8 Hour GA SAFE Comprehensive: 2019 Mortgage CE

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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) and Real Estate Settlement Procedures Act (RESPA)

LESSON OBJECTIVES

By the end of this lesson students should:
- Be familiar with TILA provisions
- Be familiar with RESPA provisions
- Understand what must be disclosed to the client

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.

In this Lesson we will discuss two of the most important Consumer Protection Laws in the Mortgage Lending Industry:
- 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 this lesson with a review of the Truth in Lending Act and some of its pertinent provisions. We will then review some of the pertinent provisions found in the Real Estate Settlement Procedures Act. Once we review both of these important laws, we can turn to the next lesson where we will discuss the changes the Dodd-Frank Act has made to the above laws, specifically regarding their disclosures.

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 purpose of this Act is to promote the informed use of consumer credit by requiring specific disclosures regarding terms and costs in the extension of consumer credit. [Regulation Z, 12 CFR §1026.1(b)]. The regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling and 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 the same act in §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 act specifically 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
- specifies limitations on home equity lines of credit and some closed-end home mortgages
- and provides the right of rescission for consumer

To put it simply, 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. TILA also sets forth terminology in the industry as standard across disclosure and documents, making it easier for a consumer to understand what they are entering into.

In order to establish consumer protections, TILA requires certain documents be provided to the consumer that contain pertinent information regarding credit transactions. 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 lien 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

These disclosures proposed must 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)]

TILA 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

Certain lending practices associated with the Truth in Lending Act have been changed by the Mortgage Disclosure Improvement Act, which was enacted within the Housing Economic Recovery Act, or HERA.

HERA 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 if it is not the consumer's principal place of residence.

The amendments made to TILA created early disclosures that now cover different types of transactions: [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

TILA's early disclosure requirements now cover any extension of credit secured by the dwelling fo a consumer, including refinance and home equity loans. [Regulation Z, 12 CFR §1026.19 (a) (1) (i).

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 [Regulation Z, 12 CFR §1026.19(a)(2)(ii)]
- 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, along with other changes brought forth by the Dodd Frank Act.

Another important provision within TILA is that of 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)]

The right of rescission enables the borrower enough time to really think through their decision to enter into this type of transaction. Each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind. [Regulation Z, 12 CFR §1026.23(a)(1)]

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

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)].

In an effort to protect consumers from unfair or deceptive lending, TILA also offers rules regarding advertising. 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)].

Before moving on to reviewing some of the Real Estate Settlement Procedure Act provisions, let's review some of the specific charges and costs for which TILA necessitates disclosures.

Of grave importance within TILA is the list of costs that are considered "finance charges", and therefore must be disclosed. Examples of finance charges includes the following types of charges: [Regulation Z, 12 C.F.R. §1026.4(b)]

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.

Assumption fees can also be considered as finance charges 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. [*Regulation Z, 12 CFR §1026.4(b)(3)]*

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.

Premiums such as mortgage guaranty insurance, holder in due course insurance, and repossession insurance should be included in the finance charge only for the period that the creditor requires the insurance be maintained. [Regulation Z, CFR §1026.4(b)(5)]

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.

Creditors can 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. If any part of the discounts for payment are financed, it must be disclosed as a finance charge [Regulation Z, 12 CFR §1026.4(b)(9) paragraph 4(b)(9)]

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.

Some charges or fees shown as finance charges can be excludable Premiums for credit life insurance, or appraisal fees may be excluded from finance charges under Regulation Z. [Regulation Z, 12 CFR §10.26.4(b)].

The Act also specifies charges that are excluded from the finance charge. Below is a brief list of those included in the Act. The following content can be found in Regulation Z, 12 CFR §1026.4(c):

1. Application fees charged to all applicants for credit, whether or not credit is actually extended.
2. Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.
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.
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.
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.

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

With regards to items considered as finance charges, their disclosure is meant to be provided as a dollar amount and must include a brief description. For transactions that include variable rates, the creditor can modify the descriptor to say something such as "which is subject to change." The finance charge must be shown in disclosures as a total amount and need not be itemized. [Regulation Z, 12 CFR §1026.18(d)].

Now that we have gone over some of the more pertinent provisions in the Truth in Lending Act, let's review provisions within the Real Estate Settlement Procedures Act.

Real Estate Settlement Procedures Act

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]

RESPA was passed in 1974 and has two main goals:

- To provide borrowers with information about closing costs
- To eliminate kickbacks and referral fees that unnecessarily increase settlement costs

The Act is divided into two sections:

- The first section manages disclosures and servicing requirements for transactions involving a "federally related residential loan." The second section prohibits the payment or receipts of unearned fees (fee-splitting) or referral fees. [Regulation X, 12 CFR §1024.14 (a)(b)]

Like, TILA, RESPA ensures that the consumer receives certain disclosures. RESPA denotes that 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

RESPA applies to all federally related loan transactions. This means any 1-4 family residential property, condominium unit or cooperative apartment, or lot with a mobile home secured by a mortgage or deed of trust. These transactions include: [Regulation X, 12 CFR §1024.2 (b)

- Purchase loans
- Assumptions
- Refinances
- Property improvement loans
- Equity lines of credit
- Reverse mortgages

On these transactions the lender must also be 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.

RESPA does not 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

For loan transactions where RESPA does apply, there are certain requirements:

- 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 requires the following disclosures be provided during the mortgage lending application process:

- 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 received 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"

Additionally, RESPA requires other disclosure be provided before the actual closing of a mortgage loan:

- 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

And lastly (with regards to disclosures), RESPA requires the following be provided after the closing of the mortgage loan:

- 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

As mentioned earlier, aside from requiring specific disclosures, RESPA denotes prohibited practices, such as kickbacks, fee splitting, and unearned fees. 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 lender’s 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.

So, there you have it. TILA and RESPA are two of the most important laws regarding mortgage lending. Above, we reviewed some of the most pertinent provision each of these laws puts forth. Next, we will review changes to these laws that occurred as a result of the Dodd-Frank Act that passed in 2010.

<u>SUMMARY</u>

TILA

- 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

- 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.
- TILA also denotes that the consumer must have a right of rescission.

- 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.

RESPA

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

Lesson 2: Dodd-Frank Act changes to TILA and RESPA

LESSON OBJECTIVES

In this lesson, we will go over some of the changes the Dodd-Frank Act made to what is required to be disclosed during the course of creating and extending credit. In particular the Act reflects changes in the disclosures purported by TILA and RESPA. We will discuss the Loan Estimate and the Closing Disclosure with regards to what they must disclose, when they should be disclosed, and what can trigger the need for the disclosure to be revised and redisclosed.

By the end of this lesson students should:

- Be familiar with the disclosures necessary to comply with the changes brought forth by the Dodd-Frank Act.
- Understand when changed circumstances trigger revised disclosures
- Be familiar with the timeliness of the Loan Estimate and Closing Document and their revisions.

