misrepresentations that no fees are charged;
- The existence, cost, payment terms, or other terms associated with any additional product or feature that is or may be sold in conjunction with the mortgage credit product, including but not limited to credit insurance or credit disability insurance;
- The terms, amounts, payments, or other requirements relating to taxes or insurances associated with the mortgage credit product, including but not limited to misrepresentations about:
  - Whether separate payment for taxes or insurances is required; or
  - The extent to which payment for taxes or insurance is included in the loan payments, loan amount, or total amount due from the consumer;
- Any prepayment penalty associated with the mortgage credit product, including misrepresentations concerning the existence, nature, amount, or terms of such penalty;
- The variability of interest, payments, or other terms of the mortgage credit product including misrepresentation of the word "fixed";
- Any comparison between:
  - Any rate or payment that will be available for a period less than the full length of the mortgage credit product; and
  - Any actual hypothetical rate or payment;
- The type of mortgage credit product, including but not limited to misrepresentations that the product is or involves a fully amortizing mortgage;
- The amount of the obligation, or existence, nature, or amount of cash or credit available to the consumer in connection with the mortgage credit product, including misrepresentations that the consumer will receive a certain amount of cash or credits as part of a mortgage credit transaction;
- The existence, number, amount, or timing of any minimum or required payments, including misrepresentation about any payments or that no payments are required in a reverse mortgage or other mortgage credit product;
- The potential for default under the mortgage credit product, including misrepresentations concerning the circumstances under which the consumer could default for nonpayment of taxes, insurance, or maintenance, or for failure to meet other obligations;
- The effectiveness of the mortgage credit product in helping the consumer resolve difficulties in paying debts, including misrepresentations that any mortgage credit product can reduce, eliminate, or restructure debt or result in a waiver or forgiveness, in whole or in part, of the consumer's existing obligation with any person;
- The association of the mortgage credit product or any provider of such product with any other person or program. Including misrepresentations that:
  - The provider is, or is affiliated with, any governmental entity or other organization; or
  - The product is or relates to a government benefit, or is endorsed, sponsored, by or affiliated with any government or other program, including through the use of formats, symbols, or logos that resemble those of such entity, organization, or program.

- The source of any commercial communication, including the misrepresentation that a commercial communication is made by or on behalf of the consumer's current mortgage lender or servicer;
- The right of the consumer to reside in the dwelling that is the subject of the mortgage credit product, or the duration of such right, including the misrepresentation concerning how long or under what conditions a consumer with a reverse mortgage can stay in the dwelling;
- The consumer's ability or likelihood to obtain any mortgage credit product or term, including misrepresentations concerning whether the consumer has been preapproved or guaranteed for any such product or term;
- The consumer's ability or likelihood to obtain a refinancing or modification of any mortgage credit product or term, including misrepresentations concerning whether the consumer has been preapproved or guaranteed for any such refinancing or modification; and
- The availability, nature, or substance of counseling services or any other expert advice offered to the consumer regarding any mortgage credit product or term, including to the qualification of those offering the services or advice.

Again, as you can see, this particular regulation is very detailed as, prior to its creation, there were various occurrences of misrepresentation in advertising that led to the taking advantage of many people looking for mortgage credit products. With regulations such as this in place, consumers are better able to make a sound decision and can be more trusting of the products and services they are being offered. Aside from the prohibition of material misrepresentation in advertising, Regulation N also places recordkeeping requirements on persons publishing advertisements.

Persons subject to Regulation N must keep records of the commercial communication regarding any term of any mortgage credit product for at least a 24-month period from the date it was disseminated or made. [Regulation N, 12 CFR §1014.5]. Additionally, copies of materials such as sales scripts, training materials, and marketing materials regarding the mortgage credit product that a person made or disseminated must be kept for the 24-month period. Documents that describe or provide evidence that the mortgage product that is being offered in the commercial communication is real at the time should be kept for the same time as well. It is a violation of the law to fail to keep such records. [Regulation N, 12 CFR §1014.5(a)(1)(2)(3)(b)]. Furthermore, it is a violation of the law for any person to try to obtain a waiver from any consumer of any protection that is provided by Regulation N. [Regulation N, 12 CFR §1014.4].

