8 Hour SC SAFE Comprehensive: Compliance for 2018

STUDY MANUAL

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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.

Regulation Z, 12 C.F.R. §1026.18(d)(1)

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.*

SUMMARY

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.

Disclosures Required at Loan Application

- 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"

Disclosures Required Before Settlement/Closing Occurs

- 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

Disclosures After Settlement

- 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]
    - o An attorney is compensated for services performed [Regulation X, 12 CFR §1024.14 (g) (i)]
    - o 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)]
    - o 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)]
    - o 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
    - o 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:
   1. 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

<u>Notice of Adverse Action Form - ECOA Notice</u>

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.		

<u>Minimum Cash Investment & LTV</u>

- 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

<u>Sales Concessions</u>

- 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 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.

SARs and MLOs

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: Review of South Carolina Mortgage Laws

Part 1: South Carolina Department of Consumer Affairs and South Carolina Board of Financial Institutions

OVERVIEW

In this lesson students will learn about the South Carolina Department of Consumer Affairs, the South Carolina State Board of Financial Institutions, as well as some of the laws and regulation definitions pertaining to mortgage lending. Students will have an understanding of the importance of and be well versed in the responsibilities, limitations, and structure of both the South Carolina Department of Consumer Affairs and the South Carolina State Board of Financial Institutions. Additionally, students will become familiar with some of the more important laws and regulation definitions relating to mortgage lending in South Carolina, including the South Carolina Mortgage Lending Act and the High Cost Consumer Protection Code, as well as provision in Chapter 3 and Chapter 10 of Title 37 in the South Carolina Code of Law.

Learning Objectives

After reviewing this lesson, students should:

- Be able to discuss the authority, structure, and responsibilities of the South Carolina Department of Consumer Affairs and the South Carolina State Board of Financial Institutions
- Understand different definitions included in the state laws and regulations
- Know some of South Carolina Laws and Regulations as they pertain to mortgage loan originators

South Carolina Department of Consumer Affairs

There are two very important regulatory offices in South Carolina that, among other things, pertain to mortgage lending and licensing; the South Carolina Department of Consumer Affairs and the South Carolina State Board of Financial Institutions. We will first start by discussing the South Carolina Department of Consumer affairs and later move on to discussing the South Carolina State Board of Financial Institutions.

In 1974, the South Carolina Consumer Protection Code [Title 37] established the South Carolina Department of Consumer Affairs (SCDCA or Department for short). The Department of Consumer Affairs is meant to administer and enforce the Consumer Protection Code. As South Carolina's consumer protection agency, the Department is also entrusted to enforce Title 37 as well as other regulatory statutes. The Department's goal is to protect consumers in South Carolina.

The South Carolina Department of Consumer Affairs website, http://www.consumer.sc.gov/, has a lot of useful information regarding its purpose, structure, and responsibilities. We will go over some of this information below.

The South Carolina Department of Consumer Affairs helps:

- Formulate and modify consumer laws, policies and regulations
- Regulate the consumer credit marketplace

- Resolve complaints arising out of the production, promotion, and sale of consumer goods and services in the state (whether or not credit is involved)
- Promote a healthy competitive business climate with mutual confidence between buyers and sellers.

The Consumer Protection Code authorizes the South Carolina Department of Consumer Affairs to do the following:

- Analyze and mediate individual complaints
- Investigate business practices if a pattern of fraud is suspected
- Inform about complaints filed against a business
- Educate consumers about unfair and deceptive practices
- Take legal action to prevent persons from violating the Code and prohibit unconscionable conduct.

However, the Consumer Protection Code does **not** authorize the Department to:

- Advise a consumer of whether a particular business is reputable
- Recommend a company with which a consumer should do business
- Handle complaints against a state agency

In order for the Department to do what the Code has authorized it to do, it has had to be structured in a specific way. The Commission on Consumer Affairs governs the South Carolina Department of Consumer Affairs as well as appoints the Administrator and the Department itself is structured into six different parts, each with different and specific responsibilities:

- Administration – This division includes:
    - The resources necessary to support the operation of the Department.
    - The appointed person who is the Administrator. The Administrator runs the daily operations of the Department and is entrusted with advising the legislature and Governor on consumer issues and the state of credit in South Carolina.
    - Procurement, human resources, accounting and information technology.
- Consumer Services
    - The consumer services division handles consumer complaints that are made regarding the businesses that are regulated by the Department as well as complaints that are unregulated. Complaints against businesses that are not regulated by the Department are referred to the appropriate jurisdiction.
    - The division's mediation process helps alleviate the courts' workload and saves consumers and businesses money as going through the courts usually entails a larger cost.
- Consumer Advocacy
    - The consumer advocacy division specifically deals with the insurance interests of consumers. To do so, the division reviews insurance rate requests that are filed with the Department of Insurance with the goal of generating savings for both consumers and businesses.

  - The division has regulatory responsibility over various different organizations as denoted in many acts:
    - Continuing Care Retirement Communities (Act 97 of 1989),
    - Discount Medical Plan Organizations (Act 377 of 2006),
    - Professional Employer Organizations (Act 169 of 1933), and
    - The regulation of the sale of cosmetic contact lens without a prescription from an authorized dispenser.
- Public Information and Education
  - The public information and education division's sole purpose is to provide the consumer, businesses and media with education and educational resources. This division provides information on consumer rights and responsibilities and provides presentations, webinars, and other resources helpful to the consumer.
  - A few of the helpful webinar topics covered by the division and available to consumers include webinars on:
    - Identity theft
    - Debt collection
    - Foreclosures
    - Credit
  - The division also takes calls from consumers regarding consumer scams and laws and provides press releases and consumer education brochures.
- Identity Theft Unit
  - The identity theft division handles the administration and enforcement of the South Carolina's Financial Identity Fraud and identity Theft Protection Act as well as other state acts pertaining to identity theft and the protection of consumers.
  - The identity theft division also provides education and outreach for consumers. However, the division's main focus is on identity theft.
  - The division also provides warnings to the public regarding new scams.
  - Additionally, the division provides step-by-step guidance on what to do if a consumer is a victim of identity theft.
- Legal Division
  - The legal division administers and enforces the law governing consumer credit transactions.
  - The legal division also has regulatory responsibility over other industries:
    - Motor Clubs (Act 400 of 1984),
    - Rent-to-own businesses (Act 121 of 1985),
    - Physical Fitness Services (Act 165 of 1985),
    - Pawnbrokers (Act 491 of 1988),
    - Mortgage Loan Brokers (Act 544 of 1988),
    - Telephone Solicitations (Act 656 of 1988),

        - Express Warranties on Motor Vehicles (Act 142 of 1989),
        - Athlete Agents (Act 456 of 1990; Act No. 300 of 2004),
        - Motor Vehicle Subleasing (Act 131 of 1991),
        - Loan Brokers (Act 452 of 1992),
        - Motor Fuel Pricing (Act 161 of 1993),
        - Prize Promotions (Act 483 of 1994),
        - Prepaid Legal Services (Act 328 of 2000),
        - Consumer Credit Counseling (Act 111 of 2005)
    - The division also provides consumer law guidance to the financial industry, magistrates, attorneys, and law enforcement agencies, and serves as the legal counsel for the Board of Financial Institution's Consumer Finance Division, of which we will discuss later on in this lesson.

As you can see, the South Carolina Department of Consumer Affairs has many responsibilities and handles various different aspects pertaining to the financial sector in an effort to protect South Carolina's consumers. Another important regulatory office is that of the South Carolina State Board of Financial Institutions. We will review its responsibilities and structure next.

South Carolina State Board of Financial Institutions

The South Carolina State Board of Financial Institutions (the Board) is another important office in South Carolina pertaining to consumer protection. According to their website, the South Carolina Board of Financial Institutions' mission is to serve the people of South Carolina by preserving a sound financial community and protecting the borrowing public by ensuring that the state banking and consumer finance laws and regulations are followed. The State Board is responsible for the supervision, licensing, and examination of:

- All State chartered banks
- Savings and loans associations
- Savings banks
- Credit unions
- Trust companies
- Development corporations
- Consumer finance companies
- Deferred presentment companies
- Check cashing companies

Title 34 of South Carolina's Code of Laws establishes the South Carolina State Board of Financial Institutions. Title 34 Section 34-1-20 details the structure of the Board.

- The Board is composed of eleven members.
- Members of the Board cannot serve more than two consecutive four-year terms.
- The code denotes requirements that must be met in order to be appointed to the board:

- One of the members is the State Treasurer who also is the chairman of the Board.
- The rest of the members of the Board are appointed by the Governor with the advice and consent of the Senate.
- Four of the members must be involved in banking and recommended by the South Carolina Bankers Association.
- One of the members must be recommended by the association of supervised lenders.
- One of the members must be engaged in the mortgage lending business and recommended by the Mortgage Banker Associations of the Carolinas.
- One of the members must be engaged in the licensed consumer finance business as a restricted lender or a supervised lender and recommended by the Independent Consumer Finance Association.
- Two of the members must be engaged in the cooperative credit union business and recommended by the State Cooperative Credit Union League.
- One of the members must not be affiliated with a financial organization and serve as a representative of the consumers in the South Carolina.

Title 34, Chapter 1, entitled State Board of Financial Institutions, refers to the Board and states that it has the power to supervise all banks and building and loan associations and provide regulations and instructions for the direction, control and protection of all such institutions, the conservation of their assets and the liquidation thereof [§34-1-60].

Additionally, no bank, building and loan association, savings and loan association or savings bank can be granted a charter of be established without the written approval of the Board [§34-1-70].

If a bank, building and loan association, savings and loan association, or savings bank wants to become established, it is up to the Board to commence an investigation and determine whether the applicant is qualified to operate the institution, has complied with the law, and whether they would serve the public interest. Furthermore, the Board must conduct an annual study regarding the capital reserve position of all financial institutions and intermediaries subject to its supervision and report its findings to the General Assembly. The Board must include any recommended legislation within the report to the General Assembly [§34-1-130].

Title 34 also denotes that the Board must have an examining department. The Board must appoint a Commissioner of Banking that will be in charge of the examining department. It is the Commissioner of Banking that reports criminal violations to the Board [§34-1-90].

If anyone is deemed guilty of obstructing the Commissioner of Banking or his assistants, he or she will be subject to imprisonment for no more than one year, or fined no more than one thousand dollars, or both, in the discretion of the court [§34-1-120].

It is the South Carolina State Board of Financial Institutions that legally permits mortgage lenders and loan originators operating pursuant to a license to make mortgage loans, to engage in a mortgage lending activity authorized for licensed mortgage lender and loan originators by law or by regulation of an agency given supervisory authority over those institutions [§34-1-110 (A)(5)].

In fact, the Board is given a lot of legal power to permit various financing related activity. The Board, by law, may permit all of the following: [§34-1-110 (A)(1)(2)(3)(4)(5)(B)]

- State-chartered banks to engage in any activity authorized for national banks and by federal law or regulation of the Comptroller of the Currency or for state-chartered savings and loan associations by this title [34] or regulation or operational instruction of the State Board of Financial Institutions

- State-chartered savings and loan associations to engage in any activity authorized by federally chartered savings and loan associations by federal law or regulation of the Office of Thrift Supervisions or for the state-chartered banks by this title [34] or regulation or operational instruction of the State Board of Financial Institutions
- Cooperative credit unions to engage in any activity authorized for federally chartered credit unions by federal law or by regulation of the National Credit Union Administration
- Consumer finance companies operating pursuant to a license to make supervised loans as provided in Part 5, Chapter 3, Title 37, to engage in any lending activity authorized for supervised financial organizations by law or by regulation of any agency given supervisory authority over those institutions, except where otherwise restricted by statute
- The Board permits mortgage lenders and loan originators operating pursuant to a license to make mortgage loans as provided in Chapter 22, Title 37, to engage in a mortgage lending activity authorized for licensed mortgage lenders and loan originators by law or an agency given supervisory authority over those institutions, except where otherwise restricted by statute.

As you can see, the South Carolina State Board of Financial Institutions is entrusted with a lot of responsibility. In order to oversee and complete all that the Board is responsible for, the Board is efficiently divided into two parts. The Boards website (www.bofi.sc.gov) summarizes the division as follows:

- The Banking Division - supervises and regulates State chartered banks, trust companies, savings banks, and credit unions.
- The Consumer Finance Division - is responsible for regulating licensing and compliance examination for non-depository consumer lending, deferred presentments services, check cashing, mortgage lending, mortgage servicing and all of their employees doing loan originating or loan modification activity.
    - The following must be licensed by the Consumer Finance Division:
        - Consumer loans made by non-bank/depository institutions with interest rates exceeding 12% APR
        - A person engaging in the business of deferred resentment services (payday lending)
        - Non-depository entities performing check cashing activities where fees are charged or other consideration is made
        - Mortgage lending or servicing by non-depository entities
        - Subsidiaries of depository institutions that are not entirely owned and regulated by one of the federal banking agencies
        - Loan originators employed by licensed lenders/servicers

The Board, just as the Department, plays a large role in matters pertaining to mortgage lending and licensing in the state of South Carolina. Both of these institutions are responsible for various aspects of the process of receiving and keeping a mortgage loan originator license.

Officially, the South Carolina State Board of Financial Institutions regulates mortgage lender or servicers and mortgage loan originators. The South Carolina Department of Consumer Affairs regulates mortgage brokers, including table funding and loan correspondents, and it regulates mortgage broker loan originators.

It depends on the type of business operations which licensing jurisdiction, whether the Department of Consumer Affairs or the State Board of Financial Institutions, the individual will belong to.