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.

For more than 30 years, Federal law had required lenders to provide two different disclosure forms to consumers applying for a mortgage. The law also had generally required two different forms at or shortly before closing on the loan. Two different Federal agencies developed these forms separately, under two Federal statutes: The Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act of 1974 (RESPA), which we reviewed in the previous lesson.

The information on these forms was overlapping and the language was inconsistent. Not surprisingly, consumers often found the forms confusing. It is also not surprising that lenders and settlement agents found the forms burdensome to provide and explain.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) directs the Consumer Financial Protection Bureau (the Bureau) to integrate the mortgage loan disclosures under TILA and RESPA sections 4 and 5. Section 1032(f) of the Dodd-Frank Act mandated that the Bureau propose for public comment rules and model disclosures that integrate the TILA and RESPA disclosures by July 21, 2012. The Bureau satisfied this statutory mandate and issued proposed rules and forms on July 9, 2012.

To accomplish this, the Bureau engaged in extensive consumer and industry research, analysis of public comment, and public outreach for more than a year. After issuing the proposal, the Bureau conducted a large-scale quantitative study of its integrated disclosures with approximately 850 consumers, which concluded that the Bureau's integrated disclosures had on average statistically significant better performance than the current disclosures under TILA and RESPA. The Bureau finalized a rule with new, integrated disclosures (TILA-RESPA rule).

The TILA-RESPA rule also provides a detailed explanation of how the forms should be filled out and used.

The first form (the Loan Estimate) is designed to provide disclosures that will be helpful to consumers in understanding the key features, costs, and risks of the mortgage loan for which they are applying. The Loan Estimate must be provided to consumers no later than three business days after they submit a loan application. This disclosure was created as a replacement to the Good Faith Estimate, or GFE, which was uniformly used in the industry. The GFE was a disclosure that listed a breakdown of the estimated payments due at the closing of a mortgage loan. This document enabled a borrower to compare costs and shop around. However, there were several issues with the GFE. Though it was a line-by line disclosure, it was believed to be lacking in full and clear information regarding the true cost of a mortgage loan. To give you an idea of how lacking the disclosure was, in its original form, the GFE did not provide total funds for closing or the total monthly mortgage payment note. As you can imagine, not including vital information regarding a cost of the loan is detrimental to a consumer's knowledge of what he or she is entering into. The Loan Estimate disclosure that replaced this document as well as the initial Truth-in-Lending disclosure as of October 3, 2015, provides some of the same information within three business days of having completed a loan application. The Loan Estimate provides an estimate of the interest rate, monthly payment, closing costs, taxes and insurances, prepayment penalties, and other loan features for the particular loan for which the borrower is applying. Though providing some of the same information as the GFE, it is designed to hold all pertinent information to the borrower, be clearer and more user-friendly for the consumer.

The second form (the Closing Disclosure) is designed to provide disclosures that will be helpful to consumers in understanding all of the costs of the transaction. The Closing Disclosure must be provided to consumers three business days before they close on the loan. This particular disclosure was created as a replacement to the HUD-1 Settlement Statement, which was uniformly used in the industry. The Closing Disclosure includes the final terms and costs of the loan. These terms and costs are meant to be compared with those received earlier in the Loan Estimate document. The Closing Disclosure will include the loan terms, the projected monthly payments, and closing costs and fees associated with the mortgage loan. This disclosure was also implemented along with the Loan Estimate starting on October 3, 2015.

The forms use clear language and are designed to make it easy for consumers to locate key information, such as interest rate, monthly payments, and costs to close the loan. The forms also provide information to help consumers decide whether they can afford the loan and to compare the cost of different loan offers, including the cost of the loans over time.

We will examine these disclosures as well as when they need to be used in further detail.

Integrated Disclosures

The Loan Estimate

- Definition of application includes: [Regulation Z, 12 CFR §1026.2(a)(3)(i)]
    - Consumer's name
    - Income
    - Social Security number to obtain a credit report
    - Property address
    - Estimate value of the property
    - Amount of mortgage loan applying for

        - Other information deemed necessary for properly underwriting and assessing the borrower's ability to repay may be requested and obtained by the mortgage loan originator
- Loan Estimate Form - This information will be detailed more in the next section
    - First page
        - Information on borrower and loan
        - Loan terms, amount, payments and rate
        - Prepayment penalties and balloon features
        - Projected payments
        - Estimated costs to close and settlement fees
    - Second page
        - Settlement costs and fees
        - Details on escrows and down payment
    - Third page
        - Discloses payments over 5 years, Annual Percentage Rate (APR), Total Interest Payment (TIP) and several other disclosures

Delivery of the Loan Estimate

- The Loan Estimate must be delivered or placed in the mail no later than the third business day after receiving the application. (Regulation Z, 12 CFR §1026.19(e)(1)(iii))
- *Business Day* will include any day the creditor's offices are open to the public to carry on substantially all of its business functions (Regulation Z, 12 CFR §1026.2(a)(6)
- If the Loan Estimate is not provided to the consumer in person
        - It will be considered they received the Loan Estimate within the three-business day time schedule after delivery or placed in the mail (Regulation Z, 12 CFR §1026.19(e)(1)(iv))
- If the loan application will not or cannot be approved within the three-business day time period or if the application is withdrawn
    - Creditor does not have to provide a Loan Estimate (Comment 19(e)(1)(iii)-3)
- If the borrower amends the application in a favorable manner and the application process can continue
    - Creditor must comply with delivery of the Loan Estimate guidelines
        - Within three business day of receiving the updated application (Comment 19(e)(1)(iii)-3)
- The Loan Estimate must be delivered or placed in the mail not later than the seventh business day before consummation of the mortgage loan (Regulation Z, 12 CFR §1026.19(e)(1)(iii)(B))
- Borrower may waive the seven-business day waiting period for a bona-fide personal financial emergency (Regulation Z, 12 CFR §1026.19(e)(1)(v)).
    - Example: Imminent sale of consumer's home at foreclosure
    - Borrower must provide lender with a
        - A dated, written statement describing the emergency
        - Explain reason for a waiver of the waiting period
        - Must be signed by all borrowers
            - Pre-printed waiver forms are not acceptable (Regulation Z, 12 CFR §1026.19(e)(1)(v))
- The Loan Estimate is an estimate in "Good Faith"
    - Mortgage loan originators must act in good faith when assessing costs for the Loan Estimate
    - If exact dollar amount is not available when the Loan Estimate is prepared