Also related to this type of consumer protection law is Regulation O regarding Mortgage Assistance Relief Services. Regulation O states that any communications regarding Mortgage Assistance Relief Services must be clear and prominent. In textual communications, the required disclosures must be easily readable. In communications disseminated orally, the disclosures must be delivered slowly and deliberately and in a reasonably understandable volume and pitch. In communications disseminated through video, the required disclosures must be simultaneous with the audio and visual parts of the commercial communication and delivered in a manner consistent with the other requirements of Regulation O. In communications made through interactive media, the required disclosures must be consistent with the above, be unavoidable, and be made on the same page or the prior page on which the consumer takes any action to incur a financial obligation. [Regulation N, 12 CFR §1015.2 (1)(2)(3)(4)(i)(ii)(iii)]. These requirements are part of an effort to protect consumers from misinterpreting what is said in advertisements for mortgage credit products as well as force those offering the product to be honest in their advertising.

Regulation N and Regulation O are an important part of the consumer protection laws as they protect consumers from what they hear and see regarding mortgage products available to the public. However, there are other areas of the mortgage industry that also require more regulation in order to provide proper consumer protection. Let's turn to these next.

The Bank Secrecy Act

The Bank Secrecy Act, also known as The Currency and Foreign Transaction Reporting Act, was created to make financial institutions assist the United States government agencies detect and prevent money laundering. The Bank Secrecy Act demands that persons in the mortgage lending industry and those involved in any industry having to do with finances do their best to prevent the occurrence of money laundering. It is now part of a loan originators due diligence to make sure all documents are thoroughly reviewed and determine whether any red flags exist in what your customers are giving you when attempting to obtain a mortgage loan.

In order to comply with the Bank Secrecy Act, financial institutions must keep records of cash purchases of negotiable instruments, file reports of cash purchases exceeding $10,000 per day, and report suspicious activity that might signify money laundering, tax evasion, and other criminal activities.

> For the purposes of this particular law, cash is defined as currency and coins of the United States or any other country. The term cash also includes other monetary instruments such as traveler's checks, money orders, cashier's checks, and bank drafts. The term cash does not include personal checks. [31 U.S.C. §5312 (3)(a)(b)(c)].

Some of the general provisions found in the Bank Secrecy Act are as follows:

According to the law, when a domestic financial institution is involved in a transaction they must file a report on the transaction at the time in which the Secretary of the Treasury may require. The Secretary of Treasury can designate a financial institution as an agent of the United States Government to receive a report. The person required to file a report under this section of the law must file the report: [31 U.S.C. §5313(a)(b)(c)(1)(a)(b)(c)]

- With the institution involved in the transaction if the institution was designated;
- In the way the Secretary prescribes when the institution was not designated; or
- With the Secretary.

With regards to transactions with a foreign financial agency, the Secretary of Treasury requires a resident or citizen of the United States to keep records, file reports, or keep records and file reports, when the resident or citizen makes a transaction or maintains a relation for any person with a foreign financial agency. These records and reports must contain the following:
[31 U.S.C. §5314(a)(1)(2)(3)(4)]:

- The identity and address of participants in a transaction or relationship
- The legal capacity in which a participant is acting
- The identity of real parties in interest
- A description of the transaction.

It is in this section of the law that Anti-Money Laundering Programs are made mandatory. These programs aim to guard against money laundering in financial institutions. The law states that financial institutions must establish anti-money laundering programs that include, at a minimum:
[31 U.S.C. §5318(h)(1)(a)(b)(c)(d)(2)]

- The development of internal policies, procedures, and controls;
- The designation of a compliance officer;
- An ongoing employee training program; and
- An independent audit function to test programs.

The Secretary of the Treasury can prescribe minimum standards for the programs mentioned above and has the authority to exempt certain financial institutions from those requirements.

With regards to general bank records related to Anti-Money Laundering Programs, the law poses an 120-hour rule. No later than 120 hours after receiving a request from an appropriate Federal Banking Agency for information related to anti-money laundering compliance by a covered financial institution or a customer of such institution, the covered financial institution must provide information and account documentation for any account opened, maintained or managed in the United States by the covered financial institution. [31 U.S.C. §5318(k)(2)].