We will delve into what these regulations look like with regards to applying for, obtaining, and maintaining a license as a mortgage loan originator later in the course. For now, we will go over the various Acts enacted that provide the requirements that both of these offices enforce and monitor when it comes to mortgage lending, licensing, and overall consumer protection. We will turn to these laws next.

South Carolina Law and Regulation Definitions - The South Carolina Mortgage Lending Act

The South Carolina Mortgage Lending Act is now part of the South Carolina Consumer Protection Code, or Title 37. Chapter 22 of Title 37 contains the regulations pertaining to Mortgage Lending. We will discuss these here. If you would like to access the law itself, it can be accessed through the South Carolina Legislature website: www.scstatehouse.gov.

Before we get into what the law states about mortgage lending and licensing itself in South Carolina, we should review some of the terminology and its legal definitions that we will encounter while discussing this law and many other laws pertaining to mortgage lending. These definitions can be found in Chapter 22 of the Consumer Protection Code. The following provides the legal definition to terminology that is most commonly used in the mortgage industry as it is intended to be defined in the state of South Carolina.

For the purposes of South Carolina law regarding mortgage lending:

- *"Act as a mortgage broker"* means to act, for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly, by:
    - (i) soliciting, processing, placing, or negotiating a mortgage loan for a borrower from a mortgage lender or depository institution or offering to process, place, or negotiate a mortgage loan for a borrower from a mortgage lender or depository institution,
    - (ii) engaging in table funding of a mortgage loan, or
    - (iii) acting as a loan correspondent whether those acts are done by telephone, by electronic means, by mail, or in person with the borrowers or potential borrowers. "Act as a mortgage broker" also includes bringing a borrower and lender together to obtain a mortgage loan or rendering a settlement service as described in 12 U.S.C. 2602(3) and 24 C.F.R. Part 3500.2(b). [§37-22-110(1)]
- "*Act as a mortgage lender*" means to engage in the business of making or servicing a mortgage loan for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly, including soliciting, processing, placing, or negotiating a mortgage loan. [§37-22-110 (2)]
- "Board" means the State Board of Financial Institutions [[§37-22-110(6)].
- "Borrower" means a natural person in whose dwelling a security interest is or is intended to be retained or acquired if that person's ownership interest in the dwelling is or is to be subject to the security interest [§37-22-110(7)].
- "Branch manager" means the natural person who is in charge of and who is responsible for the business operations of a branch office of a licensee
[§37-22-110(8)].

- “Branch office” means an office of the licensee that is separate and distinct from the licensee’s principal office [§37-22-110(9)].
- “Clerical or support duties” mean administrative functions after the receipt of an application by a licensed mortgage originator or lender, such as gathering information, requesting information, word processing, sending correspondence, or assembling files, and may include [§37-22-110(10)(a)(b)]:
    - the receipt, collection, and distribution common for the processing or underwriting of a residential mortgage loan; or
    - any communication with a borrower to obtain the information necessary for the processing or underwriting of a loan, to the extent that such communication does not include taking a residential mortgage loan application, offering or negotiating loan rates or terms, or counseling consumers about residential mortgage loan rates or terms.
- “Commissioner” means the designee of the State Board of Financial Institutions for the purposes of licensing and regulation of mortgage lenders and mortgage loan originators pursuant to this chapter [§37-22-110(11)].
- “Employee” means a natural person who has an employment relationship, acknowledged by both the natural person and the mortgage lender, and is treated like an employee for purposes of compliance with the federal income tax laws
  [§37-22-110(15)].
- “Exempt person” means: [§37-22-110(18)(a)(b)(c)(d)(e)(f)(g)(h)(i)(j)]
    - an employee of a licensee whose responsibilities are limited to clerical or support duties for the employer and who does not solicit borrowers, accept applications, or negotiate the terms of loans on behalf of the employer;
    - a depository institution or subsidiary that is wholly owned and controlled by the depository institution and regulated by a federal banking agency or an institution regulated by the Farm Credit Administration. This chapter does not apply to the exempt persons described in this subitem;
    - an officer, registered loan originator, or employee of an exempt person described in subitem (b) of this section when actin gin the scope of employment for the exempt person;
    - a person who offers or negotiates terms of a mortgage loan with or on behalf of an immediate family member of the individual;
    - an individual who offers or negotiates terms of a mortgage loan secured by a dwelling that served as the person’s residence;
    - an employee whose employment as a processor or underwriter is undertaken pursuant to the direction and supervision of a licensee or exempt person except when the processor or underwriter is working as an independent contractor;
    - an attorney who works for a mortgage lender, pursuant to a contract, for loss mitigation efforts or third party independent contractor who is HUD-certified, Neighborworks-certified, or similarly certified, who works for a mortgage lender, pursuant to a contract, for loss mitigation efforts;

    - a manufactured home retailer and its employees if performing only clerical or support duties in connection with the sale or lease of a manufactured home and the manufactured home retailer and its employees receive no compensation or other gain from a mortgage lender or a mortgage broker for the performance of the clerical or support duties; or
    - any other person deemed exempt pursuant to the Secure and Fair Enforcement Licensing Act (SAFE Act), Section 1508, Title V of the Housing and Economic Recovery Act of 2008, Public Law 110-289, and any regulations promulgated thereunder.

- "Individual servicing a mortgage loan" means an employee of a mortgage lender licensed in South Carolina that: [§37-22-110(22)(a)(b)(c)]
  - collects or receives payments including payments of principal, interest, escrow amounts, and other amounts due on existing obligations due and owing to the licensed mortgage lender for a mortgage;
  - works with the borrower and the licensed mortgage lender, collects data, and makes decisions necessary to modify, either temporarily or permanently, certain terms of those obligations; or
  - otherwise finalizes collection through the foreclosure process.
- "Licensee" means a person who is licensed pursuant to this chapter [§37-22-110(23)].
- "Loan correspondent" means a person engaged in the business of making mortgage loans as a third party originator and who does not engage in all three of the following activities with respect to each mortgage loan: [§37-22-110 (25(a)(b)(c)]
  - underwrite the mortgage loan written by their employees;
  - approve the mortgage loan; and
  - fund the mortgage loan utilizing an unrestricted warehouse or credit line
  - A loan correspondent is not a mortgage lender

    (This particular definition was added to this chapter after the Mortgage Lending Act was amended)
- "Loan originator" means a natural person who, in exchange for compensation or gain or in the expectation of compensation or gain as an employee of an employee of a licensed mortgage lender, solicits, negotiates, accepts, or offers to accept applications for mortgage loans, including electronic applications, or includes direct contact with, or informing mortgage loan applicants of, the rates, terms, disclosures, and other aspects of the mortgage loan.
  - The definition of "loan originator" does not include an exempt person described in item (18) or a person solely involved in extensions of credit relating to timeshare plants, as that term is defined in Section 101(53D) of Title 11, United States Code.
  - The definition of loan originator does not apply to an individual servicing a mortgage loan as that term is defined in this chapter until July 31, 2011, unless the United States Department of Housing and Urban Development or a court of competent jurisdiction determines before that time that those individuals servicing mortgage loans are "loan originators" as that term is defined in the SAFE ACT pursuant to Section 1508 of Title V of the housing and Economic Recovery Act of 2008, Public Law 110-289. Solely acquiring and reviewing a credit report does not constitute acting as a loan originator. [§37-22-110 (26)]

- “Mortgage broker” means a person who acts as a mortgage broker, as that term is defined in time (1)” [§37-22-110].
- “Registered loan originator” means a natural person who meets the definition of loan originator and is an employee of a depository institution or a subsidiary that is wholly owned and controlled by the depository institution and regulated by the federal banking agency or an institution regulated by the Farm Credit Administration and is registered with and maintains a unique identifier through the National Mortgage Licensing System and Registry. [§37-22-110(36)]

The definitions that we just reviewed, which are included in the South Carolina Mortgage Lending Act, are important for the understanding of certain laws and regulations that pertain to mortgage lending in South Carolina.

The South Carolina Mortgage Lending Act of 2009 not only provides definitions to some of the more important terms in the mortgage lending industry, it also provides the requisites to become a licensed mortgage lender, loan originator, or someone acting as a mortgage lender.

The South Carolina Mortgage Lending Act explains that it is unlawful for a person, other than an exempt person, doing business in South Carolina to: [§37-22-120A(1)(2)]

- act as a mortgage lender or, directly or indirectly, engage in the business of a mortgage lender under any name or title; or
- circulate or use advertising, including electronic means, make a representation or give information to a person which indicates or reasonably implies activity within the scope of this chapter

The law also states that it is unlawful for a person to employ, compensate, or appoint as its agent a loan originator unless the loan originator is licensed as a loan originator pursuant to this chapter. An exempt person is not subject to this subsection. [§37-22-120(B)]

The license of a loan originator is not effective during a period that the person is not employed by a mortgage lender licensed pursuant to this chapter. [§37-22-120(C)]

If a loan originator ceases to be employed by a mortgage lender licensed pursuant to this chapter, the loan originator and the mortgage lender by whom that person is employed promptly shall notify the commissioner in writing. The mortgage lender’s notice must include a statement of the specific reason or reasons for the termination of the loan originator’s employment. The reason for termination is confidential information and must not be released to the public. [§37-22-120(D)]

A loan originator must not be employed simultaneously by more than one mortgage lender licensed pursuant to this chapter. [§37-22-120(E)]

Independent contractors, except for exempt persons, must be licensed separately. Processors and underwriters who are independent contractors must be licensed as provided in section 37-22-110(34)(c). [§37-22-120(F)]

Aside from providing definitions to important terminology and the requirements for licensing of a mortgage lender or loan originator, the law also delineates reasons for revocation suspension, and termination of a license.

The South Carolina Mortgage Lending Act also provides a list of prohibited activities and demands participation in the national mortgage registry.

It also specifies that the act can be enforced by the commissioner of the Consumer Finance Division of the Board of Financial Institutions. On May 19, 2017, amendments were made to the South

Carolina Mortgage Lending Act, which went into effect on September 1, 2017. The amendments include, among others,

- the addition of the definition of “loan correspondent” to the list of defined terminology in the act;
- updated the pre-licensing and continuing education requirements for mortgage loan originators;
- placed new requirements on surety bond amounts;
- enabled a mortgage loan originator’s residence be deemed a branch office, and
- reconciled the term “exempt person” with persons deemed exempt in the federal SAFE Act.

It was this amendment that added the requirement for South Carolina Law content in both pre-licensing and continuing education for mortgage loan originators.

We will be delving into the details the South Carolina Mortgage Lending Act provides for mortgage loan originator license requirements, qualifications, and the application process later in the course.

South Carolina Law and Regulation Definitions - The High Cost and Consumer Home Loan Act

Another important act in South Carolina pertaining to mortgage lending is the High Cost and Consumer Home Loan Act.

- The Act was added to the Consumer Protection Code, or Title 37, under Chapter 23 in 2003.
- The Act sets up protections for South Carolina homeowners and creates a category for high cost home mortgages with a threshold.
- The Act also provides definitions for relevant terminology. We will review some of these terms first and then discuss the provisions of the Act.

According to the High Cost and Consumer Home Loans Act: [§37-23-20]:

- “Affiliate” means a company that controls, is controlled by, or is under common control with another company, as described in the Bank Holding Company Act of 1956 (12 U.S.C. Section 1841, et seq.), as amended [§37-23-20(1)].
- “Annual percentage rate” means the annual percentage rate for the loan calculated according to the provisions of the federal Truth in Lending Act (15 U.S.C. Section 1601, et seq.) and the regulations promulgated under it by the Federal Reserve Board, both as amended [§37-23-20(2)].
- “Broker” or “mortgage broker” means a person or organization in the business of soliciting, processing, placing, or negotiating mortgage loans for others or offering to process, place, or negotiate mortgage loans for others. A broker or mortgage broker also includes a person or organization who brings borrowers or lenders together to obtain mortgage loans or renders a settlement services. [§37-23-20(3)]
- “Consumer home loan” means a loan in which: [§37-23-20(4)(a)(b)(c)]
    - the borrower is a natural person;
    - the debt is incurred by the borrower primarily for personal, family, or household purposes; and

  - the loan is secured by a mortgage on real estate upon which is located or is to be located a structure designed principally for occupancy of from one to four families and that is or is to be occupied by the borrower as the borrower's principal dwelling.