        - Estimates may be used
            - Keep in mind, new disclosures may be required (Regulation Z, 12 CFR §1026.17(c) or 1026.19)
            - Estimated items must be shown as an "Estimate" (Comment 17(c)(2)(i)-2)
    - Good faith by lender will be determined when comparing the original Loan Estimate with the actual charges shown on the Closing Disclosure (Regulation Z, 12 CFR §1026.19(e)(3)(i) and (ii))
        - If charge is in excess of original disclosed amount, this is considered not in good faith
        - If charge is less, this is considered to be in good faith
- Circumstances where mortgage loan originators can charge more than amount on Loan Estimate
    - Charged amount is within tolerance thresholds (Regulation Z, 12 CFR §1026.19(e)(3)(ii))
    - A changed circumstance allows for a revised Loan Estimate or Closing Disclosure (Regulation Z, 12 CFR §1026.19(e)(3)(iv))
- Items not subject to tolerance limitation
    - Prepaid interest (Regulation Z, 12 CFR §1026.19(e)(3)(iii)(A)-(C))
    - Charges paid to third party service provider (Regulation Z, 12 CFR §1026.19(e)(3)(iii)(E))
        - These are charges or services not required by the lender
    - Use best information available when quoting these charges (Regulation Z, 12 CFR §1026.19(e)(3)(iii))
- For items paid at closing that exceed original amount on the Loan Estimate
    - If beyond allowable threshold
        - Lender must refund excess dollar amount to the borrower
            - No later than 60 days after consummation (Regulation Z, 12 CFR §1026.19(f)(2)(v))
        - Zero tolerance items
            - Any amount charged beyond the amount disclosed on the Loan Estimate must be refunded to the consumer. (Regulation Z, 12 CFR §1026.19(e)(3)(i))
        - 10% cumulative tolerance items
            - Difference refunded to the borrower (Regulation Z, 12 CFR §1026.19(e)(3)(ii))

The Closing Disclosure

- Will provide the consumer with a detailed analysis of their mortgage transaction
- Will be provided three days before the closing takes place (Regulation Z, 12 CFR §1026.19(f)(1)(ii))
    - This gives the consumer additional time to review their final loan documents
- Business day defined for the Closing Disclosure
    - Different from the Loan Estimate
- All calendar days except Sundays and legal holidays (Regulation Z, 12 CFR §1026.2(a)(6), 1026.19(f)(1)(ii)(A) and (f)(1)(iii))
    - Legal public holidays
        - New Year's Day
        - Martin Luther King, Jr., Birthday
        - Washington's Birthday
        - Memorial Day

            - Independence Day
            - Labor Day
            - Columbus Day
            - Veterans Day
            - Thanksgiving Day
            - Christmas Day
  - The Closing Disclosure must contain the actual terms and costs associated with the loan transaction (Regulation Z, 12 CFR §1026.19(f)(1)(i)).
    - As with the Loan Estimate, lenders must act in good faith when preparing the Closing Disclosure
    - The Closing Disclosure will contain all actual terms and costs of the loan transaction (Regulation Z, 12 CFR §026.19(f)(1)(i))
    - Any changes in costs or terms will require a corrected disclosure delivered to the borrower
      - A new three-day waiting period may be required for a corrected Closing Disclosure (Regulation Z, 12 CFR §026.19(f)(2))
    - Three categories of changes requiring a corrected Closing Disclosure (Regulation Z, 12 CFR §1026.19(f)(2))
      - Changes occurring
        - Before consummation not requiring a new three business day waiting period (Regulation Z, 12 CFR §1026.19(f)(2)(i))
        - Before consummation that require a new three business day waiting period (Regulation Z, 12 CFR §1026.19(f)(2)(ii))
        - After consummation (Regulation Z, 12 CFR §1026.19(f)(2)(iii))
  - If any of the following changes take place after delivery of the Closing Disclosure and before consummation, a corrected disclosure will be provided to the consumer showing the changed items (Regulation Z, 12 CFR §1026.19(f)(2)(ii))
    - No later than three business days before consummation
  - Those changes are
    - APR becomes inaccurate
      - Closing Disclosure must show correct APR and any other changed terms
    - Loan product changes
      - Closing disclosure must show correct loan product and any other changed items
    - Prepayment penalty has been added
      - Closing disclosure must show the prepayment provision and any other changed items
- If terms or costs change after consummation and within a 30-day period and Closing Disclosure becomes inaccurate, a corrected Closing Disclosure must be delivered to the borrower
  - Delivery of the corrected Closing Disclosure must take place within 30 days of lender's knowledge of the error (Regulation Z, 12 CFR §1026.19(f)(2)(iii))
- Allowable fees prior to consumer's receipt of the Loan Estimate
  - Lender may not impose any fee until the Loan Estimate is received by the consumer, including: (Regulation Z, 12 CFR §1026.19)(e)(2)(i)(B))
    - Application fee
    - Appraisal fees
    - Underwriting fees
    - Other fees imposed on the consumer
      - With the exception of a bona fide and reasonable fee for obtaining a consumer's credit report

The above documents enable clearer disclosures of important details on a mortgage loan. Aside from having to disclose the information within these two documents to the consumer, there is another important part of the mortgage lending process having to do with disclosures that is regulated by law. We will turn to this next.

Loan Estimate and Change of Circumstances

Obviously, changes to loan terms or costs can occur sometime between what was originally disclosed to the borrower and what they actually are at the closing table. We refer to this occurrence as a "changed circumstance," where what was initially disclosed must be revised and disclosed to the consumer.

Regulation X, 12 CFR §1024.7 or §1026.19, specifically deals with the redisclosure of credit terms or costs due to changed circumstance. What this refers to is the disclosure of a change in the Loan Estimate after it has already been disclosed to the consumer. Obviously, the Loan Estimate is meant to be an estimate and it need not be exact. However, it needs to be as close as accurate in order for the consumer to truly understand what he or she is getting into when purchasing a mortgage loan. For all intents and purposes, the law prohibits mortgage loan originators from making miscalculations or mistakes when it comes to costs or charges that have already been disclosed, but there are certain situations where charges can change without them having been miscalculated. For such changes, the law does provide a procedure. If there is a change in any of the previously disclosed items on the Loan Estimate, the creditor is allowed to revise the Loan Estimate and deliver a new one with the revised numbers to the consumer. The creditor can do so within 3 business days from the time he/she received information resulting in a change in the original Loan Estimate disclosed charges and fees. The Loan estimate should not be provided any later than 7 days before the closing of the mortgage loan.

The law defines a changed circumstance as:

- an extraordinary event beyond the control of any interested party or other unexpected event specific to the consumer or transaction [12 CFR §1026.19(e)(3)(iv)(A)(1)];
- information specific to the consumer or transaction that the creditor relied upon when providing the Loan Estimate and that was inaccurate or changed after the disclosures were provided [12 CFR §1026.19(e)(3)(iv)(A)(2)];
- or new information specific to the consumer or transaction that the creditor did not rely on when providing the Loan Estimate [12 CFR §1026.19(e)(3)(iv)(A)(3)].