With regards to Foreign bank related records, the Secretary of the Treasury or the Attorney General can issue a summons or subpoena to any foreign bank that maintains a correspondent account in the United States and request records related to such correspondent account, including records maintained outside the United States. [31 U.S.C. §5318(k)(3)(a)(i)]

The Secretary of the Treasury has the power to prescribe regulations for minimum standards for financial institutions and their customers when first opening an account at the financial institution. At a minimum, the regulations must require financial institutions implement, and customers to comply with, reasonable procedures for: [31 U.S.C. §5318(l)(1)(2)(a)(b)(c)]

- Verifying the identity of any person seeking to open an account to the extent reasonable and practicable
- Maintain records of the information used to verify a person's identity, including name, address, and other identifying information; and
- Consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.

Furthermore, the Bank Secrecy Act prohibits a financial institution from issuing or selling a bank check, cashier's check, traveler's check, or money order to an individual in connection with a transaction or group of such contemporaneous transactions which involves United States coins or currency or other monetary instruments in the amount or denomination of $3,000 or more unless: [31 U.S.C. §5325(a)(1)(a)(b)(2)]

- the individual has a transaction account with such financial institution and the institution verifies the fact through signature card or other information maintained on the individual in connection to his or her account and records the method of verification; or
- the individual furnishes the financial institution with such forms of identification required by the Secretary of the Treasury and verifies and records the information.

In combination, the above requirements aid in the prevention of fraud in the financial industry. But what about Bank Secrecy Act provisions relating to fraud in the mortgage lending industry? Let's take a look at what the Bank Secrecy Act has to say regarding what mortgage lenders and originators must do in order to prevent fraud in the form of money laundering.

Bank Secrecy Act and Mortgage Lending

The Bank Secrecy Act also stipulates the mandate for anti-money laundering programs for loan and finance companies or residential mortgage lenders and originators(RMLOs).

The law requires that all loan or finance companies develop and implement a written anti-money laundering program. This program is meant to prevent these companies from being used to facilitate money laundering or financing terrorist activities. [31 CFR §1029.210 (a)].

The programs must be approved by senior management and the companies must make a copy of their anti-money laundering program available to the Financial Crimes Enforcement Network upon request. The Financial Crimes Enforcement Network is entrusted to enforce and provide oversight for the provisions in the Bank Secrecy Act. The minimum requirements of the anti-money laundering programs include: [31 CFR §1029.210 (b)(1)(2)(3)(4)]

- incorporating policies, procedures, and internal controls based upon the loan or finance company's assessment of the money laundering and terrorist risks associated with its products and services
- designating a compliance officer who will be responsible for ensuring that:
    - the anti-money laundering program is implemented effectively, including monitoring compliance by the company's agents and brokers with their obligations under the program
    - the anti-money laundering program is updated as necessary; and
    - appropriate persons are educated and trained
- providing for an on-going training of appropriate persons concerning their responsibilities under the program. A loan or finance company can satisfy this requirement by directly training its employees, agent, and brokers or verifying that such persons have received training by a competent third party with respect to the products and services being offered by the company.
- providing for independent testing to monitor and maintain an adequate program, including testing to determine compliance of the company's agents and brokers with their obligations under the program.

Aside from having to create these programs and keep certain records in an effort to prevent money laundering, the law also imposes requirements involving the filing of certain reports. We will turn to these next.

Currency Transaction Reports and Suspicious Activity Reports

To comply with the Bank Secrecy Act's recordkeeping requirements financial institutions use Currency Transaction Reports and Suspicious Activity Reports.

Currency Transaction Reports (CTR) are filed for all transactions involving the physical transfer of currency from one person to the other of over $10,000. These reports must include the following information:

- Name
- Street address
- Social Security Number or taxpayer identification number
- Date of Birth
- Account number
- Amount and kind of transaction

Suspicious Activity Reports (SAR) are filed when a financial institution detects certain known or suspected violations of federal law or suspicious transactions related to money laundering activity in violation of the Bank Secrecy Act. An activity is considered to be suspicious if it involves $5,000 or more in funds or assets that the financial institutions suspects may indicate profit from some illegal activity. Those involved in the mortgage lending industry must also comply with this act and report any suspicious activity to the federal government.