- "Conventional conforming discount points" means loan discount points knowingly paid by the borrower for the purposes of reducing, and which in fact result in a bona fide reduction of, the interest rate applicable to the loan, so long as the home loan has an annual percentage rate that does not exceed the conventional mortgage rate by more than one percentage point [§37-23-20(5)]
- "Conventional mortgage rate" means the required net yield for a ninety-day standard mandatory delivery commitment for a reasonably comparable loan from either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, whichever is greater [§37-23-20(6)]
- "Conventional prepayment penalty" means a prepayment penalty or fee that may be collected or charged in a home loan and that is authorized by law other than by this chapter, provided the home loan (a)does not have an annual percentage rate that exceeds the conventional mortgage rate by more than two percentage points; and
  (b) does not permit prepayment fees or penalties that exceed two percent of the amount prepaid [§37-23-20(7)]
- "Flipping" a consumer home loan means the making of a consumer home loan that refinances within forty-two months an existing consumer home loan of the borrower when the new loan does not have a reasonable, tangible net benefit to the borrower, considering all the circumstances, including the terms of both the new and refinanced loans, the cost of the new loan, and the borrower's circumstances. [§37-23-30(8)].
- "High-cost home loan" means: [§37-23-20(9)(a)(i)(ii)(iii)(iv)(v)(b)]
  - a loan, other than an open-end credit plan or a reverse mortgage transaction, in which the:
    - principal amount of the loan does not exceed the conforming loan size limit for a single-family dwelling as established from time to time by the Federal National Mortgage Association;
    - borrower is a natural person;
    - debt is incurred by the borrower primarily for personal, family, or household purposes;
    - loan is secured by either a security interest in a residential manufactured home, as defined in Section 37-1-201(24) which is to be occupied by the borrower as the borrower's principal dwelling, or a mortgage on real estate upon which there is located or there is to be located a structure designed principally for occupancy from one to four families and which is or is to be occupied by the borrower as the borrower's principal dwelling; and
    - terms of the loan exceed one or more of the thresholds as defined in item (15); or
    - be an adjustable rate mortgage at the fully indexed rate assuming a fully amortizing repayment schedule that would exceed one more of the thresholds as defined in item (15)
- "Obligor" means each borrower, co-borrower, cosigner, or guarantor obligated to repay the loan [§37-23-20(11)]

- “points and fees” means: [§37-23-20 (13)(a)(b)(c)(d)]
  - items required to be disclosed pursuant to Sections 226.4(a) and 226.4(b) of Title 12 of Code of Federal Regulations, as amended, except interest or the time-price differential;
  - charges for items listed in Section 226.4(c)(7) of Title 12 of the Code of Federal Regulations, as amended from time to time, but only if the lender receives direct or indirect compensation in connection with the charge or the charge is paid to an affiliate of the lender; otherwise, the charges are not included within the meaning of the phrase “points and fees”;
  - compensation paid directly by the borrower to a mortgage broker not otherwise included in the subitem (a) or (b);
  - the maximum prepayment fees and penalties that may be charged or collected pursuant to the terms of the loan documents. Interest that may accrue in advance of payment in full of a loan made under a local, state, or federal government-sponsored mortgage insurance or guaranty program, including a Federal Housing Administration program, is not considered a prepayment fee or penalty
- “Threshold” means either (A) or (B) in a loan transaction, whichever is applicable: [§37-23-20(15)(A)(B)(i)(ii)(iii)(C)(i)(ii)(iii)]
  - *(A)* Without regard to whether the loan transaction is a “residential mortgage transaction” as the term “residential mortgage transaction” is defined in Section 226.2 (a)(24 of Title 12 of the Code of Federal Regulations, as amended, the annual percentage rate of the loan at the time the loan is consummated is such a rate that the loan is considered to be a “mortgage” pursuant to Section 152 of the Home Ownership and Equity Protection Act of 1994, as amended, and regulations adopted pursuant to it by the Federal Reserve Board, including Section 226.32 of Title 12 of the Code of Federal Regulations, as amended, except with regard to a mortgage or loan secured by a nonreal estate manufactured housing lien, the term “threshold” means the annual percentage rate of the nonreal estate secured manufactured housing line at the time the mortgage or loan is consummated exceeds by more than ten percentage points the yield on United States Treasury securities having comparable periods of maturity as of the fifteenth day of the month immediately preceding the month in which the application of extension of credit is received by the lender;
  - *(B)* the total points and fees payable by the borrower at or before the loan closing exceed:
    - five percent of the total loan amount if the total loan amount is twenty thousand dollars or more;
    - the lesser of eight percent of the total loan amount or one thousand dollars if the total loan amount is less than twenty thousand dollars; or
    - three percent of the total loan amount for nonreal estate secured manufactured housing transactions if the total loan amount in the nonreal estate secured housing transaction is twenty thousand dollars or more;
  - *(C)* Except that the following discount points and prepayment fees and penalties are excluded from the calculation of the total points and fees payable to the borrower:
    - up to and including two conventional conforming discount points payable by the borrower in connection with the loan transaction but only if the interest rate from which the loan’s interest rate is discounted does not exceed by more than one

parentage point the required net yield for a ninety-day standard mandatory delivery commitment for a reasonably comparable loan from either Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, which is greater; or

    - up to and including one conventional conforming discount point payable by the borrower in connection with the loan transaction, but only fi the interest from which the loan's interest rate is discounted does not exceed by more than two percentage points the required net yield for a ninety-day standard mandatory delivery commitment for a reasonably comparable loan from either the Federal national Mortgage Association or Federal Home Loan Mortgage Corporation, whichever is greater;
    - a conventional prepayment penalty.

The above terminology is important in order to understand what the High-Cost and Consumer Home Loan Act provides for the mortgage lending industry in South Carolina. Section 37-23-30 of the High-Cost and Consumer Home Loan Act denotes what a high-cost home loan agreement should and should not contain. A high-cost home loan agreement may **not** contain:

- a provision that allows the lender to call a loan at his or her discretion [§37-23-30(1)]
- a balloon payment [§37-23-30(2)]
- negative amortization [§37-23-30(3)]
- an increase in the rate after default [§37-23-30(4)]
- requirements of more than two periodic payments to the loan to be paid in advance from the loan proceeds provided to the borrower [§37-23-30(5)]
- a charge to the consumer for fees to modify, renew, extend, or amend a high-cost home loan [§37-23-30(6)]
- provide the consumer with a choice of law provisions to avoid South Carolina law [§37-23-30(7)]

The Act also provides limitations on lenders of high-cost home loans. The lender of a high-cost home loan may not:

- make a high-cost home loan without first receiving written certification from a counselor approved by the State Housing Finance and Development Authority that the borrower has received counseling on the advisability of the loan transaction [§37-23-40(1)]
- provide a high-cost home loan without determining first whether the consumer can repay the loan [§37-23-40(2)]
- finance, directly or indirectly, prepayment penalties [§37-23-40(3)(a)]
- finance, directly or indirectly, more than 2.5 percent in points or fees [§37-23-40(3)(b)]
- charge fees or points to refinance a loan made by the lender [§37-23-40(4)]
- pay a contractor for a home improvement loan from the proceeds of a high-cost home loan [§37-23-40(5)]
    - the check must be payable jointly to the borrower and contractor [§37-23-40(5)(a)] or
    - through a third party escrow agent [§37-23-40(5)(b)]

Additionally, the High Cost and Consumer Home Loan Act protects consumer home loans by listing prohibited acts. According to section 37-23-70:

- A lender may not engage knowingly or intentionally in the unfair act or practice of “flipping” a consumer loan [§37-23-70(A)]
- Al lender may not finance directly or indirectly credit life, disability, debt cancellation, or unemployment insurance, or other life or health insurance premiums, except that insurance premiums calculated and paid on a monthly basis are not considered to be financed by the lender [§37-23-70(B)]
- A lender may not recommend or encourage default on an existing loan or other debt before and in connection with the closing planned or closing of a consumer home loan that refinances all or a portion of the existing loan or debt [§37-23-70(C)]
- At the time of application, the loan originator or mortgage broker must provide the consumer with information as to where the consumer can file a complaint [§37-23-70(D)]

If a lender violates this section and is found to have committed one of the prohibited acts discussed above, he or she is subject to actual damages and a penalty in an amount determined by the court of no less than $1,500 and no more than $7,500 for each transaction. However, there is a statute of limitations of 6 years, after which the borrower may no longer bring action to the lender for the violation [§37-23-70(F)].

The Act also specifies the types of disclosures consumers must have access to during the lending process. These disclosures will help educate the consumer of what is occurring during the lending process.

At the time when the borrower receives the Loan Estimate (LE) and prior to the loan closing, the broker or mortgage broker must disclose in writing the amount being earned on the loan. The Department of Consumer Affairs shall provide a disclosure form that includes the following: [§37-23-75 (A)(1)(2)(3)(4)]

- The dollar amount of the yield spread premium and the percentage yield spread premium in relation to the loan amount;
- An itemization of the dollar amounts for points, fees, and commissions with a combined total given
- Dollar amount total of both of the item above
- If the loan is an adjustable rate mortgage, the listing of the schedule for when the loan may be reset, for each and every reset, and a listing of the monthly payment that is owed for each change that is allowed by the terms of the contract.

The disclosure form must include a signature line for the borrower to acknowledge that he has received the disclosures and that they have been explained to him or her [§37-23-75(B)].

Together, the above provisions help protect South Carolina consumers with regards to their mortgage loans.

Chapter 3 and Chapter 10 of the South Carolina Consumer Protection Code also add other provisions that enable the protection of consumers and their mortgage loans. We will turn to these next.

South Carolina Law and Regulation Definitions - Consumer Protection Code, Chapter 3 and Chapter 10

Chapter 3

Chapter 3 of South Carolina's Consumer Protection Code, or Title 37, focuses on loans. As such, it provides definitions of terminology having to do with loans.

According to Chapter 3 a "consumer loan" is:

- A loan made by a person regularly engaged in the business of making loans which: [§37-3-104(a)(b)(c)(d)]
    - A debtor is a person other than an organization;
    - The debt is incurred primarily for a personal, family, or household purpose;
    - Either the debt is payable in installments or a loan finance charge is made; and
    - Either the principal does not exceed twenty-five thousand dollars or the debt is secured by an interest in land.
- A consumer loan does not include a loan secured by a first lien or equivalent security interest in real estate [§37-3-105]

Chapter 3 defines "loan" to include:

- The creation of debt by the lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor;
- The creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately;
- The creation of debt pursuant to a lender credit card or similar arrangement; and
- The forbearance of debt arising from a loan. [§37-3-106]

Chapter 3 defines "Lender" to include an assignee of the lender's right to payment but use of the term does not in itself impose on an assignee any obligation of the lender with respect to events occurring before the assignment [§37-3-107(1)].

The chapter defines "principal" as the total of: [§37-3-107(3)(a)(b)(c)(i)(ii)]

- The net amount paid to, receivable by, or paid or payable for the account of the debtor;
- The amount of any discount excluded from the loan finance charge; and
- To the extent that payment is deferred:
    - Amounts actually paid or to be paid by the lender for registration, certificate of title, or license fees if not included in the net amount paid; and
    - Additional charges permitted by Chapter 3

Chapter 3 defines a "finance charge" as the sum of: [§37-3-109 (1)(a)(b)]

- all charges payable directly or indirectly by the debtor and imposed directly or indirectly by the lender as an incident to the extension of credit, including interest or any amount payable under a point, discount or other system of charges, premium or other charge for any guarantee or insurance protecting the lender against the debtor's default or other credit loss

- charges incurred for investigating the collateral or creditworthiness of the debtor or for commissions or brokerage for obtaining the credit, irrespective of the person to whom the charges are paid or payable, unless the lender had no notice of the charges when the loan was made but excluding fees and charges paid to persons registered as mortgage loan brokers.

The above definitions provide clarity regarding certain aspects pertaining to different loans, but Chapter 3 also includes provisions that allow lenders to do certain things during the lending process.

- Chapter 3 enables the lender to collect closing costs, including fees or premiums for title, appraisals, insurances, and fees and charges to persons registered as mortgage loan brokers. [§37-3-202(d)(i)(ii)(iii)(iv)(v)(e)(f)(2)].
- The chapter also enables a lender to refinance a borrower's loan, or "unpaid balance" and charge a finance charge for doing so. [§37-3-205].
- If a loan requires a rate schedule, it must designate the rate as a variable rate and disclose the index for calculating changes in the rate and the cap or other limitation, if any, on any increases or decreases in the rate [§37-3-305(2)]

Aside from allowing lenders to conduct themselves a certain way and providing clarity regarding some of the terminology important to the world of consumer loans, this Chapter includes other provisions that add accountability to those involved in mortgage lending.

Chapter 3 grants the State Board of Financial Institutions the authority to examine periodically the loans, businesses, and records of every licensee [§37-3-506(1)].

This means that at any point the South Carolina State Board of Financial Institutions can demand access to the offices, places of business, and records of any lender in order to determine whether the lender has acted in accordance to the law. Knowing that this is the case further motivates licensees to behave in accordance to South Carolina and Federal law.

Furthermore, Chapter 3 states that any provisions that conflict with the SAFE Act must be changed in order for them to be interpreted as those in the SAFE Act and that all disclosures and advertisements must be in compliance with the Truth-in-Lending Act [37-3-301, 304].

<u>Chapter 10</u>

Chapter 10 of the Consumer Protection Code deals with "miscellaneous loan provisions." This Chapter contains additional provisions regarding loans that were not covered in Chapter 3 and other chapters in Title 37.

Chapter 10 states that prior to closing a loan, the creditor must know the borrower's preference for an attorney that will represent him or her in the closing of the loan. The creditor must do the same regarding the borrower's insurance agent for both hazard and flood insurance. [§37-10-102(a)] In order to comply with such, the creditor has the following options:

- He or she can include the preference information on the credit application [§37-10-102(1)]
- Provide written notice to the borrower with the information when the notice is being delivered no later than 3 days after the application is received [§37-10-102(2)]

This provision enables the consumer to be in charge of decision-making regarding the costs associated with representation in both the loan itself and the home. The consumer has the right to shop around for these services and does not need the permission of the creditor to pick his or her attorney or insurance agent.

Furthermore, a consumer is not punished for paying his or her debt in full. Chapter 10 states that for loans of 150,000 dollars or less, a debtor can prepay in full the debt without incurring any penalty as long as the debt is represented by a personal, family, or household purpose loan agreement that is secured in whole or in party by a first or junior lien on real estate and the aggregate of all sums advanced does not exceed 150,000 dollars.
[§37-10-103]

If a loan is agricultural in its purpose or under 25,000 dollars, and the debtor wants to prepay in full, the maximum loan finance charge that is allowed is 18% per annum, calculated according to the actuarial method. [§37-10-104]

This chapter also provides an additional protection to the consumer by denoting that the maximum rate of interest per year is 6%, except upon written contracts wherein, by express agreement, any interest may be charged.