There are a few situations that the law denotes enable a change of circumstance and, therefore, the creation and delivery of a revised Loan Estimate:

1. changed circumstances that cause an increase in closing costs
2. changed circumstances that affect the consumer's eligibility for the mortgage loan or affect the value of the property securing the loan
3. consumer-requested changes
4. interest rate locks
5. expiration of the Loan Estimate originally provided
6. construction loan closing delays

Let's review each of these circumstances.

1. Changed Circumstances that change closing costs: [12 CFR §1026.19(e)(3)(iv)(A)]

In this situation, if closing costs go up higher than the allotted tolerance in the Loan Estimate, the lender can provide a revised loan estimate to reflect that change.

2. Changed Circumstances that affect the consumer's eligibility for the mortgage loan or affect the value of the property securing the loan. [12 CFR §1026.19(e)(3)(iv)(B)]

In this situation, a revised Loan Estimate could be provided if something has caused the consumer to not be eligible for the mortgage loan. For instance, if the consumer's credit decreased or their debt-to-income is higher due to new credit. Alternatively, a revised Loan Estimate could be provided if the appraisal came back with a lower value than initially expected in comparison to the purchase price.

3. Consumer Requested Changes [12 CFR §1026.19(e)(3)(iv)(C)]

In this situation, a revised loan estimate would be provided if there is a change in credit terms or closing costs that are a direct result of the borrower's actions. Maybe the borrower is out of town during the expected closing date and decides to use a power of attorney, thus changing title costs.

4. Interest Rate Locks [12 CFR §1026.19(e)(3)(iv)(D)]

In this situation, a revised Loan Estimate would be provided if the floating interest rate initially disclosed changes once it is officially locked.

5. Loan Estimate Expiration [12 CFR §1026.19(e)(3)(iv)(E)]

If the intent to proceed with the mortgage loan application is more than 10 business days from the delivery of the Loan Estimate and there has been an increase in closing costs, a revised Loan estimate must be provided.

6. Construction Loan Closing Delay [12 CFR §1026.19(e)(3(iv)(F)]

Sometimes, with new construction, one can tell that the closing date will occur later than 60 days after the initial Loan Estimate has been provided to the borrower. If on the original disclosures it is disclosed that the lender may issue a revised Loan Estimate, then the lender can provide a new Loan Estimate closer to the closing date.

Tolerance Levels and Timing for Changed Circumstances Revisions

It is important to make note of the fact that there are very specific tolerance levels denoted in the law for each of the above scenarios that trigger the revision of the Loan Estimate. A creditor may provide and use a revised Loan Estimate redisclosing closing costs if changed circumstances cause the estimated changes to increase or, in the case of charges subject to the 10% cumulative tolerance, cause the sum of those charges to increase by more than 10% tolerance. [12 CFR §1026.19(e)(3)(iv)(A); Comment 19 (e)(3)(iv)(A)-1)]

Thus, to put it simply, if for some reason the changes to the charges originally disclosed amounts to a total increase of 10% or higher, the creditor can provide a new revised Loan Estimate to the borrower that outlines these changes.

The law is also very specific on when a revised Loan Estimate should be disclosed. As mentioned earlier, the new revised Loan Estimate must be disclosed within three business days after having received information that triggers the need for a revised Loan Estimate. In other words, if any of the mentioned changed circumstances occur, then a revised Loan Estimate must be created and delivered within three days of that changed circumstances occurrence. Furthermore, the creditor has to make sure the revised Loan Estimate is delivered before providing the consumer with the Closing Disclosure. The revised loan estimate must be provided no later than four business days prior to consummation. If the creditor plans to mail the revised disclosure, he/she must place it in the mail no later than seven business days before consummation of the mortgage loan. By providing it no later than seven days, it ensures that the borrower has the new disclosure at least three days prior to the consummation of the mortgage loan. [12 CFR §1026.19(e)(4)].

It is possible that a change of circumstance occurs sometime between the four or three days prior to the consummation. If this happens, the creditor should reflect the changes on the Closing Disclosure, so long as it is provided at least three business days before the consummation. If there is a change that occurs after the Closing Disclosure was provided, the creditor can provide a new revised Closing Disclosure on the date of consummation. [12 CFR §1026. Comment 19(e)(4)(ii)-1].

- We should take a second to discuss the difference between consummation and closing. The law does make a distinction between the two. For the purposes of the delivery of the Closing Disclosure, consummation occurs when the borrower becomes contractually obligated to the creditor on the loan. A closing would mean that the borrower becomes contractually obligated to a seller on the real estate transaction. Therefore, the Closing Disclosure must be delivered three days before the borrower is obligated to the creditor on the loan, not when he/she becomes obligated to the seller. Of course, consummation and the closing can happen on the same date. Every state has specific regulations regarding this distinction, therefore it is important for you to determine when actual consummation will occur and make sure the proper disclosures have been provided. [12 CFR §1026.2(a)(13)]

As mentioned earlier, Section 1026.19(e)(3)(i) states that certain estimated charges are in good faith if the sum of all of the charges paid or imposed on the borrower do not exceed the sum of all the charges disclosed in Section 1026.19(e)(1)(i) (the section explaining what is to be disclosed in the Loan Estimate) by more 10%. However, there are some limited increases that are permitted for certain changes in charges.

Section 1026.19(e)(3)(ii) permits this limited increase for only the following items:

- Fees paid to an unaffiliated third party if the creditor permitted the consumer to shop for the third-party service.
- Recording Fees.

This section of the law allows an aggregate increase that is limited to ten percent. The following examples taken from the regulation listed in the CFPB website shows the determination of good faith charges subject to the above regulation [§1026.19(e)(3)(ii)]:

1. Assume, in the disclosure provided under §1026.19(e)(1)(i), the creditor includes a $300.00 estimated fee for a settlement agent, the settlement agent fee is included in the category of charges subject to §1026.19(e)(3)(ii), and the sum of all charges subject to §1026.19(e)(3)(ii) (including the settlement agent fee) equals $1,000.00. In this case, the creditor does not violate §1026.19(e)(3)(ii) if the actual settlement agent fee exceeds the estimated settlement

agent fee by more than 10% (in other words, if the fee exceeds $330.00), provided that the sum of all actual charges does not exceed the sum of all such estimated charges by more than 10% (in other words, by more than $1,100.00).

2. Assume that, in the disclosures provided under §1026.19(e)(1)(i), the sum of all estimated charges subject to §1026.19(e)(3)(ii) equals $1000.00. If the creditor does not include an estimated charge for a notary fee, but a $10 notary fee is charged to the consumer, and the notary fee is subject to §1026.19(e)(3)(ii), then the creditor does not violate §1026.19(e)(1)(i) if the sum of all amounts charged to the consumer subject to §1026.19(e)(3)(ii) does not exceed $1,100.00, even though an individual notary fee was not included in the estimated disclosures provided under §1026.19(e)(1)(i).