A national bank shall file a SAR with the appropriate Federal law enforcement agencies and the Department of the Treasury on the form prescribed by the Office of the Comptroller of Currency and in accordance to the form's instructions. The completed SAR must be filed with the Financial Crimes Enforcement Network when a financial institution detects certain known or suspected violations of federal law or suspicious transactions related to a money laundering activity in violation of the Bank Secrecy Act. The report can be filed electronically via the BSA E-Filing System.

A Suspicious Activity Report must be filed if any of the following potential crimes are present [12 CFR §21.11 & §163.180]:

- violations involving insider abuse regardless of the dollar amount
- violations where there is an identifiable suspect and the transaction involves $5,000 or more
- violations where there is no identifiable suspect and the transaction involves $25,000 or more
- if there is any suspicious activity that is indicative of potential money laundering or Bank Secrecy Act violations and the transaction involves $5,000 or more.

➢ It is important to note that the consumer whom the SAR is being filed for should not have any knowledge that a SAR is being filed.

The SAR must be filed no later than 30 calendar days after the initial detection of facts that constitute the basis for filing the SAR. If there was no suspect identified the date of detection of the incident, the bank can delay 30 calendar days after the initial detection to submit a SAR. However, a SAR must not be delayed more than 60 days after the initial detection of a reportable transaction.

In situations involving violations that require immediate attention, the financial institution should notify immediately by telephone an appropriate law enforcement authority in addition to filing a SAR. Where thought appropriate, financial institutions are encouraged to file a copy of the SAR with local law enforcement agencies. Furthermore, situations such as robberies or burglaries are exempt from SARs. [12 CFR §21.11(d)(e)(f)]

The law requires that a copy of all reports filed must be kept by the financial institution for at least 5 years from the date the report was filed. In addition, any supporting documentation should be identified and maintained by the financial institution as well. All reports must be filed with the Financial Crimes Enforcement Network, which is responsible for the oversight and enforcement of the Bank Secrecy Act. [31 C.F.R. §1010.306(a)(1)(2)(3)]

The Bank Secrecy Act also specifically places the above requirements on mortgage loan originators. Those involved in mortgage lending must also file Suspicious Activity Reports.

<u>SARs and MLOs</u>

The Bank Secrecy Act defines residential mortgage lenders and originators (RMLOs) as persons engaged in the activities of a residential mortgage lender and/or residential mortgage originator, whether or not on a regular basis or as an organized business concern. Excluded from this definition are individuals employed by residential lenders and originators.

As stated earlier, RMLOs must develop and implement written Anti-Money Laundering programs. RMLOs must also file with the Financial Crimes Enforcement Network suspicious activity reports.

Just as discussed before, the filling should be made within 30 calendar days after the date of the initial detection and a copy must be retained for 5 years. A SAR would be necessary if a transaction involves funds of at least $5,000 and the RMLO suspects that the transaction is suspicious in any way.

Examples of what may seem suspicious in residential mortgage dealings are:

- Mortgage fraud
- Identity theft
- Check fraud
- False statement
- Over-pricing of property
- Under-pricing of property
- Unverifiable documentation
- Conflicting information from customer

These are only a few of the examples of what may constitute suspicious activity. However, **ANY** suspicious behavior that is suspected by loan originators should be reported to the Financial Crimes Enforcement Network.

BSA Violations

Until now, we have discussed what the Bank Secrecy Act states financial institutions must do with records and reports in order to help in the prevention of money laundering, but what happens if an institution does not comply with the Bank Secrecy Act?

Overall, the authority for enforcement and compliance of the Bank Secrecy Act is given to the Financial Crimes Enforcement Network. [31 CFR §101.810]. To aid in the monitoring of compliance, the law states that all financial institutions establish a Bank Secrecy Act Compliance Program. The program must include: [31 CFR §21.21(a)(b)]

- continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements
- require a customer identification program to be implemented as part of the Bank Secrecy Act compliance program

The compliance program's contents should include:

- a system of internal controls to assure ongoing compliance
- independent testing for compliance to be conducted by bank personnel or by an outside party
- designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance
- provide training for appropriate personnel.