The chapter also defines both the terms legal rate of interest and lawful rate of interest. Whenever the term legal rate of interest is used or lawful rate of interest in used in a contract it is meant to mean the rate specified in Section 34-31-20, which states that in all cases of accounts stated and in all cases wherein any sum or sums of money shall be ascertained and, being due, shall draw interest according to law, the legal interest shall be at the rate of eight and three-fourths percent per annum. [§34-31-20(A), §37-10-106(1)(2)]

If the provisions discussed above are in some way violated, the person violating the chapter can incur a penalty determined by the court of no less than $1,500 and no more than $7,000. The statute of limitations for the violation is 3 years. [§37-10-105]

Chapter 3 and Chapter 10 of the South Carolina Consumer Protection Code add to the protection of consumers by including provisions having to do with consumer loans that give more power to the consumer and add a level of accountability for mortgage lenders and brokers.

We have discussed different South Carolina laws pertaining to consumer protection. Next, we will discuss in more detail some of the provisions found in the Mortgage Lending Act and in South Carolina's Consumer Protection Code that pertains specifically to mortgage loan originators.

Part 2: South Carolina License Law and Regulation

OVERVIEW

In this lesson we will review details on South Carolina laws and regulations pertaining to licensing. We will go over what activities the law states require a license, what is required of persons wanting to become licensed as mortgage loan originators or mortgage lenders, what makes a person qualified for a mortgage loan originator license as well what the application process to get a license is like in South Carolina. Additionally, we will review what the law states regarding maintaining a mortgage loan originator license once one is obtained. And finally, we will also go over what the laws and regulations state are the grounds for denying a license.

Learning Objectives

After reviewing this lesson, students should be able to:

- Know what activities require a mortgage loan originator license
- Understand what the law requires of persons wanting to become licensed as mortgage loan originators and what the application process is like for a license
- Know the requisites to maintain a mortgage loan originator license as well as the reasons for the denying of a license

South Carolina License Law and Regulation

Before we begin this lesson, it is important to understand that there are two main titles and chapters in the South Carolina Code of Laws that pertain to mortgage lending: Title 37, Chapter 22, and Title 40, Chapter 58. What we will be predominantly reviewing below is what the law denotes in Title 37, Chapter 22, which is the Mortgage Lending Act. However, Title 40, Chapter 58, or the Licensing of Mortgage Brokers Act is also relevant. Title 40, Chapter 58 contains provisions that are almost identical to those provisions in Title 37, Chapter 22.

Their main difference, however, is the fact that Chapter 22 places regulatory authority on the Commissioner of the Consumer Finance Division of the State Board of Financial Institutions and Chapter 58 places regulatory authority on the Administrator of the Department of Consumer Affairs.

As you will recall, from the last section, both of these offices are South Carolina’s regulatory authority for mortgage lending in the state. The South Carolina State Board of Financial Institutions regulates mortgage lender or servicers and mortgage loan originators, while the Department of Consumer Affairs regulates mortgage brokers, including table funding and loan correspondents, and mortgage broker loan originators.

South Carolina provides specific laws and regulations pertaining to mortgage loan originators. These laws and regulations include activities that require licensure. Before we move on to discuss these, let’s reacquaint ourselves with what South Carolina law defines as a mortgage loan originator.

According to Chapter 22 of Title 37, also known as the Mortgage Lending Act, a loan originator means a natural person who, in exchange for compensation or gain or in the expectation of compensation or gain as an employee of a licensed mortgage lender, solicits, negotiates, accepts, or offers to accept applications for mortgage loans, including electronic applications, or includes direct contact with, or informing mortgage loan applicants of, the rates, terms, disclosures, and other aspects of the mortgage loan. The definition “loan originator” does not include an exempt person or a person solely involved in extensions of credit relating to timeshare plans. [§37-22-26]

This same chapter defines “act as a mortgage broker” to mean to act, for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly, by:

(i) soliciting, processing, placing, or negotiating a mortgage loan for a borrower from a mortgage lender or depository institution or offering to process, place, or negotiate a mortgage loan for a borrower from a mortgage lender or depository institution,

(ii) engaging in table funding of a mortgage loan, or

(iii) acting as a loan correspondent whether those acts are done by telephone, by electronic means, by mail, or in person with the borrowers or potential borrowers.

“Act as a mortgage broker” also includes bringing a borrower and lender together to obtain a mortgage loan or rendering a settlement service. [§37-22-1].

Since we will be discussing what must occur in order to obtain a license in this lesson it is convenient that Chapter 22 also defines what a licensee means. A “licensee” is defined as someone who is licensed pursuant to Chapter 22.

Title 37, Chapter 22, Section 260 gives the commissioner of the South Carolina State Board of Financial Institutions the regulatory authority to create new provisions necessary to put into effect the purpose of the chapter. Using this regulatory authority in order to comply with the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, and with HUD rules, the South Carolina State Board of Financial Institutions added Article 4, regulations 15-64. The addition of these regulations to previous lending law were meant to clarify existing provisions in Chapter 22 as well as to ensure that the provisions were in line with federal laws. To that end, these regulations also define some relevant terminology: [Article 4 §15-64 (A)(2)(3)(4)(5)]

- Day - means all calendar days including Saturdays, Sundays and legal public holidays
- Employee for the purposes of compliance with the federal tax laws- means a natural person whose manner and means of performance of work are subject to the right of control of, or are controlled by, a person, and whose compensation for federal income tax purposes is reported, or required to be reported, on a W-2 form issued by the controlling person.
- Notice - means written notification received by the Commissioner within (7) days of any change except as defined in Section 37-22-180 (A), which states that a licensee shall report to the commissioner a change of address of the principal place of business or branch office at least 7 days before the change. (We will go over this section later in the lesson.)
- Prior Written Consent - means written consent given by the Commissioner authorizing a change of control prior to that change of control taking place. To request authorization from the Commissioner, all information regarding acquisition via stock purchase or other device must be sent to the Commissioner at least 30 days prior to the change of control.

The definitions above are important to understand what Chapter 22 states are activities that require a license as well as what the requisites are for becoming licensed and remaining licensed in South Carolina. We will now turn to the chapter’s provisions regarding licensing.

Persons Required to be Licensed

There are certain activities that persons cannot participate in if they are not licensed pursuant to Chapter 22. In the state of South Carolina, if you want to participate in the following activities, you must be a licensee [§37-22-120(A)(1)(2)(B)(C)]

- Act as a mortgage lender or, directly or indirectly engage in the business of a mortgage lender under any name or title

- Circulate or use advertising, including electronic means, make a representation or give information to a person which indicates or reasonably implies activity within the scope of Chapter 22
- Employ, compensate, or appoint as its agent a loan originator unless the loan originator is licensed as a loan originator pursuant to Chapter 22
- Continue to conduct activities of a licensee if you are not employed by a mortgage lender that is licensed pursuant to Chapter 22

Thus, in accordance to state law, you must be a licensee if you want to participate in activities as a mortgage broker or lender. This includes advertising for any lending activity.

> It is important to note that if you do obtain a license as a mortgage loan originator, but are not employed by a mortgage lender, you cannot practice mortgage origination activities. Additionally, Chapter 22 states that if you are licensed as a mortgage loan originator, but are not employed by a mortgage lender, you and the mortgage lender must notify the commissioner of the State Board of Financial Institutions in writing with a statement that explains the reasons for termination. [§37-22-120(D)] And, a loan originator must not be employed simultaneously by more than one mortgage lender that is licensed pursuant to Chapter 22. [§37-22-120(E)]

There are some exemptions to the above. Exempt persons are not required to have a license. In the last lesson, we reviewed what an "exempt person" means according to Chapter 22. Let's quickly review this again:

"Exempt person" means: [§37-22-110(18)(a)(b)(c)(d)(e)(f)(g)(h)(i)(j)]

- an employee of a licensee whose responsibilities are limited to clerical or support duties for the employer and who does not solicit borrowers, accept applications, or negotiate the terms of loans on behalf of the employer;
- a depository institution or subsidiary that is wholly owned and controlled by the depository institution and regulated by a federal banking agency or an institution regulated by the Farm Credit Administration. This chapter does not apply to the exempt persons described in this subitem;
- an officer, registered loan originator, or employee of an exempt person described in subitem (b) of this section when actin gin the scope of employment for the exempt person;
- a person who offers or negotiates terms of a mortgage loan with or on behalf of an immediate family member of the individual;
- an individual who offers or negotiates terms of a mortgage loan secured by a dwelling that served as the person's residence;
- an employee whose employment as a processor or underwriter is undertaken pursuant to the direction and supervision of a licensee or exempt person except when the processor or underwriter is working as an independent contractor;
- an attorney who works for a mortgage lender, pursuant to a contract, for loss mitigation efforts or third party independent contractor who is HUD-certified, Neighborworks-certified, or similarly certified, who works for a mortgage lender, pursuant to a contract, for loss mitigation efforts;

    - a manufactured home retailer and its employees if performing only clerical or support duties in connection with the sale or lease of a manufactured home and the manufactured home retailer and its employees receive no compensation or other gain from a mortgage lender or a mortgage broker for the performance of the clerical or support duties; or
    - any other person deemed exempt pursuant to the Secure and Fair Enforcement Licensing Act (SAFE Act), Section 1508, Title V of the Housing and Economic Recovery Act of 2008, Public Law 110-289, and any regulations promulgated thereunder.

The persons and activities mentioned above are not required to have a mortgage lending license or a loan originator license. However, aside from those deemed exempt, anyone wanting to engage in mortgage broker activities as well as those activities mentioned at the beginning of this lesson must have a license in order to do so in the state of South Carolina.

In order to obtain a license to participate in these activities, you must go through the license application process. Next, we will discuss what this entails.

<u>Licensee Qualifications and Application Process</u>

In order to obtain a mortgage loan originator license, an application for licensure must be filed with the commissioner of the Consumer Finance Division of the South Carolina State Board of Financial Institutions, on forms approved by the commissioner.

The Consumer Finance Division of the State Board of Financial Institutions focuses on regulating licensing and compliance examination for non-depository consumer lending, deferred presentment services, check cashing, mortgage lending, mortgage servicing and all of their employees doing loan originating or loan modifications. Thus, it is no surprise, that it is the commissioner of the Consumer Finance Division that is given a lot of authority in Chapter 22 when it comes to licensing in South Carolina; starting with the fact that applicants for licensure must submit their applications to him or her.

The application itself must include information that the commissioner considers necessary.

The following is information deemed necessary for the application of a license: [§37-22-140(A)(1)(2)(3)(4)(i)(ii)(iii)(5)(6)(i)(ii)(iii)]

- name, address, and social security number or, if applicant, Employer Identification Number (EIN);
- form and place of organization, if applicable;
- proposed method of and locations for doing business, if applicable;
- qualification and business history and, if applicable, the business history of any partner, officer, or director, a person occupying a similar status or performing similar functions, or a person directly or indirectly controlling the applicant, including:
    - a description of any injunction or administrative order by a state or federal authority to which the person is or has been subject, including denial, suspension, or revocation of a financial services or financial services related license or registration;

  - a conviction, or plea of guilty or nolo contendere to a misdemeanor within the last ten years involving financial services or a financial services related business or any fraud, false statements or omissions, theft or wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, money laundering, breach of trust, or a conspiracy to commit any of these offenses; and
  - a conviction of, or plea of guilty or nolo contendere to a felony;
- financial condition, credit history, and business history, with respect to an application for licensing as a mortgage lender; and credit history and business history, with respect to the application for licensing as a loan originator; and
- consent to a national fingerprint-based criminal history record check pursuant to Section 37-22-240 and submission of a set of the applicant's fingerprints in a form acceptable to the commissioner. In the case of an applicant that is a corporation, partnership, limited liability company, association, or trust, each natural person who has control of the applicant or who is the managing principle or a branch manager shall consent to a national fingerprint-based criminal history record check pursuant to Section 37-22-240 and submit a set of that natural person's fingerprints pursuant to this item. Refusal to consent to a criminal history record check constitutes grounds for the commissioner to deny licensure to the applicant as well as to any entity:
  - by whom or by which the applicant is employed;
  - over which the applicant has control; or
  - as to which the applicant is the current or proposed managing principal or a current or proposed branch manager.

As stated above, along with the rest of the requisites, the applicant for licensure must undergo a national criminal record check, supported by fingerprints, by the FBI. The law states that the results of the checks must be reported to the commissioner and the Nationwide Mortgage Licensing System and Registry is authorized to retain the fingerprints for certification purposes and for notification of the commissioner regarding subsequent criminal charges. The information gathered will be kept by the commissioner in accordance with applicable state and federal guidelines. [§37-22-240]

- ➢ Please note that before, a state criminal background check was required. However, since the Nationwide Mortgage Licensing System and Registry is authorized to conduct national background checks for companies and individuals, and their background check includes state and federal data, the state criminal background check is no longer required by law. The included state data in the background check is reported within 24 hours of processing.

In addition to the above requirements, South Carolina law also requires that a person applying for licensure as a mortgage loan originator: [§37-22-140(B)(1)(2)(3)(4)(5)]

- have attained the age of at least 18 years;
- work for licensed mortgage lender;
- have satisfactorily completed pre-licensing education of at least twenty hours, which shall include at least three hours on South Carolina laws and regulations, and the National Test Component with Uniform State Content;
  - It is important to note that South Carolina's General Assembly introduced a bill for the 2017-2018 legislative session amending certain provisions in Chapter 22 of Title 37 of the South Carolina Code of Laws. The bill changes state law by requiring the use of the National SAFE Mortgage Loan Originator Test with Uniform State Content. This test now combines both the national and state testing requirements purported by the SAFE

Act. This change in law also includes the deletion of the original State test used prior to the change.