Furthermore, increases are permitted for services for which the consumer may, but does not, select a settlement service provider. If the creditor permits the consumer to shop for a settlement service provider and the consumer either does not select a settlement service provider identified by the creditor on the list, then good faith is determined by §1026.19(e)(3)(ii). For example, if, in the disclosures provided, a creditor discloses an estimated fee for an unaffiliated settlement agent and permits the consumer to shop for that service, but the consumer either does not choose a provider, or chooses a provider identified by the creditor on the written list provided, then the estimated settlement agent fee is included with the fees that may, in aggregate, increase by no more than 10%.

With regards to recording fees, they are not charges for third-party services because they are paid to the applicable government entity where the documents related to the mortgage transaction are recorded, and are not paid to an affiliate of the creditor or shopped for by the consumer.

To be pursuant when calculating the aggregate amount of estimated charges for purposes of the good faith analysis, the estimated charges must reflect charges for services that are actually performed. For example, assume that the creditor included an $100.00 estimated fee for a pest inspection in the disclosures provided and the fee is included in the category of charges subject to §1026.19(e)(3)(ii), but a pest inspection was not obtained in connection with the transaction, then for purposes of the good faith analysis, the sum of all charges subject to §1026.19(e)(3)(ii) paid by or imposed on the borrower is compared to the sum of all such charges disclosed, minus the $100.00 estimated pest inspection fee.

For good faith to be determined under §1026.19(e)(3)(ii) a creditor must permit a consumer to shop for third-party services consistent with the regulation. So long as the settlement service provider is not the creditor or an affiliate of the creditor. If the settlement service provider is the creditor or affiliate of the creditor, good faith is determined under §1026.19(e)(3)(i), which provides some exemptions to the general rule, such as: fees paid to the creditor, mortgage broker, or an affiliate of the creditor or mortgage broker, or fees paid to an unaffiliated third-party if the creditor did not permit the consumer to shop for a third party service provider for a settlement service, or for transfer taxes.

In this lesson, we have discussed the rules relating to the proper disclosure of documents pertaining to the costs and credit terms of a mortgage loan, what these disclosures consist of, the proper disclosure of the revision of these disclosures, as well as permitted and not permitted tolerances to charges or credit terms in a mortgage loan transaction. This information should be beneficial to you as you disclose pertinent information to consumers regarding their potential mortgage loan. Next, we will discuss another important part of the mortgage lending laws that relate to how credit is extended.

SUMMARY

The Loan Estimate

- The Loan Estimate must be delivered or placed in the mail no later than the third business day after receiving the application.
- Business Day for the loan estimate will include any day the creditor's offices are open to the public to carry on substantially all of its business functions.
- The Loan Estimate is an estimate in "Good Faith" and mortgage loan originators must act in good faith when assessing costs for this document.

The Closing Disclosure

- Must be provided to the consumer, with a detailed analysis of their mortgage transaction, three days before the closing takes place. This gives the consumer additional time to review their final loan documents and compare these figures with the Loan Estimate given at application.
- A business day defined for the Closing Disclosure will be different from the Loan Estimate - All calendar days except Sundays and legal holidays.

Mortgages covered by the disclosure rules are closed end consumer credit transactions secured by real estate and subject to RESPA. This includes loans secured by vacant land on which a home will be constructed with the loan proceeds used within two years after settlement. Loans not covered are Home Equity Lines of Credit (HELOC), Reverse Mortgages, mortgages secured by a dwelling not attached to land, for example a mobile home, and loans by a creditor with five or fewer mortgages made in one year.

The definition of application includes the consumer's name, income, social security number to obtain a credit report, property address, estimate value of the property, amount of mortgage loan applying for. Other information deemed necessary for properly underwriting and assessing the borrower's ability to repay may be requested and obtained by the mortgage loan originator.

Changed Circumstances

From the time a Loan Estimate is initially disclosed to the consummation, there is a possibility of a change in the credit terms or charges that were originally disclosed. The changes are allowable but trigger the revised disclosure of such credit terms or charges.

The law defines a changed circumstance as any of the following:

- an extraordinary event beyond the control of any interested party or other unexpected event specific to the consumer or transaction [12 CFR §1026.19(e)(3)(iv)(A)(1)];
- information specific to the consumer or transaction that the creditor relied upon when providing the Loan Estimate and that was inaccurate or changed after the disclosures were provided [12 CFR §1026.19(e)(3)(iv)(A)(2)];
- or new information specific to the consumer or transaction that the creditor did not rely on when providing the Loan Estimate [12 CFR §1026.19(e)(3)(iv)(A)(3)].

Situations deemed as changed circumstances, which trigger a revised Loan Estimate:

1. changed circumstances that cause an increase in closing costs
2. changed circumstances that affect the consumer’s eligibility for the mortgage loan or affect the value of the property securing the loan
3. consumer-requested changes
4. interest rate locks
5. expiration of the Loan Estimate originally provided

6. construction loan closing delays

Tolerance levels and timing for disclosure revisions:

- Changes in the total charges originally disclosed in the Loan estimate that exceed 10% tolerance levels must be disclosed in a revised Loan Estimate
  - Within 3 days of receiving information of the changed circumstance
  - Revised Loan Estimate must be provided no later than 4 days prior to consummation
    - If the revised disclosure is sent by mail, it must be placed in the mail no later than 7 days prior to the consummation of the mortgage loan.
  - If changes occur after the Closing Disclosure has been provided, the creditor can provide a revised Closing Disclosure on the date of consummation.

Please note, the law does distinguish the difference between consummation and closing. A consummation occurs when the borrower becomes contractually obligated to the creditor on the loan. A closing occurs when the borrower becomes contractually obligated to a seller on the real estate transaction. Both scenarios can occur on the same day, but the difference is important when determining the proper timeline for disclosures.

Limited increases are permitted for certain charges:

- Fees paid to an unaffiliated third party if the creditor permitted the consumer to shop for the third-party service
- Recording fees

Lesson 3: The Equal Credit Opportunity Act, Privacy, and Mortgage Lending

LESSON OBJECTIVES

In this lesson we will explain the purpose of the Equal Credit Opportunity Act as well as its mandated disclosures. We will then turn to the subject of consumer privacy of information and review the Privacy of Consumer Information Regulation.

By the end of this lesson students should:

- Explain the purpose of the Equal Credit Opportunity Act
- Know when to use ECOA disclosures
- Understand what consumer information must remain private

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.

Equal Credit Opportunity Act

The Equal Credit Opportunity Act (ECOA), Regulation B, was passed in 1974 and applies to all consumer credit.