Aside from these compliance programs, the Financial Crimes Enforcement Network continually oversees institutions' compliance with the law. For those that are found to violate the Bank Secrecy Act, the law provides for civil and criminal penalties.

Civil Penalties:

The law allows for civil penalties if there is noncompliance with the Bank Secrecy Act. A domestic financial institution or nonfinancial trade or business, and a partner, director, officer, or employee of domestic financial institution or nonfinancial trade or business, willfully violates the provisions mentioned above, is liable to the United States Government for a civil penalty of not more than the greater of the amount involved in a transaction or $25,000. This amount may not exceed $100,000. If an institution does not maintain appropriate procedures to ensure compliance with regulations to guard against money laundering, a separate violation occurs for each day the violation continues at each office, branch, or place of business at which a violation occurs or continues.
[31 USC §5321(a)(1)]

For those that do not file a report or submit a report that contains a material omission or misstatement, the Secretary of the Treasury may impose an additional civil penalty. This civil penalty must not be more than the amount of monetary instrument for which the report was required. [31 USC §5321(a)(2)] The Secretary of Treasury may also impose a civil money penalty for anyone that tries to structure a transaction in a way that will not require a report. For foreign financial agency transaction violations where someone does not keep records prescribed by section 5314, the Secretary of Treasury can impose a penalty not exceeding $10,000. However, if it is found that there was a willful violation, the penalty can be increased to the greater of $100,000 or 50% of the amount of the transaction or the balance found in the account that should have been reported on.
[31 USC §5321(a)(5)(a)(b)(c)(d)].

If it is found that a financial institution or nonfinancial trade or business has negligently violated any of the provisions mentioned above, the Secretary of the Treasury can impose a civil money penalty of no more than $500. If it is found that this institution has a pattern of negligent violations of any of the provisions, a penalty can be added of not more than $50,000. [31 USC §5321(a)(6)(a)(b)].

The Secretary of the Treasury can also impose a civil money penalty in an amount equal to not less than 2 times the amount of the transaction, but not more than $1,000,000, on any financial institution that violates international counter money laundering measures. [31 USC §5321(a)(7)]

The law provides time limits on assessments and civil actions: [31 USC §5321(b)(1)(2)]

- The Secretary of the Treasury can assess any civil penalty at any time before the end of 6 years after the date of the transaction.
- The Secretary of the Treasury can commence a civil action to recover civil penalties assessed at any time before the end of 2 years after the later of the date the penalty was assessed or the date any judgment becomes final in any criminal action

Criminal Penalties:

A person willfully violating the provisions of the Bank Secrecy Act can be fined not more than $250,000, or imprisoned for not more than 5 years, or both. Additionally, a person willfully violating the provisions of the act, while also violating another law of the U.S. or as part of a pattern of illegal activity involving more than $100,000 in a 12-month period, can be fined not more than $500,000, be imprisoned for no more than 10 years, or both. If it is found that a financial institution has not prepared appropriate procedures to ensure compliance with regulations to guard against money

laundering, a separate violation occurs for each day the violation continues and at each office, branch, or place of business at which the violation occurs or continues. [31 U.S.C. §1010.840].

Financial institutions that establish or maintain accounts for a person that is not from the United States must establish appropriate, specific, and where necessary, enhanced, due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering through those accounts [31 U.S.C. §5318(i)]. If it is found that the institution does not establish these due diligence policies, it can be fined an amount equal to not less than 2 times the amount of the transaction, but nor more than $1,000,000. [31 U.S.C. §5322(a)(b)(c)(d)].

Examples of Noncompliance With BSA

Failing to comply with the Bank Secrecy Act is considered very serious and carries with it very serious punishments. To give you an example, on October 27, 2017, The Financial Crimes Enforcement Network fined a small Texas Bank a $2,000,000 fine for willfully violating anti-money laundering requirements of the Bank Secrecy Act.