  - an applicant must pass the national test
  - if the applicant fails the test the applicant can retake the test as follows
    - After initial fail, applicant must wait 30 days before retaking the exam
    - After second attempt, applicant must wait 30 days before retaking the exam
    - After third attempt, the applicant must wait 180 days prior to retaking the exam
- have never had a loan originator license revoked in any governmental jurisdiction; and
- have not been convicted of, or pled guilty or nolo contendere to, a felony in a domestic, foreign, or military court: (i) during the ten-year period preceding the date of the application of licensing, or (ii) at any time, if the felony involved an act of fraud, dishonesty, breach of trust, or money laundering.

So long as the applicant meets the legal requirements above, he or she should have no impediment in obtaining a license as a mortgage loan originator.

If the applicant is applying for licensure as a mortgage lender, the applicant must comply with the following at the time of application and all times after that:
[§37-22-140(C)(1)(2)(3)(4)(5)]

- If the applicant is a sole proprietor, the applicant shall have at least three years of experience in financial services or financial services related business or other experience or competency requirements as the commissioner may impose.
- If the applicant is a general or limited partnership, at least one of its general partners shall have the experience described above
- If the applicant is a corporation, at least one of its principal officers shall have the experience described above
- If the applicant is a limited liability company, at least one of its members or managers shall have the experience described above
- Instead of showing three years experience, an applicant may show proof of three years employment with a federally insured depository institution or a VA-, FHA-, or HUD-approved mortgagee.

These applicants must also identify one person meeting the above requirements to serve as their managing principal [§37-22-140(D)].

Though we have already reviewed a lot of the legal requisites for licensure, we have yet to mention some of the financial requirements posited by law on those that want to become licensed. Applying for a license does come with certain financial requisites and responsibilities.

When applying for licensure, whether as a mortgage lender or a mortgage loan originator, each applicant must pay a filling fee. [§37-22-140(E)]

- If the application is for licensure as a mortgage lender, the filing fee is set at $1,000.00
- If the application is for a mortgage loan originator, the filing fee is $50.00

- These filing fees are in addition to the cost associated with obtaining credit reports and national fingerprint-based criminal history record checks.
- And, if a loan originator changes employment a new license must be issued for a fee of $25.00

Aside from a filing fee, there are also surety bond requisites mandated by the law. A surety bond is a legally binding contract that ensures the parties involved will meet their obligations. The surety bond is usually a three-way agreement between the principal, person who needs the bond, an obligee, person who requires the bond, and a surety company that sells the bond. The bond is meant to serve as a guarantee that the principal will do as required. If the principal does not, the bond will cover the outcome. A mortgage lender must post and maintain a surety bond in the amount determined by the commissioner of the South Carolina State Board of Financial Institutions. The amount is based on the total dollar amount of a mortgage loan subject to regulation by the commissioner in a calendar year pursuant to the following: [§37-22-140(F)]

- Dollar volume of mortgage loans from $0-$49,999,999, surety bond of $50,000
- Dollar volume of mortgage loans from $50,000,000 to $249,999,999, surety bond of $100,000
- Dollar volume of mortgage loans greater than $250,000,000 surety bond of $150,000

According to state law the surety bond of a mortgage lender can never be less than $50,000. The surety bond itself must be executed by a surety company authorized by South Carolina state law. The surety bond must also be executed to the commissioner and must be for the use of the State for the recovery expenses, fines, and fees, or any of them, levied pursuant to Chapter 22 and for consumers who have losses or damages as a result of noncompliance with Chapter 22 by the mortgage lender. The full amount of the surety bond must be in effect at all times. Unless a new bond is filed with the surety company prior to the termination of the previous surety bond, the licensee's license is considered terminated. If the licensees license expires based on bond termination, all licensed activity must stop, and the person must apply for a license again.

Additionally, any sole proprietor, general partner, member or manager of a limited liability company, or officer of a corporation who meets individually the requirements to obtain a license, upon payment of the applicable fee, meets the qualifications necessary to obtain a license as a loan originator. [§37-22-140(G)]

With regards to licensed mortgage lenders, each principal office and individual branch offices must be licensed pursuant to Chapter 22 and have individual licenses issued. A licensed mortgage lender must file an application form with the commissioner that identifies the address of the principal office and each branch office as well as the offices' branch managers. If necessary, the commissioner can license a personal residence of a loan originator as a branch office if it is located more than 70 miles from a commercial branch office location. The licensee fee for each branch office is $150.00. [§37-22-140(H)]

- New legislation signed into law during the 2017 legislative session amends parts of the South Carolina Code of laws and states that as long as a personal residence is more than 75 miles away from a commercial branch office location, a department can license that personal residence as a branch location.

We have so far mentioned the need for a license as a mortgage loan originator as well as a license for a mortgage lender, but what of those persons that act as both? The law states that a person who obtains a license as a mortgage lender, upon notice of the commissioner on a form prescribed by the commissioner, may act as a mortgage broker. However, there are times where mortgage lenders will act as mortgage brokers. The law states that a mortgage lender that also acts as a mortgage broker is not required to obtain a license as a mortgage broker.

However, in accordance to changes made to the law during the 2017 legislative session, there is a threshold in place that determines when a mortgage lender must obtain a license as a mortgage broker. The threshold is as follows:

If a person acts as a mortgage broker with regard to the majority of the mortgage loans reported on their Mortgage Call Report filed during the previous two quarters they must obtain a license as a mortgage broker. [§37-22-140(K)]. Thus, if a mortgage lender predominantly acts as a mortgage broker, he or she needs a license as a broker. Furthermore, a mortgage lender acting as a mortgage broker must comply with the South Carolina Licensing of Mortgage Brokers Act, which states the different prohibited activities for someone who is a licensed mortgage broker and provides details as to how a mortgage broker should conduct themselves and their business. We will delve into the provisions of the Licensing of Mortgage Brokers Act (or Title 40, Chapter 58 of the South Carolina Code of Law) in the next lesson.

So as to keep distance from what an individual does while licensed versus what the government officially approves of or does not approve of, one of the provisions in Chapter 22 makes it a point to state that the fact that a licensee has been issued a license pursuant to the laws of the state does not mean that his or her services are approved by the State or state agency [§37-22-140(J)].

> It is important to note that when completing and submitting your application along with other documentation, if any of the information provided and filed with the commissioner becomes inaccurate or incomplete, the licensee must promptly file a correcting amendment to the information contained in the document. [§37-22-140(M)]

Overall, the law denotes that if the commissioner determines that an applicant meets the qualifications for licensure and finds that the financial responsibility, character, and general fitness of the applicant are such as to command the confidence of the community and warrant belief that the business is to be operated honestly, fairly and efficiently, the commissioner can issue a license to the applicant. However, if the commissioner does not believe this to be the case in part or it its entirety, the commissioner can refuse to license the applicant and must notify him or her of the denial. [§37-22-140(I)] Therefore, the law really does leave it up to the commissioner to decide whether he or she believes an applicant should be licensed or not. Later in this lesson we will go into detail about what constitutes grounds for denying a license. Let’s first discuss what the law states is necessary in order to maintain a license.

License Maintenance

Aside from the financial responsibility of the application fee and the surety bond when qualifying or applying for licensure as a mortgage loan originator or mortgage lender, there are also other financial responsibilities and other requirements that the applicant or licensee must meet in order to maintain their license. We will turn to these next.

Chapter 22 explains that all licenses issued by the commissioner of the South Carolina State Board of Financial Institutions expire annually on the thirty-first day of December or on another date that the commissioner determines. This means that licensees must renew their license every year if they want to continue to practice mortgage loan originator activities that require a license in the state of South Carolina. The renewal period for licensees is from November first through December thirty-first annually or it can be another date that the commissioner sets. A licensee that wants to renew his or her license must submit an application to the commissioner in order to do so. Applications that are received after the renewal due date are considered late and subject to a late fee.
[§37-22-150(A)(1)(2)]

According to Chapter 22, licenses can be renewed by paying to the commissioner a renewal fee as prescribed by the Board for each of the following:

- For a licensed mortgage lender, an annual renewal fee of no more than $800 and no more than $150 for each branch office
- For a licensed loan originator, the renewal fee is no more than $50.00
    - ➢ New legislation signed into law during the 2017 legislative session amends parts of the South Carolina Code of laws and states that in addition to the initial nonrefundable license application fee of $550.00 for first time mortgage broker licensees, they must also pay a nonrefundable processing fee of $200.00. After these initial fees, mortgage broker licensees will pay a nonrefundable renewal fee of $550.00. A mortgage broker licensee will pay an initial fee of $150.00 and, thereafter, a renewal fee of $150.00 for each branch location. Amendments to fees for mortgage loan originator licensees include a $50.00 nonrefundable initial fee and a $50.00 nonrefundable renewal fee. All licensees must pay the cost of obtaining credit reports and background checks.

If a license for a licensed mortgage lender is not renewed by the renewal date, a late fee of no more than $500 as prescribed to the Board must be assessed. If a license for a licensed mortgage loan originator is not renewed during the renewal period, a late fee of no more that $100 as prescribed by the Board must be assessed as a late fee. However, if the licensee fails to renew his or her license within 30 days after the date the license expires or fails to maintain a valid license, the commissioner will require that the licensee comply with the requirements denoted by law for obtaining an initial license as well as pay the fee that has accrued. [§37-22-150(B)]

A good rule of thumb: always renew your license on time every year in order to avoid paying a fee or eventually having to go through the license application process all over again.

The law also states that at any time, the commissioner can require each person with a license to furnish a national fingerprint-based criminal history check and a set of fingerprints in a form acceptable to the commissioner. If a person refuses to do so, it could constitute grounds for the commissioner to deny the licensee's license renewal as well as to refuse the renewal of the license of the person by which he or she is employed, over which he or she has control, or which he or she is the current or proposed managing principal or branch manager. [§37-22-150(C)]

Aside from a renewal fee, in order to renew a license as a mortgage loan originator there are yearly requirements the licensee must meet. To renew a license:
[§37-22-160(A)(B)(C)(D)]

- A licensee must complete at least 8 hours of continuing professional education every year
    - Continuing education must include at least 1 hour of South Carolina Laws and Regulations
    - The completion of the continuing professional education must be reported to the commissioner every year
    - Licensees must maintain documentation of all courses completed
    - Documentation of the courses completed is subject to inspection by the commissioner for up to two years after the date of course completion
- Continuing education credit may be granted only for the year in which the class is taken and may not be granted for the same course in successive years.
- If a licensee fails to complete the continuing professional education before the license expiration date, his or her license expires and he or she will have to pay a penalty of no more than $100.00 in addition to other fees that may have accrued.

- The South Carolina 2017 legislative session made amendments to some of the education requirements for licensure and renewal. The amendments include the requirement of at least one hour of South Carolina specific laws within the 8 hour continuing education requirement. Licensees have until November 2018 to satisfy this particular requirement.

It is important to note that all pre-licensing education, continuing education, and written examinations must be approved through the Nationwide Mortgage Licensing System and Registry before credit can be given to applicants or licensees. Applicants and licensees that successfully complete education or testing approved through the NMLS fulfill requirements of this State.

The law also imposes other responsibilities on licensees in order to maintain a license in good standing. For example: there are certain records that licensees must keep and certain information they must report while conducting everyday loan originating activities. A licensee must make and keep accounts, correspondence, memoranda, papers, books, and other records prescribed by the commissioner. [§37-22-210(C)(D), §40-58-65 (A)]

Licensees must preserve their records for at least 3 years, unless the commissioner says otherwise. These records are important and must be safely maintained. A licensee should develop, maintain, and test disaster recovery plans for all records that are maintained. If the records are somehow misplaced, incomplete or destroyed, the licensee could be subject to disciplinary action.

State law states that if a licensee chooses to maintain their records electronically, they can do so as long as these electronic records can be readily accessible for examination by the commissioner at any time. [§37-22-210(C)(1)(2)(D)].

- Mortgage broker records as required by law used to include the stipulation that a broker must have a physical location in South Carolina and therefore records should be kept in that physical location. The latest changes in state law that came out of the 2017 legislative session amend this regulation and remove the requirement for a mortgage broker to have a physical location in South Carolina. [S366 amendment to §40-58-65]

In addition to the maintenance of the records just mentioned, licensees must also keep records in the form of a Mortgage Log. The Mortgage Log must contain the following information:

- Credit score of borrower
- Adjustable or fixed type of loan
- Term of loan
- Annual percentage rate of the loan
- Appraised value of the collateral

On the 31st of March of each year, each licensee must submit their mortgage log to the commissioner. If the licensee is late in their submission or the submission is incomplete, they are responsible for paying a fine of $100.00 per day it is late or remains incomplete. The compilation of data received by the commissioner will then be organized and submitted to the Department where it will be prepared and made available to the public. This report will become available on June 13 of every year. A licensee must submit a correcting amendment to the information given to the commissioner if the information becomes incomplete or inaccurate.

As stated in the beginning of the lesson, the State Board of Financial Institutions put into place Article 4 Regulations 15-64 in an effort to add and clarify some of the provisions in Chapter 22. Pursuant to Section 37-22-210, regulations in Article 4 state that the Mortgage Log required of licensees must: [Article 4 Reg.15-64(D)(1)(a)(b)]

- Be completed electronically as required by the Consumer Finance Division. The Licensee is responsible for the costs associated with doing so.
- Include all mortgage loans or applications where a credit report is requested, regardless of whether a mortgage loan is originated or modified.