Under this act, Consumer Credit is defined as:

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

- Race/color
- Religion
- National origin
- Sex

- Marital status
- Age
- 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

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 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

❖ Please note that additional information has been added to the loan application for more detailed collection of borrower information. On the loan application, under the category of Race or National Origin the options are as follows:

  - American Indian or Alaska Native (print name of enrolled or principal tribe)
  - Asian
    - Asian Indian
    - Chinese
    - Filipino
    - Japanese
    - Korean
    - Vietnamese
    - Other Asian (print race)
  - Black or African American
  - Native Hawaiian or Other Pacific Islander
    - Native Hawaiian
    - Guamanian or Chamorro
    - Samoan
    - Other Pacific Islander (print race)
  - White
  - I do not wish to provide this information

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

- Hispanic or Latino
- Not Hispanic or Latino

❖ Please note that the loan application now provides different options under the category of Ethnicity in order to collect more detailed and accurate information. The options are as follows:

- Hispanic or Latino
  - Mexican
  - Puerto Rican

        - Cuban
        - Other Hispanic or Latino (print origin)
    - 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

In addition to requiring certain collecting of information and determining anti-discrimination provisions, The Equal Credit Opportunity Act also requires specific disclosures.

<u>Required Disclosures</u>

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

As mentioned above, the Equal Credit Opportunity Act applies to all creditors and was enacted to make credit equally available to all credit worthy customers without regard to sex or marital status. During the process of extending credit, creditors cannot discriminate on the basis of race, color, religion, national origin, sex, marital status, or age, or the possibility that the origin of an applicant's income comes from any public assistance program. To this end, ECOA provides two theories of liability:

1. disparate treatment
2. disparate impact

Let's discuss these. Disparate treatment occurs when a creditor treats an applicant differently based on a prohibit basis. For example, if the creditor basis their decision to deny credit because of a person's race. This is different from Disparate impact, which occurs when a creditor employs facially neutral policies or practices that have an adverse effect on a protected class. An easy way to remember these is to look at the word "disparate." The word means that someone is treating someone else differently. Following are some examples of Disparate Treatment Scenarios and Disparate Impact Scenarios.

Disparate Treatment Scenario Example:

- Imagine that you, a loan originator, are flooded with prequalification requests. It is nearing 5pm and you want to get home at a reasonable hour to have dinner with your family. Three people, Mr. Jones, Mrs. Oliveras, and Ms. Rogers are asking you for prequalification, but you only have time to prequalify two before you go home. You decide to prequalify Mr. Jones and Ms. Rogers and leave Mrs. Oliveras prequalification for tomorrow because you are aware that Mrs. Oliveras is Latina and you believe that this may mean that the likelihood of being able to prequalify her is lesser than the likelihood of doing so for your other two clients. This is a perfect example of disparate treatment. You are treating clients differently because of their ethnicity. It isn't that you are refusing to prequalify Mrs. Oliveras, but you are prioritizing your other clients now because you believe the work you put into them now will likely result in a commission. In other words, you treated Mrs. Oliveras differently based on her ethnicity, thinking that working on her eligibility may not lead to a commission because of her ethnicity.

The previous scenario is different than a separate impact scenario. Let's look at one.

Disparate Impact Scenario Example:

- Imagine an investor allows for a 620 credit score for a particular mortgage program. Your boss, the branch manager, states that those eligible for mortgage loans at your company need a 680 credit score or higher in order to be eligible. This rule set by your boss was created in an effort to bring in the best performing loans. Unfortunately, what this causes is for certain areas that happen to be higher minority areas or underserved areas are ignored because of the high credit score requirement. Under ECOA, this constitutes as a disparate impact because this practice is forcing you to not treat all areas or persons the same. If an investor allows for a lower credit score, the policy in place for a higher score must be justified empirically and not simply put in place because higher credit score applicants perform in a less risky manner.

Obviously, to be in compliance with ECOA, you must never behave in a way that might be considered as disparate treatment in your everyday dealings with consumers. ECOA does, however, enable a creditor to consider certain points of information about the borrower for consideration in the extension of credit. We will turn to this point next.

Creditworthiness and ECOA

Among other things, and in compliance with ECOA, the act specifically states that in their decision to extend or not to extend credit:

- A creditor can ask about and use information about the permanent residency and immigration status in the U.S. of an applicant. [12 CFR §1002.5(e) and §1002.6(b)(7)]
- A creditor may use an applicant's age and income derived from public assistance in the following systems for analyzing credit: [12 CFR §1002.6(b)(2)]
    - Though creditworthiness on the basis of age is prohibited, there are certain scenarios where it is not. For example, in the case of people 62 years or older. Eligibility for certain programs, such as a reverse mortgage, is partly based on the age of the applicant.
- A creditor can use the credit history, when available, of accounts designated as accounts that the applicant is permitted to use or is contractually liable. [12 CFR §1002.6(b)(6)]

- A creditor can use, on the applicant's request, any information the applicant may present that tends to indicate the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness. [12 CFR §1002.6(b)(6)]
- A creditor can use, on the applicant's request, the credit history of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness. [12 CFR §1002.6(b)(6)]
- Use state property laws directly or indirectly affecting creditworthiness. [12 CFR §1002.6(c)]

The above review of certain Equal Credit Opportunity Act provisions should help you determine what proper behavior is when conducting everyday activities as a mortgage loan originator. There are very specific protected classes for which you should not discriminate against during the process of extending credit. There are also very specific ways in which to inform a consumer of whether or not there will be an extension of credit or not by way of disclosures. As with all other regulations in this industry, you should be familiar with the law and follow it during the course of your career.

Next, we will discuss another important part of the extension of credit: the privacy of consumer financial information.

Privacy of Consumer Information

An important condition in the process of working with consumers is to keep their personal/private information as private as possible. In order to determine eligibility for a mortgage loan the most personal bits of information are necessarily disclosed to a licensed professional. Part of the unspoken contract between the loan originator and the consumer is that the consumer will be open and honest about this information and the loan originator/financial institution will keep this information private. Actually, "unspoken contract" really is not the best terminology for this considering that the law literally states that this must be the case.

The Privacy of Consumer Information regulation [16 CFR §313], delves into the proper treatment of nonpublic personal information belonging to consumers by financial institutions. Its purpose is stated as: [16 CFR §313.1]

- Governing the treatment of nonpublic personal information about consumers by the financial institutions:
  - Requires a financial institution in specified circumstances to provide notice to consumers about its privacy policies and practices
  - Describes the conditions under which a financial institution may disclose nonpublic personal information about consumers to nonaffiliated third parties
  - Provides a method for consumers to prevent a financial institution from disclosing information to most nonaffiliated third parties by "opting out" of that disclosure

It is important to note that this particular part of the law only applies to consumers who obtain financial products or services for primarily personal, family, or household purposes. These provisions do not apply to those who obtain financial products or services for business, commercial, or agricultural purposes.