The Texas bank was charged because it accepted a Mexican bank as a customer without conducting significant due diligence on the bank. Apparently, if due diligence had been conducted, the Texas bank would have found that the owner of the Mexican bank was involved in securities fraud. The Financial Crimes Enforcement Network also found that the Texas bank had operated other high-risk accounts without conducting appropriate due diligence.

Another example of the severity of the punishment that a violation of the Bank Secrecy Act carries with it is the $1,000,000 civil money penalty the Financial Crimes Enforcement Network placed on the Chief Compliance Officer for MoneyGram International, Inc. on December 2014. The penalty was placed on him for failing to ensure that the company abided by the anti-money laundering provisions of the Bank Secrecy Act.

As you can imagine, the Financial Crimes Enforcement Network does a thorough job enforcing the provisions in the Bank Secrecy Act. If financial institutions do not comply with the act, punishment is sure to follow.

Some Changes in Penalties for BSA/MLA

Recently, the Financial Crimes Enforcement Network has issued some changes to some of the penalties involved in violating the Bank Secrecy Act. After the enactment of the Federal Civil Penalties Inflation Adjustment Improvements Act of 2015, a formula was applied to increase, in accordance to inflation, the civil penalties already in place for violations of the Bank Secrecy Act.

As of 2016, The Financial Crimes Enforcement Network has placed the following changes in the penalties for violations of the Bank Secrecy Act and it is suggested that more changes are to come:

- Penalty for recordkeeping violations for fund transfers increased from $10,000 to $19,787.
- Penalty for failing to register a person as a money transmitter increased from $5,000 to $7,954
- Penalty range for willful violations of the Bank Secrecy Act requirements increased from $25,000-$100,000 to $53,907-$215,628

Conclusion

In this lesson we reviewed more of the ways in which consumers are protected from predatory and fraudulent behavior. Specifically, we went over the provisions that denote proper ways to advertise mortgage credit products; provisions that require anti-money laundering programs; and provisions that mandate the filing of reports for suspicious financial activity. By enforcing these provisions, consumers are less likely to be preyed upon when making some of the biggest financial decisions of their lives. The consumer protection laws reviewed aim at lowering the incidences of fraud while encouraging ethical behavior in dealings between professionals and consumers.

SUMMARY

Regulation N states that it is a violation of the law for any person to make a material representation, expressly or by implication, in any commercial communication regarding any term of any mortgage credit product.

Persons subject to Regulation N must keep records of the commercial communication regarding the mortgage credit product for at least 2 years from the date it was disseminated or made.

Regulation O deals specifically with Mortgage Assistance Relief Services. Regulation O states that any communications regarding these services must be clear and prominent, regardless of the form the communication takes.

The Bank Secrecy Act was created to make financial institutions assist the United States government agencies detect and prevent money laundering.

Financial institutions must keep records of cash purchases of negotiable instruments, file reports of cash purchases exceeding $10,000 per day, and report suspicious activity that might signify money laundering, tax evasion, and other criminal activities.

Domestic financial institutions involved in transactions must file a report on the transaction at any point in which the Secretary of the Treasury requires. If a transaction involves a foreign financial agency, the resident or U.S. citizen must keep records, file reports, or keep records and file reports regarding the transaction.

The act also mandates Anti-Money Laundering Programs. At a minimum these should include:

- the development of internal policies, procedures, and controls
- the designation of a compliance officer
- an ongoing employee training program
- an independent audit function to test programs

Loan or finance companies must also establish Anti-Money Laundering Programs.

The law poses a 120-hour rule:

- No later than 120 hours after receiving a request from a federal banking agency for information related to anti-money laundering compliance, the information must be provided

Currency Transaction Reports (CTR) are filed with the IRS for transactions involving the physical transfer of currency from one person to the other of over $10,000.

Suspicious Activity Reports (SAR) are filed when a financial institution detects certain known or suspected violations of federal law or suspicious transactions related to money laundering activity in violation of the Bank Secrecy Act. An activity is considered to be suspicious if it involves $5,000 or more in funds or assets that the financial institutions suspects may indicate profit from some illegal activity.

The SAR must be filed no later than 30 days after the initial detection of suspicion and should not be delayed more than 60 days after the initial detection of suspicion.