Additionally, Section 37-22-220 states that licensees must maintain records in a way that helps the commissioner determine whether the licensee is complying with the provisions of Chapter 22 and with federal laws. The recordkeeping system of a licensee will be deemed sufficient so long as the required information is available. These records do not need to be kept in the place of business where loans are made if the commissioner is given free and full access to the records wherever they may be. By March 31st of each year, licensees must file an annual report relating to all the mortgage loans made, serviced, or brokered. The report should include the following information:

- First and subordinate lien loans originated by licensee and closed in the name of another party;
- First and subordinate line loans originated by another party and closed in the name of licensee;
- First and subordinate lien loans originated by and closed in the name of licensee;
- First and subordinate lien loans originated by and closed in the name of another party but funded by licensee;
- Loans purchased by licensee;
- First and subordinate lien loans serviced by licensee;
- Loans owned with and without servicing rights;
- Loans sold with and without servicing rights;
- Loans paid off before and at maturity;
- Unpaid loans at the beginning and end of the reporting year;
- Delinquent loans that are 30-59, 60-89, and ninety days or more delinquent, of all the loans the licensee owned as of December 31st
- Loans in foreclosure as of December 31st and foreclosed in the previous calendar year by licensee;
- Mortgage loans charged against reserve for loan losses as a result of foreclosures during the reporting year; and
- Loans repurchased during the previous calendar year

The annual report must also include the total gross revenue earned in the State under the license, the total dollar amount of points paid to the licensee by borrowers first and subordinate lien mortgage loans, total dollar amount of points paid to brokers by the licensee on first and subordinate lien mortgage loans, including yield spread premiums, and the lending institution, maximum amount available, outstanding balance, and expiration date of licensee's four largest warehouse lines of credit during the previous calendar year. [§37-22-220 (A)(B)(C)(1)(2)(3)(4)(5)(6)(7)(7)(9)(10)(11)(12)(13)(14)(D)].

The State Board of Financial Institutions' Article 4, Regulations 15-64 adds to this section of Chapter 22 the following:

- The annual report required by §37-22-220 must include a Mortgage Call Report that includes: [Article Reg.15-64(D)(2)(a)(b)]
  - A loan activity report submitted electronically on a quarterly basis as required by the Nationwide Mortgage Licensing System and Registry by the mortgage lender or servicer for all locations and loan originators
  - A corresponding financial condition report submitted electronically as required by the Nationwide Mortgage Licensing System and Registry.

As already noted earlier, Section 37-22-140(M) states that if any information contained in a document submitted to the commissioner becomes inaccurate or incomplete, the licensee must promptly file a correcting amendment with the commissioner. Article 4 states that, pursuant to this provision, the applicant must supply the required information to the Consumer Finance Division of the South Carolina State Board of Financial Institutions within 120 days of the initial submission or the application will be abandoned as incomplete. [Article 4 Reg.15-64(E)]. Thus, "promptly" in this case means that the correcting amendment must be filed with the commissioner within 120 days of the original submission.

In addition to keeping records of their activity and in an effort for licensees to be held accountable for their actions and to reduce the incidence of mortgage fraud, the law also mandates that licensees must always clearly display the unique identifier assigned by the Nationwide Mortgage Licensing System and Registry on all mortgage loan forms, solicitations, or advertisements including business cards or websites and any other documents furnished in connection with a mortgage loan transaction. [§37-22-210(F)] By doing so, it is easy for consumers to look up the licensee's activity history as well as enabling the records of their transactions to be tracked down. Overall, this requirement on licensees is intended to bring a new level of security to the prevention of fraud in the mortgage industry.

Article 4, Regulations 15-64 adds that The Nationwide Mortgage Licensing System and Registry unique identifier for licensed mortgage lenders or servicers, licensed branch offices, and licensed mortgage loan originators must be displayed on all mortgage loan applications. However, only the unique identifier of the licensed mortgage lender or servicer is required to be displayed on all other mortgage loan forms. The unique identifier of a licensed mortgage lender or servicer or licensed mortgage loan originator must also be used in all advertising. [Article 4 Reg.15-64 (B)(1)(2)]

It is important to remember that it is also the responsibility of the licensee to report any changes that may occur to the commissioner. A licensee must report to the commissioner a change of address of the principal place of business or a branch office at least seven days before the change. Change of address notification of a licensed location must be accompanied by a fee of $25.00. A mortgage lender licensed pursuant to Chapter 22 must display in plain view in its principal office and in each branch the license issued by the commissioner. A loan originator licensed pursuant to Chapter 22 must display in each branch office in which mortgage loans are originated a copy of the license issued by the commissioner. [37-22-180(A)(B)]

Important to note is the fact that included in the notification, should be a plan of withdrawal with timetables for the disposition of the business, the location of the books, records, and accounts until the end of the retention period, and certification of the proper disposal of those records after that. [§37-22-210(G)].

So far what we have discussed has had to do with requirements for a person to obtain a mortgage license as well as what a licensee must do in order to maintain their license once they have obtained one.

Let us now move on to determining what may prevent an applicant from obtaining a license or what may force someone who already has a license to either lose or suspend his or her license.

Grounds for Denying a License

Aside from having the power to issue a license, the commissioner of the South Carolina State Board of Financial Institutions also has the power to deny, suspend, revoke, or refuse to issue or renew a license. We will now discuss the powers the commissioner has in South Carolina regarding the denial, suspension, revocation, or refusal to issue a license. As you will see, the commissioner can do various different things to licensees if he or she deems it necessary.

The commissioner may deny, suspend, revoke or refuse to issue a license if he or she finds that both: [§37-22-200(A)(1)(2)(a)(b)(c)(d)(e)(f)(g)(h)(i)(j)]

- The order is in the public interest; and
- The applicant, licensee, or any partner, member, manager, officer, director, loan originator, managing principal, or other person occupying a similar status or performing similar functions or a person directly or indirectly controlling the applicant or licensee:
    - Has filed an application for license that, as of its effective date or as of a date after filing, contained a statement that, in light of the circumstances under which it was made, is false or misleading with respect to a material fact;
    - Has violated or failed to comply with a provision of this chapter or order of the commissioner;
    - Within the past ten years has been convicted of, or pled guilty or nolo contendere to, a misdemeanor involving financial services or financial services related business or an offense involving breach of trust or fraudulent or dishonest dealing, or money laundering or has been convicted of, or pled guilty or nolo contendere to, a felony in a domestic, foreign, or military court.
    - A permanently or temporarily enjoined by a court of competent jurisdiction from engaging in or continuing conduct or practice involving financial services or financial services related business;
    - Is the subject of an order of the commissioner denying, suspending, or revoking that person's license;
    - Is subject of an order entered by the authority of a governmental entity with jurisdiction over the financial services or financial services related industry denying or revoking that person's license;
    - Does not meet the qualifications or the financial responsibility, character, or general fitness requirements, or a bond or capital requirements, pursuant to Chapter 22
    - Has been the executive officer or controlling shareholder or owned a controlling interest in a financial service or financial services related business that has been subject to an order or injunction described above
    - Has failed to pay the proper filling or renewal fee pursuant to Chapter 22 or a fine, penalty, or fee imposed by any governmental entity. However, the commissioner may enter only a denial order, and the commissioner shall vacate the order when the deficiency is corrected; or
    - Has falsely certified attendance or completion of hours at an approved education course.

- Furthermore, the commissioner may postpone or suspend the license of a licensee pending final determination of a proceeding. Once the commissioner enters the order to postpone or suspend a license, he or she must notify the applicant or licensee promptly that the order has been entered and provide the licensee an explanation as to why it was entered in the first place. The commissioner must also explain in the notice the procedure for requesting a hearing before the Administrative Law Court. If both the licensee does not request a hearing and if the commissioner does not request a hearing, the order remains in effect until it is modified or vacated by the commissioner. [§37-22-200(B)]
- The commissioner may also impose an administrative penalty on a licensee, or any member, partner, officer, director, or other person occupying similar status or performing similar functions on behalf of a licensee for violation of Chapter 22. The administrative penalty, whether for the licensee or any other person, cannot exceed $10,000.00 for each violation of the chapter by a licensee. [§37-22-200(C)]
- Additionally, the commissioner can order a person to cease from a prohibited action. If the person who has been ordered to cease from the prohibited action fails to request a contested case hearing, or if the person requests a hearing and it is denied or dismissed and the person continues to engage in the action, the person is subject to an administrative penalty that cannot exceed $20,000.00 for each violation of the commissioner's order. [§37-22-200(D)]

If a licensee is accused of any act, omission, or misconduct that subjects the licensee to disciplinary action, the licensee, with the consent and approval of the commissioner, may surrender his or her license and the rights and privileges that come with it and is no longer eligible to receive, or submit an application for, licensure for a period of time established by the commissioner. [§37-22-200(F)]

If the commissioner believes that the licensee or another person has violated Chapter 22 or that facts exist that would be the basis for an order against a licensee or other person, the commissioner can investigate or examine the loans and business of the licensee and examine the books, accounts, records, and files of the licensee or other person relating to the complaint or matter under investigation. In other words, if a licensee seems to have violated a provision in this chapter, the commissioner has the right to do what he or she must do in order to uncover evidence of the violation. Whatever the cost may be for investigating or examining, as long as it is "reasonable," will be charged to the licensee. The commissioner may also require the licensee or other person to submit a national fingerprint-based criminal record check and a set of fingerprints in connection to the investigation or examination. If the licensee or other person refuses to do so, they will be subject to disciplinary action. [§37-22-200(G)]

The commissioner may also subpoena documents and witnesses and compel their production and attendance, to examine under oath all persons whose testimony the commissioner considers relative to the person's business and require the production of books, papers, or other materials. At the licensee's expense, the commissioner may also conduct routine examinations of the books and records of a licensee to determine their compliance to Chapter 22. The commissioner can cooperate and share information with an agency of this State, or other states, or with the federal government concerning behavior that is regulated by Chapter 22. He or she can also participate in examinations with these agencies. [§37-22-200(G)(H)(I)(J)]

If the commissioner finds that the managing principal, branch manager, or loan originator of a licensee had knowledge of, or reasonably should have had knowledge of, or participated in an activity that results in the entry of an order suspending or withdrawing the license of a licensee, the commissioner can prohibit the branch manager, managing principal, or loan originator from serving as a branch manager, managing principal, or loan originator for a time of his choosing. The

commissioner can also require a person to pay to a borrower or other natural person amounts received by the person or its employees in violation of Chapter 22. [§37-22-200(K)(L)]

As reviewed, the commissioner of the Consumer Finance Division of the South Carolina State Board of Financial Institutions has a lot of discretion with regards to licensing. However, one should note that this does not mean that he or she is not held accountable. The commissioner must still report information to the Board as well as the Nationwide Mortgage Licensing System and Registry. In fact, any order issued by the commissioner regarding Chapter 22, must be reported to the Nationwide Mortgage Licensing System and Registry. [§37-22-200(M)].

It is important to state that if any of the provisions we have mentioned thus far are violated, state law imposes disciplinary action on the violator. A person who violates any of the provisions we have discussed and found in Chapter 22 of Title 37 of the South Caroline Code of Law, is guilty of a misdemeanor and, upon conviction, must be fined not more than $500.00 or imprisoned not more than 6 months, or both, for each violation. Each transaction involving the unlawful making or servicing of a mortgage loan is a separate offense. [§37-22-230]

Conclusion

After reviewing this lesson, you should now be familiar with what the law requires you to do if you would like to apply to become a mortgage loan originator as well as what is required of you once you have obtained your license.

Part 3: Compliance and Disciplinary Action

OVERVIEW

In this lesson we will review South Carolina law as it pertains to licensee behavior. We will go over what the law denotes as prohibited conduct and practices as well as what the law states is required conduct for licensees. We will also review fees and charges associated with being a licensee and the disclosures and agreements licensees will come across in their daily originating activities. Furthermore, we will go over how to advertise in the mortgage lending industry in accordance to state law. Lastly, we will discuss what South Carolina law states about disciplinary action, including notifications, hearings, and appeals; the suspension, revocation and rescissions of licenses; penalties and fines; and civil and criminal liability.

Learning Objectives

After reviewing this lesson, students should be able to:

- Recognize prohibited conduct and practices for licensees
- Know the different disclosures and agreements licensees encounter in their activities as mortgage loan originators
- Know how what is required of licensees if they want to advertise for business
- Understand what state law states disciplinary action should be for licensees that violate state provisions

Compliance

As mentioned previously, there are two main titles and chapters in the South Carolina Code of Laws that pertain to mortgage lending and licensing: Title 37, Chapter 22, and Title 40, Chapter 58. What we will be predominantly reviewing below is what the law denotes in Title 37, Chapter 22, which is the Mortgage Lending Act. However, we will also be covering some of the provisions in Title 40, Chapter 58, or the Licensing of Mortgage Brokers Act. Title 40, Chapter 58 contains provisions that are almost identical to those provisions in Title 37, Chapter 22.

Their main difference, however, is the fact that Chapter 22 places regulatory authority on the Commissioner of the Consumer Finance Division of the State Board of Financial Institutions and Chapter 58 places regulatory authority on the Administrator of the Department of Consumer Affairs. As you will recall, from a previous section, both of these offices are South Carolina’s regulatory authority for matters relating to mortgage lending services in the state. The South Carolina State Board of Financial Institutions regulates mortgage lender or servicers and mortgage loan originators, while the Department of Consumer Affairs regulates mortgage brokers, including table funding and loan correspondents, and mortgage broker loan originators.

Prohibited Conduct and Practices; Required Conduct

So far, we have focused on what one must do in order to apply for a mortgage lending license or mortgage loan originator license in the state of South Carolina as well as what one must do in order to maintain a license once it has been obtained.

We will now turn to what the law provides regarding conduct and behavior for those who have obtained a license.

Below we will review what the law states are prohibited practices and conduct of a person that is licensed as a mortgage loan originator.