The law sets forth a specific definition to what "nonpublic personal information" means: [16 CFR §313.3(n)(1)]

- Personally identifiable information; and
- Any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available.
- Nonpublic personal information does NOT include:
  - Publicly available information or
  - Any list, description, or other grouping of consumers (and publicly available information pertaining to them (that is derived without suing any personally identifiable financial information that is not publicly available.
- Examples of lists:
  - Nonpublic personal information includes any lists of individuals' names and street addresses that is derived in whole or in part using personally identifiable financial information (that is not publicly available), such as account numbers
  - Nonpublic personal information does not include any lists of individuals' names and addresses that contains only publicly available information, is not derived, in whole or in part, using personally identifiable financial information that is not publicly available, and is not disclosed in a manner that indicates that any of the individuals on the list is a consumer of a financial institution.

The law also states that personally identifiable financial information means any information: [16 CFR §313.3(o)(1)]

- A consumer provides to you to obtain a financial product or service from you;
- About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or
- You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer.

Examples of personally identifiable financial information includes:

- Information a consumer provides to you on an application to obtain a loan
- Account balance information, payment history, overdraft history, and credit or debit card purchase information;
- The fact that an individual is or has been one of your customers or has obtained a financial product or service from you;
- Any information about your consumer if it is disclosed in a manner that indicates that the individual is or has been your consumer;
- Any information that a consumer provides to you or that you or your agent otherwise obtain in connection with collecting on, or servicing, a credit account;
- Any information you collect through an internet "cookie"; and
- Information from a consumer report.

Perhaps more importantly to provide a proper distinction between what is public versus private, the law offers this definition for publicly available information: [16 CFR §313.3(p)(1)]

- Any information that you have a reasonable basis to believe is lawfully made available to the general public form:
  - Federal, State, or local government records;
  - Widely distributed media; or
  - Disclosures to the general public that are required to be made by Federal, State, or local law.

Difference between a Customer and a Consumer

In order to advise consumers of their privacy rights, this regulation requires certain disclosure be provided. Let's go over some of these.

An initial privacy notice must be disclosed to consumers. The notice must be clear and conspicuous that accurately reflects your privacy policies and practices. It is important to determine who is considered a consumer versus who is considered a customer because the notice must be delivered at different times depending on the individual.

According to 16 CFR §313.4(a)(1)(2) a privacy notice must be given to a **customer** who is an individual who becomes your customer, no later than when you established a customer relationship. The notice for a **consumer** must be provided before you disclose any nonpublic personal information about the consumer to any nonaffiliated party.

So, when are you dealing with a customer and when are you dealing with a consumer? That a very good question. The law provides for a special rule for loans. You establish a customer relationship with a consumer when you originate a loan to the consumer for personal, family, or household purposes. If you subsequently transfer servicing rights to that loan to another financial institution, the customer relationship transfers with the servicing rights. [16 CFR §313.4(c)(2)]. In other words, everyone you deal with in your professional capacity is a consumer until you officially originate a loan for them, which makes them a customer.

Aside from the initial privacy notice, there is also an annual privacy notice required for all customers. For this disclosure, you must provide a clear and conspicuous notice to customers that accurately reflects your privacy policies and practices not less than annually during the continuation of the customer relationship. This means that at least once in a 12-month period where a customer relationship exits, the customer must receive a privacy notice. [16 CFR §313.5(a)(1)].

Remember, this disclosure has to be sent to anyone considered a customer, which for these purposes is any person you have originated a loan for until you no longer provide any statements or notices to the customer concerning that relationship or has ceased using your services. At this point the individual is considered a former customer and disclosures need not be sent to the individual. [16 CFR §313.5(2)(iv)]

Let's take a look at what should be included in the privacy notices.

The privacy notices must include the following information: [16 CFR §313.6 (a)(1)(2)(3)(4)(5)(6)(7)(8)]

- The categories of nonpublic personal information that you collect;
- The categories of nonpublic personal information that you disclose;
- The categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal data;
- The categories of nonpublic personal information about your former customers that you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information about your former customers;
- If you disclose nonpublic personal information to a nonaffiliated third party under a separate s of the categories of information you disclose and the categories of third parties with whom you have contracted;

- An explanation of the consumer's right to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including method(s) by which the consumer may exercise that right at that time;
- Any disclosures that you make
- Your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information; and
- Any disclosure that you make under the following:
    - Description of nonaffiliated third parties subject to exceptions.

An opt out notice is also a necessary disclosure. To opt out means that the consumer does not want you to disclose nonpublic personal information about them to a nonaffiliated third party. A consumer should be given a reasonable opportunity to opt out. [16 CFR §313.10 (a)(2)]

The opt out notice must say: [16 CFR §313.7(a)(1)]
- That you disclose or reserve the right to disclose nonpublic personal information about your consumer to a nonaffiliated third party;
- That the consumer has the right to opt out of that disclose; and
- A reasonable means by which the consumer may exercise the opt out right.

An adequate opt out notice is one that provides adequate notice that the consumer can opt out of the disclosure of nonpublic personal information to a nonaffiliated third party. This will include most or all of the following: [16 CFR §313.7(a)(2)(i)(A)(B)(ii)(A)(B)(C)(D)]
- All categories of nonpublic personal information that you disclose or reserve the right to disclose are identified.
- The financial product or service the consumer has obtained is identified.
- A reasonable means to exercise an opt out right is provided.
- Check-off boxes in a prominent position on relevant forms with the opt out notice is designated.
- A reply form is included which provides the address to which the form should be mailed; or
- An electronic means to opt out is provided
- A toll-free telephone number is provided that the consumer can use to opt out.

So, there you have it. As per the regulation, an initial privacy notice, an annual privacy notice, and an opt-out notice must be provided to customers. With regards to their delivery, 16 CFR §313.9(a)(b)(1)(i)(ii)(iii), states that a consumer will be reasonably expected to have received actual notice if you hand-deliver a printed copy of the notice to the consumer, mail a printed copy of the notice to the last known address of the consumer; clearly and conspicuously post the notice as a necessary step to obtaining a particular financial product or service.

Obviously, throughout the course of a mortgage loan transaction a lot of pertinent personal information must be shared. The process of eligibility for a mortgage loan program involves gathering personal financial information that most people do not share with others. In a modern and heavily technological time as the one we find ourselves in now, it has become easier and easier for people's information to be taken by others and used fraudulently. We hear about cases of identity theft constantly and new businesses that have made it a point to get paid to prevent such occurrences. The fear of identity theft makes it even more important that trust exist between you and a customer and in order to build that trust, privacy policies and practices must be in place and customers must be made aware of such policies and practices. After all, it should be up to the individual what personal private information should remain private and when it should not. Privacy policies and practices, in compliance with the law, enable the individual's control over his/her personal information.

SUMMARY

The Equal Credit Opportunity Act (ECOA)/Regulation B Consumer Credit is defined as credit extended to an individual for personal, family, or household purposes.

ECOA Purpose is to promote the availability of credit to all creditworthy applicants without regards to race, color, religion, national origin, sex, marital status, age, to the fact that all or part of their 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.