Copies of all reports filed must be kept by the financial institution for at least 5 years.

Mortgage loan originators must also file a SAR if a transaction involves funds of at least $5,000 and the MLO suspects that the transaction is suspicious in any way.

- Suspicious activities in residential mortgage dealings could include mortgage fraud, identity theft, check fraud, false statement, over-pricing of property, under-pricing of property, unverifiable consumer documents, conflicting consumer information
- Any suspicious activity should be reported

The Financial Crimes Enforcement Network is entrusted with the oversight and enforcement of the Bank Secrecy Act. To aid in the monitoring of compliance, financial institutions must have a Bank Secrecy Act Compliance Program.

Financial institutions that willfully violate BSA provisions are liable to various monetary civil penalties. Additionally, there are criminal penalties which include fines and imprisonment for individuals and financial institutions that willfully violate provisions of the BSA.

Lesson 8: California Mortgage DBO

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 Finance Lenders Law, abbreviated CFLL), and Division 20 (known as the California Residential Mortgage Lending Act, abbreviated CRMLA.)

Before proceeding we have one more recommendation for you. We have made available Division 9 and Division 20 of the California Financial Code available for you in the resources section.

Once you have downloaded the documents we recommend you actually read them. I know it sounds like a chore, but there are two specific reasons it will provide benefit to you.

First, when talking to clients (and competing with others in the industry) you can have these documents somewhere visible to the clients. At some point you may want to cite a portion of the California Finance Lenders Law or the California Residential Mortgage Lending Act.

Then you can show your clients the documents you have printed and say something like, “These are the primary laws that govern mortgage lending. I’ve actually read them, and occasionally refer to them to ensure I deliver to you everything required by law along with a level of competence and service I’m confident you’ll appreciate.”

Continue to let them know that most Mortgage Loan Originators have never actually fully read the statutes. Instead, they rely on what they are taught by their company or what they learn in courses they are required to take on a periodic basis. It’s a form of priming that helps create an attachment between you and the potential clients since they will appreciate working with someone that appears so diligent.

The other reason for reading the law is that you may learn something surprising. The industry relies heavily on word-of-mouth, and research very clearly demonstrates such a reliance results in misconceptions and infractions. The good news is that ***usually*** the law is ***less restrictive*** than the word-of-mouth suggests. But there are times you’ll find something you didn’t know about – something that could cause problems for you in certain circumstances.

For those who operate with greed and pure self-interest, we really neither desire nor support you or your way of business. For those who strive to be honest, fair, and forthright in their business transactions, we have a simple suggestion that will make it much easier when you read the Financial Code.

As you read through its admittedly ridiculous amount of detail and originator requirements, you really don't need to be overly concerned with all the regulations you would normally comply with as a matter of your personal business ethic. However, if you run across something you find surprising, take note of it, mark its place, and refer to it again in a week.   Then refer to it once again in another week or two.

When the text you're repeatedly referring to becomes a normal part of your thought process, then it's been integrated into your personal business ethic and it's not likely you'll violate that rule. Some of the most successful originators make it a habit to spend about 15 minutes a day reading the regulatory laws and policies that govern their business. You'd be surprised how much you'll learn with just a short 15 minute per day investment, and you'll likely become the most knowledgeable mortgage loan originator you know with regard to governing regulations.

One last advantage to reading the Financial Code is that you will learn how many of the word-of-mouth restrictions (or exclusions) are not accurate. They've been reinterpreted so many times the original meaning – or at least the original intent – has been lost. You will appear to be an extremely competent and knowledgeable Mortgage Loan Originator if you will follow this advice. And, as you probably know, business tends to flow to those that appear the most capable and competent.

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.

INCREASED NOTIFICATIONS

- 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 Business Oversight 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 FINANCE LENDERS LAW

In this section we'll take a brief look at portions of the California Finance Lender Law, also known as the CFLL. 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.

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 CFLL and points out a few particularly important (or misunderstood) sections of the law.

The text of the law begins with the purpose 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 Business Oversight. (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 Finance Lenders 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 Finance Lenders 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 Finance Lenders 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!