Title 37, Chapter 22 states that the following are prohibited activities that are a violation of state and federal law.
[§37-22-90(A)(1)(2)(3)(4)(5)(6)(7)(8)(9)(a)(b)(10)(a)(b)(c)(11)(12)(13)(14)(15)(16)(17)(B)]

(Section 40-58-70 also lists prohibited activities, most of which match those below):

- In addition to the activities prohibited by other provisions of state or federal law, it is unlawful for a person licensed pursuant to Chapter 22, in the course of a mortgage loan origination, to:
  - Misrepresent or conceal the material facts or make false promises likely to influence, persuade, or induce an applicant for a mortgage loan or a mortgagor to take a mortgage loan, or to pursue a course of misrepresentation through agents or otherwise;
  - To refuse improperly or fail to issue a satisfaction of a mortgage pursuant to Section 29-3-310;
  - Fail to account for or deliver to a person entitled to receive funds, documents, or other things of value obtained in connection with a mortgage loan including money provided by a borrower for a real estate appraisal or credit report, which the mortgage lender or loan originator is not entitled to retain under the circumstances;
  - Pay, receive or collect in whole or in part any commission, fee, or other compensation for a mortgage loan origination in violation of this chapter including any unlicensed person other than an exempt person;
  - Charge or collect a fee or rate of interest or to make or service a mortgage loan with terms or conditions or in a manner contrary to the provisions of this chapter
  - Advertise mortgage loans including rates, margins, discounts, points, fees, commissions, or other material information including material limitations on the loans, unless the person is able to make the mortgage loans available as advertised to qualified applicants;
  - Fail to disburse funds in good faith and in accordance with a written commitment or agreement to make a mortgage loan that has been accepted by the borrower;
  - Engage in a transaction, practice, or course of business in connection with the making or servicing of, or purchase or sale of a mortgage loan that is not in good faith or fair dealing, that is unconscionable, as set forth in Section 37-5-108, or that constitutes a fraud upon a person;
  - Fail to pay reasonable fees within a reasonable time to a licensed third party for services that are:
    - Requested from the third party in writing by the mortgage lender or an employee of the mortgage lender; and
    - Performed by the third party in connection with the origination or closing of a mortgage loan for a customer or mortgage lender
  - Influence or attempt to influence through coercion, extortion, or bribery, the development, reporting, result, or review of a real estate appraisal sought in connection with a mortgage loan. This item does not prohibit a mortgage lender or servicer from asking the appraiser to do one or more of the following:

        - Consider additional appropriate property information
        - Provide further detail, substantiation, or explaining for the appraiser's value conclusion; or
        - Correct errors in the appraisal report;
    - Fail to comply with the mortgage loan servicing transfer, escrow account administration, or borrower inquiry response requirements imposed by Sections 6 and 10 of the Real Estate Settlement Procedures Act and regulations adopted pursuant to them and the state law;
    - Fail to provide within a reasonable time, upon written request of a borrower, a payment history statement in a form easily understood by the borrower including payment dates and amounts and charges within the twelve months preceding the month which the request is received and the total amount unpaid as of the end of the period covered by the statement;
    - Take a security interest in a borrower's principal dwelling where the amount of the mortgage loan is less than five thousand dollars;
    - Fail to provide disclosures as required by the state or federal law or collect any fee before providing required disclosures;
    - Fail to comply with Chapter 22 or other state or federal law including rules and regulations applicable to business regulated by this chapter;
    - Falsely advertise or misuse names in violation of 18 U.S.C. Section 709 (False advertising or misuse of names to indicate Federal Agency) or state law; or
    - Use any trade name or insignia of membership in an organization of which the licensee is not a member or advertise falsely through any material including, but not limited to, business card, stationery, or signage concerning a designation or certification of special education, credentials, trade organization membership, or business.
    - Charge fees for services rendered as a mortgage broker without disclosing these fees to the applicant as required by federal and state law [§40-58-75(C)].
- A violation of state or federal law applicable to a business covered by Chapter 22 is a violation of this chapter and may be enforced by the commissioner.

As you can see, there are various different ways a licensee's conduct and behavior can violate the law.

It is important to note that licensees should behave ethically and in accordance to the law in order to maintain their license in good standing.

If a licensee is involved in any of the mentioned prohibited actions, it means that the licensee is not behaving ethically and is breaking the law.

By doing so, the licensee is subject to disciplinary action, which we will discuss later in this lesson.

Fees and Charges

When working as a mortgage lender or mortgage loan originator, you will have clients that will be making one of the biggest financial decisions and commitments of their lives.

Though this commitment is one of the biggest, the majority of consumers know very little about the transaction itself. Part of the large commitment includes different fees and charges that lenders add to the transaction costs aside from the cost of the property. Consumers are not necessarily knowledgeable about these specific costs.

Due to the lack of knowledge on behalf of the consumer, state law has created provisions regarding disclosures about these fees and charges in the hopes of protecting the consumer. We will review these provisions now.

Section 75 of Chapter 58, Title 40, also known as the Licensing and Mortgage Brokers Act, deals with mortgage broker fees and agreement disclosing charges.

The law states that within three business days of receiving an application for a mortgage loan, the broker must provide a mortgage broker fee agreement. The mortgage broker fee agreement discloses the estimated charges to the borrower for the mortgage loan and itemizes the charges provided if required under, federal or state law. This particular disclosure is considered delivered when deposited with the United States Postal Service for first class delivery. [§40-58-75(A)]

The law also makes it clear that a person may not earn, charge, or collect a mortgage broker or processing fee unless the person meets the requirements of Chapter 40, is authorized to conduct mortgage brokerage services by this chapter, or is exempt from the requirements of this chapter. [§40-58-75(B)]

Whatever fees might be charged must be made known to the borrower ahead of time. In other words, all fees earned for services rendered as a mortgage broker must be disclosed to the applicant by the mortgage broker as is required by federal or state law. [§40-58-75(C)]

As mentioned above, the mandatory mortgage broker fee agreement must be in writing and given to the borrower within
3 days of the borrower's application.

The mortgage broker fee agreement must include the following information:

- Current name
- Address
- Telephone number of the mortgage broker's branch office
- Account number, if any
- Date of agreement
- Name of the borrower or proposed borrower
- Signature of borrower and mortgage broker
- Amount of any fees
- Nature of services provided to the borrower

A copy of the completed mortgage broker fee agreement must be given to the borrower and this disclosure must be signed by the borrower acknowledging that he or she received the document. If the loan could be co-brokered, the agreement must have a statement saying so. If that is the case, the mortgage broker must provide written notice of co-brokering within three days of making the final decision to co-broker. The notice must include the name and street and mailing address of the co-broker as well as which broker should be contacted regarding the progress of the services provided. Each co-broker must be licensed with the administrator. [§40-58-75 (D)]

There are also other fee and charges disclosures that are mandated and regulated by state law aside from the mortgage broker fee agreement.

Section 102 of Chapter 10, Title 37 deals with fees and other charges on mortgage loans for personal, family or household purposes. This section of the law states that whenever the primary purpose of a loan that is secured in whole or in part by a lien on real estate is for personal, family or household purpose:

- The creditor must ascertain prior to closing the preference of the borrower as to the legal counsel that is employed to represent the debtor in all matters of the transaction relating to the closing of the transaction.
    - The creditor may require the attorney or agent to provide mortgage title insurance
    - Any legal fees other than for examination and certification of the title, the preparation of all required documents, and the closing of the transaction required or incurred by the creditor in connection with the transaction is the responsibility of the creditor, regardless of who pays for the title work, document preparation, and closing
    - The creditor may contract and receive the following additional charges in a transaction:
        - The charge of any credit report
        - A nonrefundable assumption fee in an amount not exceeding the lesser of $400.00 or 1% of the unpaid balance of the loan
        - Section 202 of Chapter 3 of Title 37 authorizes the following charges: [37-3-202(1)(a)(b)(c)(i)(ii)(d)(i)(ii)(iii)(iv)(v)(e)(f)(2)(a)(b)]
            - Loan finance charge
            - Official fees and taxes
            - Charges for insurance
            - Closing costs
                - Fees or premiums for title examinations, abstract of title, title insurance, surveys, or similar purposes
                - Fess for preparation of deed, settlement statement, or other documents
                - Escrows for future payments of taxes, insurance, water, sewer, land rents, assessments for improvements
                - Fees for notarizing deeds and other documents
                - Fees for appraising real estate that is collateral for the loan
                - Charges for other benefits conferred to the debtor
                - Fees and charges paid to persons registered as mortgage loan brokers pursuant to Chapter 58, Title 40
                - Insurance against loss or damage to property, or against liability
                - Insurance written in connection to the loan

The above provisions enable mortgage loan originators and mortgage lenders to collect the various different charges and fees relating to the closing of a mortgage loan transaction aside from the cost of the property. There are many moving parts in closing a mortgage loan. These provisions help protect the consumer from being charged additional fees that should not be included in the closing process. These provisions also help make the process simpler as all money relating to the closing can be collected at once and distributed by one person.

Charges and fees are not the only matters in a mortgage loan transaction that federal and state law includes in its provisions.

Providing proper disclosures regarding all fees and the mortgage loan itself during a mortgage loan transaction is also mandated by federal and state law. We will turn to these next.

Disclosures and Agreements

Federal law requires mortgage loan originators provide many different disclosures to consumers. State law also specifies certain disclosures, some of which we have already discussed, that must be provided to consumers during a mortgage loan transaction.

Section 78 of Chapter 58, Title 40 denotes the requirements for certain disclosures.

The mortgage broker fee agreement, which as discussed earlier, must be provided to the borrower three days after their application is submitted, must contain the following statements: [§40-58-78(A)(1)(2)(3)(4)]

- The mortgage broker or loan originator is acting as the agent of the borrower in providing brokerage services to the borrower;
- When acting as agent of the borrower, it owes to that borrower a duty of utmost care, honesty, and loyalty in the transaction, including the duty of full disclosure of all material facts. If the mortgage broker or loan originator is authorized to act as an agent for any other person, the mortgage broker fee agreement must contain a statement of that fact and identification of the person;
- A detailed description of the services the mortgage broker or loan originator agrees to perform for the borrower, and a good faith estimate of any fees the mortgage broker or loan originator will receive for those services, whether paid by the borrower, the institutional lender, or both; and
- A clear and conspicuous statement of the conditions under which the borrower is obligated to pay for the services rendered under the agreement.

Additionally, at the time of application for a mortgage loan, the mortgage broker or originator or employee must provide the borrower with a document that specifies the agency designated to receive complaints or inquiries about the origination and making of the loan.

The document should include the telephone number and address of the agency. The consumer must sign a copy of the document acknowledging receipt of the disclosure and the copy must be maintained in the files of the mortgage broker or originator. [§37-23-70] This particular disclosure protects the consumer by making him or her aware of the fact that they do have a way of reporting any wrongdoing during the transaction.

The law also demands that at the time the borrower receives the Loan Estimate and before the scheduled closing of the loan, the broker or mortgage broker of a loan must disclose in writing the amount being earned on the loan. The Department of Consumer Affairs provides a disclosure form that, as required by state law, includes the following:
[§37-23-75(A)(1)(2)(3)(4)(B)]

- The dollar amount of the yield spread premium and the percentage of the yield spread premium in relation to the loan amount
- An itemization of dollar amounts for points, fees, and commissions with a combined total given. A percentage of the combined total should be specified in relation to the loan amount;

- A dollar amount total of these two items and a percentage of the total specified in relation to the total amount of the loan; and
- For an adjustable rate mortgage, a listing of the schedule when the loan may be reset, for each and every reset, and a listing of the monthly payment that is owed for each change that is allowed by the terms of the contract. If the consumer escrows the insurance and taxes with each monthly payment, it must be reflected in the payment listed.
- The form must include a signature line for the borrower to acknowledge that they have received these disclosures and that they have been explained and he or she understands them and wants to enter into the loan transaction voluntarily.

Together with the disclosures mandated by federal law, the above are state specific disclosures that must be provided to the borrower when involved in a mortgage loan transaction. If any of these disclosures are not provided to the borrower, the licensee will be subject to disciplinary action.

Advertising

Aside from licensee conduct during a mortgage loan transaction, state law also provides regulation on how a licensee should behave when conducting other activities. Licensees may want to advertise in order to obtain more business. Federal law has a lot to say about what is the correct way to advertise as a licensed mortgage loan originator. State law also has stipulations regarding advertisements.

First, advertising, for the sake of state law, is defined in the definitions portion of Chapter 22, Title 37. The law states that advertising is a commercial message in a medium that promotes, either directly or indirectly, a mortgage loan transaction. [§37-22-110(4)]

Without first obtaining a license, a person may not circulate or use advertising, including electronic means, make a representation or give information to a person which indicates or reasonably implies activities reserved for mortgage loan originators. [§37-22-120(A)(2)].

Thus, unless you are a licensee, you cannot advertise for anything relating to activities that require a license. If you were to advertise without a license, this behavior could be deemed fraudulent, and therefore illegal.

With the above in mind, it is no surprise that state law also states that a person engaging solely in loan processor or underwriter activities may not represent to the public, through advertising or other means of communicating or providing information including the use of business cards, stationary, brochures, signs, rate lists, or other promotional items that the person may or will perform any of the activities of a loan originator. [§37-22-110(35)(b)]. Again, you have to be licensed in order to advertise mortgage loan origination activities and both underwriters and loan processors are not licensed as mortgage brokers or loan originators.

State law also expresses that if you are a licensee licensed through the Nationwide Mortgage Licensing System and Registry, the law requires you to use your unique identifier assigned by the Nationwide Mortgage Licensing System & Registry in all advertising and on all mortgage loan documents [§37-22-270 (D)]. Thus, whenever promoting yourself or your business as it relates to mortgage lending activities and whenever working with a client on a mortgage loan, you must include your unique identifier as proof of your licensure and as a mode of accountability.

For all other advertising provisions, Chapter 3, Title 22 specifies compliance with the Federal Truth in Lending Act
[§37-3-301].

So far, we have discussed what state law mentions regarding proper conduct for licensees in the state of South Carolina.

We will now turn to what state law depicts is proper disciplinary action for licensees who violate the provisions in state law we have gone over.

Disciplinary Action

Notifications, Hearings, and Appeals

As we have reviewed before, the commissioner and administrator has a lot of authority when it comes to licensing in South Carolina. They also have a lot of discretion when it comes to imposing disciplinary action on those accused of violating state provisions.

However, the law does also specify ways in which a licensee accused of violating state provisions can defend himself or herself in a situation where the commissioner or administrator has requested an administrative order against the licensee. Of this, the laws say the following:

> A person aggrieved by an administrative order issued by the commissioner may request a contested case hearing before the Administrative Law Court in accordance with the court's rules and procedures. According to state law, a contested case is defined as a proceeding including, but not restricted to, ratemaking, price fixing, and licensing, in which the legal rights, duties, or privileges of a party are required by law to be determined by an agency or Administrative Law Court after an opportunity hearing [§1-23-505(3)].
>
> The Administrative Law Court, which was established by Chapter 23, Title 1 of the South Carolina Code of Law, is an agency and a court of record within the executive branch of the government of South Carolina. It consists of 6 administrative law judges. [§1-23-500] If the person aggrieved by the administrative order issued fails to request a contested case hearing, within the time provided in the court's rules of procedure, the administrative order becomes final and the commissioner may ring action to enforce its order pursuant to Chapter 23, Title 1. [§37-22-130(A), §40-58-90(A)]

Contested case proceedings are instituted by filling a request for a contested case hearing with the Administrative Law Court according to the rules of procedure of the Administrative Law Court. Copies of the request for a contested case hearing must be saved upon the commissioner and all parties of record.

The final decision of the administrative law judge may be appealed as provided in Section 1-23-380, Section 1-23-610, or Chapter 23, Title 1. [§37-22-130(B), §40-58-90(B)]

Please note that all actions and hearings pursuant to Chapter 22. Title 37 are governed by Chapter 23, Title 1. [§37-22-200(E)] Chapter 23, Title 1 includes specific provisions on state agency rule making and the adjudication of contested cases in South Carolina.

The law provides with the above the tools necessary for a licensee to defend him or herself against action taken on him or her by the commissioner or administrator. Let's discuss some of the possible actions that can be taken against licensees.

Suspension, Revocation, and Rescission of Licenses

As we discussed in the last section on applying for, obtaining, and maintaining a license, the commissioner or administrator has full discretion to determine whether an applicant or licensee should obtain a license or have his or her license suspended, denied, or revoked.

The commissioner, by order, may deny suspend, revoke, or refuse to issue or renew a license of a licensee or applicant or may restrict or limit the activities relating to mortgage loans of a licensee or person who owns an interest in or participated in the business of the licensee, if the commissioner finds that both the order is in the public interest; and:
[§37-22-200(A)(1)(a-j)]

- The applicant or licensee has filed an application for license that contained a statement that is false or misleading with respect to a material fact;
- Has violated or failed to comply with a provision in Chapter 22 or order of the commissioner;
- Within the past 10 years been convicted of, or pled guilty or nolo contendere to, a misdemeanor involving financial services or financial services related to business or an offense involving a breach of trust or fraudulent or dishonest dealing, or money laundering or has been convicted of, or pled guilty or nolo contendere to, a felony in a domestic, foreign, or military court;
- Is permanently or temporarily enjoined by a court of competent jurisdiction from engaging in or continuing conduct or practices involving financial services or financial services related business;
- Is subject of an order of the commissioner denying, suspending, or revoking that person's license;
- Is the subject of an order entered by the authority of a governmental entity with jurisdiction over the financial services or financial services related industry denying or revoking that person's license;
- Does not meet the qualifications or the financial responsibility, character, or general fitness requirements, or a bond or capital requirements;
- Has been the executive officer or controlling shareholder or owned a controlling interest in a financial services or financial services related business that has been subject to an order or injunction;
- Has failed to pay the proper filling fee or renewal fee or fine, penalty or fee imposed by any government entity. (However, if this is the case, the commissioner may only enter a denial order and the commissioner will vacate the order once the deficiency has been corrected);
- Has falsely certified his or her attendance or completion of the hours of an approved education course.

The commissioner can also: [§37-22-200(B)(C)(D)(E)(F)(G)(H)(I)(J)(K)(L)]

- postpone or suspend a license of a licensee pending final determination of a proceeding
- impose an administrative penalty on a licensee or other person occupying similar status or performing similar functions
- order a person to cease from a prohibited action
- investigate and examine licensees' books, records, accounts, files, etc, if he or she believes a violation of a provision has occurred

- subpoena documents and witnesses and compel production and attendance to examine under oath all persons whose testimony the commissioner considers relevant
- require a licensee pay to a borrower or other person amounts received by the person or its employees in violation of the provisions of Chapter 22

It is important to note that when a licensee is accused of any act, omission, or misconduct that subjects the licensee to disciplinary action, the licensee with the consent and approval of the commissioner or administrator, may surrender the license and the rights and privileges pertaining to it and is not eligible to receive, or to submit an application for, licensure for a period of time established by the administrator or commissioner.
[§40-58-80(F)]

As you can see, there are various ways in which the commissioner or administrator can punish a licensee for his or her behavior. The above is disciplinary action that the commissioner or administrator can impose against a licensee for having violated the provisions included in the South Carolina Code of Law.

State law also includes other disciplinary action provisions that are more specific with regards to the type of licensee behavior. We will turn to these next.

Penalties/Fines

What happens if a licensee does not disclose a charge or fee during a mortgage loan transaction? If a mortgage broker or loan originator violates the provisions regarding disclosures, charges and fees, the borrower can recover from the mortgage broker or loan originator charged with the violation: [§40-58-78(B)(1)(2)(3)]

- A penalty in an amount determined by the court of not less than one thousand five hundred dollars and not more than seven thousand five hundred dollars for each loan transaction;
- Fees paid by the borrower to the mortgage broker or loan originator for services rendered by the agreement; and
- Actual costs, including attorney's fees, for enforcing the borrower's rights under the agreements.

However, if the mortgage broker or loan originator can show evidence that the violation he is accused of was not intentional and resulted from a bona fide error, he or she will not be held liable. [§40-58-78(C)]. In other words, if the mortgage loan originator can show with evidence that he or she unintentionally forgot to provide the borrower with a particular disclosure regarding fees or charges, he or she will not be charged with disciplinary action.

That said, if a loan originator is found to have intentionally disregarded the law, whether by ignoring a disclosure or any other provision included in the Mortgage Lending Act, he or she will be subject to disciplinary action. The law states that a person that is found to willfully violate the provisions in Chapter 22, Title 37 will be considered guilty of a misdemeanor and, upon conviction, must be fined not more than five hundred dollars or imprisoned not more than six months, or both, for each violation. Each transaction involving unlawful making or servicing of a mortgage loan is a separate offence.
[§37-22-230].

With regards to the enforceability of an agreement or transaction, Chapter 5, Title 37 explains that if a transaction or an agreement is found to have been made unconscionably at the time it was made, the court may refuse to enforce the agreement or transaction. [§37-5-108]

Additionally, if the court believes a person is engaging or is likely to engage in unconscionable conduct in collecting a debt arising from the transaction, the court can grant an injunction and a consumer can recover actual damages from the person violating the law. [§37-5-108]. Thus, if the person found violating the law is a licensee, then the court can find that the licensee owes the consumer actual damages.

Chapter 5 also refers to what the lender can do in the case of consumer default. The law states the following:

An agreement of the parties to a consumer credit transaction with respect to default on the part of the consumer is enforceable to the extent that: [§37-5-109, §37-5-110]

- The consumer fails to make a payment as required by agreement
- The prospect of payment, performance, or realization of collateral is significantly impaired; the burden of establishing the prospect of significant impairment is on the creditor.

After a consumer has been in default for ten days for failure to make a required payment and has not voluntarily surrendered possession of goods that are collateral, a creditor may give the consumer a notice. The notice is considered delivered when the creditor delivers it to the consumer or mails it to the consumer's residence. The notice must be in writing state the following:

- Name, address and telephone number of creditor whom payment is to be made
- Brief identification of the credit transaction
- Consumer's right to cure the default
- Amount of payment
- Date by which payment must be made to cure default

The chapter provides an example of what this notice should say:

"(name, address and telephone number of creditor), (account number, if any),
(brief identification of credit transaction)

____________________________________(date is the LAST DAY FOR PAYMENT

____________________________________(amount) is the AMOUNT NOW DUE

You are late in making your payment(s). If you pay the AMOUNT NOW DUE (above) by the LAST DAY FOR PAYMENT (above), you may continue with the contract as though you were not late. If you do not pay by that date, we may exercise our rights under the law. These rights include the right to repossess any property held as collateral for this transaction and the right, in many instances, to hold you personally responsible for any difference between the amount the property brings in a sale and the balance due us on the credit transaction in question. If you are late again in making your payments, we may exercise our rights without sending you another notice like this one. If you have questions, write or telephone the creditor promptly."

After the notice of the consumer's right to cure is delivered, the creditor cannot proceed enforcing a security interest in goods that are collateral until 20 days after the delivery of the notice. It is important to note that cure restores the consumer to his rights under the agreement as though the defaults did not occur. [§37-5-111]

With regards to the location where an action is brought, chapter 5 denotes that if the action is brought to enforce an interest in land securing the consumer's obligation, the action can be brought in the county in which the land or a part thereof is located. If the current residency of the consumer is not in

South Carolina, the action can be brought to the county where the loan or sale was made. [§37-5-113]

With regards to action brought by a creditor against a consumer, the complaint must allege the facts of the consumer's default, the amount the creditor is owed, and how that amount was determined, and whether the notice of cure has been delivered or is not required. A default judgment will only be entered into action if the default has been verified by the creditor or a sworn testimony, by affidavit or otherwise, showing that the creditor is entitled to the relief demand.
[§37-5-114]

These provisions enable the creditor to take legal recourse for a fault on the part of the consumer. Let's go back to reviewing provisions that enable a consumer to take legal recourse against a licensee. We will now review what state law says of the civil and criminal liability of a licensee.

Civil and Criminal Liability

Civil Penalties:

For the purposes of the following provisions we will review, the term creditor means:

> *A person who in the ordinary course of business regularly extends or arranges for the extension of credit or offers to arrange for the extension of credit. [§37-5-203(6)]*

A creditor who, in violation of the provisions of the Federal Truth in Lending Act or Section 37-2-309 or 37-3-308, fails to disclose information to a person entitled to information regarding a mortgage, is liable to that person in an amount equal to the sum of:
[§37-5-203(1)(a)(b)]

- Twice the amount of the finance charge in connection with the transaction, but the liability pursuant to this item must be not less than $100.00 or more than $1000.00; and
- In the case of a successful action to enforce the liability, the cost of the action together with reasonable attorney's fees as determined by the court.

With respect to disclosures mandated by the Federal Truth in Lending Act and state law regarding advertising, a creditor has no liability if within 60 days after discovering an error, and before the institution of an action or receipt of written notice of the error, the creditor notifies the person of the error and makes necessary adjustments in the appropriate account to assure that the person is not required to pay a finance charge in excess of the amount of percentage rate actually disclosed.
[§37-5-203(2)]

As mentioned earlier, the law denotes that for any of the provisions violated, if the creditor can show with preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid the error, he or she is not held liable. [§37-5-203(3)]

No action, as those described above can be brought more than 1 year after the occurrence of the violation. Additionally, the liability of the creditor with regards to the above provisions is meant to be in lieu of and not in addition to his or her liability under the Federal Truth in Lending Act.
[§37-5-203(5)(8)].

Criminal Penalties:

A lender who willfully makes charges in excess of those permitted by law is guilty of a misdemeanor and upon conviction may be sentenced to pay a fine not exceeding $5,000.00, or to imprisonment not exceeding 1 year. [§37-5-301(1)]

A person, other than a supervised financial organization, who willfully engages in the business of making loans without a license where a license is required, is guilty of a misdemeanor and upon conviction may be sentenced to pay a fine not exceeding $5,000, or imprisonment not exceeding 1 year, or both. [§37-5-301(2)]

A person is guilty of a misdemeanor and upon conviction may be sentenced to pay a fine not exceeding $500.00, or to imprisonment not exceeding one year, or both, if he willfully and knowingly: [§37-5-302(1)(2)(3)]

- Gives false or inaccurate information or fails to provide information which he is required to disclose under the provisions of the Federal Truth in Lending Act,
- Uses any rate table or chart, the use of which is authorized by the provisions of the Federal Truth in lending Act, in a manner which consistently understates the annual percentage rate determined according to those provisions; or
- Otherwise fails to comply with any requirement of the provisions on disclosure of the Federal Truth and Lending Act

The criminal liability of a person is in lieu of and not in addition to his criminal liability under the Federal Truth in Lending Act; no prosecution of a person with respect to the same violation may be maintained pursuant to both South Carolina law and the Federal Truth in Lending Act.

Conclusion

In this lesson we reviewed what state law specifically states is prohibited conduct and practice, proper conduct as well as what constitutes disciplinary action for those who obtain a license and violate state law provisions.

You should now have a better understanding of what is expected of a licensee, what licensees should not do, and what can happen if a licensee is accused or found guilty of violating state provisions.