ECOA prohibits discrimination based on:

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

ECOA is established to grant all consumers an equal chance to obtain credit. Those who must comply include anyone involved in granting credit:

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

ECOA required disclosures:

- ECOA Disclosure
    - Discloses consumer rights under ECOA
    - Consumer has the right to know whether their credit application was accepted or rejected within 30 days of filing a completed loan application.
- Motive of Adverse Action
    - If application is rejected, lender must disclose specific reasons for rejection
        - Reasons should be clear and concise
        - Must be in writing and contain the following:
            - 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
- Appraisal Notification
    - Right to Receive a Copy of the Appraisal
    - A creditor must provide a copy of the appraisal

ECOA's theories of liability:

- Disparate treatment
  - Occurs when a creditor treats an applicant differently based on a prohibited basis.
- Disparate impact
  - Occurs when a creditor employs facially neutral policies and practices that have an adverse effect on a protected class.

Privacy of Consumer Information

Privacy of Consumer Information regulation delves into the proper treatment of nonpublic personal information belonging to consumers by financial institutions.

- Requires a financial institution in specific circumstances to provide notice to consumers about its privacy policies and practices.
- Describes the conditions under which a financial institution may disclose nonpublic personal information about consumers to nonaffiliated third parties.
- Provides a method for consumers to prevent a financial institution from disclosing information to most nonaffiliated third parties by "opting out" of that disclosure.

Nonpublic personal information includes:

- Personally identifiable information; and
- Any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available.

Nonpublic personal information does NOT include:

- Publicly available information or
- Any list, description, or other grouping of consumers (and publicly available information pertaining to them (that is derived without suing any personally identifiable financial information that is not publicly available.

Personal identifiable information means any information:

- A consumer provides to you to obtain a financial product or service from you;
- About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or
- You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer.

Publicly available information includes:

- Any information that you have a reasonable basis to believe is lawfully made available to the general public form:
  - Federal, State, or local government records;
  - Widely distributed media; or
  - Disclosures to the general public that are required to be made by Federal, State, or local law.

Who and when to provide privacy disclosures depends on the distinction between a customer and a consumer.

An initial privacy notice must be disclosed to a customer who is an individual who becomes your customer, no later than when you established a customer relationship. The notice for a consumer must be provided before you disclose any nonpublic personal information about the consumer to any nonaffiliated party.

- A customer relationship is established when you originate a loan for an individual for personal, family, or household purposes.
- If you subsequently transfer servicing rights to that loan to another financial institutions, the customer relationship transfers with those rights.

An annual privacy notice is required to be provided for all customers.

- So long as there is a customer relationship in a 12-month period, they must receive an annual privacy notice.

Included in the privacy notices is:

- The categories of nonpublic personal information that you collect;
- The categories of nonpublic personal information that you disclose;
- The categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal data;
- The categories of nonpublic personal information about your former customers that you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information about your former customers;
- If you disclose nonpublic personal information to a nonaffiliated third party under a separate statement of the categories of information you disclose and the categories of third parties with whom you have contracted;
- An explanation of the consumer's right to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including method(s) by which the consumer may exercise that right at that time;
- Any disclosures that you make
- Your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information; and
- Any disclosure that you make under the following:
    - Description of nonaffiliated third parties subject to exceptions.

An opt out notice must also be disclosed. The notice must say:

- That you disclose or reserve the right to disclose nonpublic personal information about your consumer to a nonaffiliated third party;
- That the consumer has the right to opt out of that disclose; and
- A reasonable means by which the consumer may exercise the opt out right.

Lesson 4: Traditional and Non-Traditional Mortgage Products

LESSON OBJECTIVES

In this lesson we will discuss the differences between qualified and non-qualified mortgages. We will delve into the different programs available for mortgage loan deemed non-traditional and begin a discussion on what Adjusted Rate Mortgages are and what they can offer for consumers.

By the end of this lesson students should:

- Recognize the difference between a qualified mortgage and a non-qualified mortgage and know the different government loan programs available
- Understand the Guidance on nontraditional mortgage products
- Know how an ARM is structured and calculated

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 are 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 later on in this lesson. First, let’s go over some of the details about Government loans that fit within the qualified mortgage category.

Federal Housing Administration Loan Programs

The United States government does offer a few loan programs to enable citizens to purchase a home. The Federal Housing Administration (FHA) was created in 1934 as part of the National Housing Act to:

- Generate new jobs by increasing construction activity
- Stabilize the mortgage market
- Promote financing, repair, improvement, and sale of real estate

Today, the FHA is part of the Department of Housing and Urban Development (HUD) and its primary function is to insure mortgage loans; compensate lenders for losses from borrower default. However, it does not build homes or make loans.

FHA functions on a Mutual Mortgage Insurance Plan, which is the insurance program funded by premiums paid by FHA borrowers. FHA uses direct endorsers, which are lenders authorized to handle the entire underwriting process for FHA loans.

The FHA mortgage loan carries with it a mortgage insurance fee, which is .85% of the loan amount.

If a borrower defaults on a loan, FHA reimburses the lender in the full amount of loss. It then becomes the borrower's responsibility to pay FHA back.

Aside from its insurance program, FHA loans have some distinguishing features:

- 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 min cash investment plus funds for
    - Closing costs
    - Discount points
    - Prepaids
- Mortgage insurance always required
- No pre-payment charges
- Property must be owner-occupied primary residence

FHA loans are a great resource for consumers who have a less than great credit score and not a lot of down payment funds. After all, FHA loan programs were created to support "low- and moderate-income buyers.

FHA loan limits are determined by the county where the home is located. For houses located in metro areas, the limits are set using the county/parish with the highest median home price within the metropolitan statistical area. Annually, FHA sets the "floor" of its loan limits in accordance to the new national conforming loan limit. The "floor" stands for FHA's minimum national loan limit. National conforming loan limits, along with FHA loan limits, increase as a result of rising home values. For 2019, conforming loan limits for mortgage acquired by Fannie Mae and Freddie Mac increased to $484,350 from the $453,100 limit placed in 2018. Loan limits in higher-cost areas are also affected by this change. In areas where 115% of the local median home value exceeds the baseline limits, the maximum loan limit will be higher. For the year 2019, the new ceiling loan limit in high-cost markets is $726,525, or 150% of the conforming loan limit of $484,350. This higher than the 2018 high-cost loan limit, which was set at $679,650. These limits are also broken down by number of units within the property. Below are the conforming loan limits broken down by units, which were published by the Federal Housing Finance Agency that apply to all conventional mortgages delivered to Fannie Mae:

1 Unit	$484,350
2 Units	$620,200
3 Units	$749,650
4 Units	$931,600

For High-Cost Areas the loan limits are broken down below:

1 Unit	$726,525
2 Units	$930,300
3 Units	$1,124,475
4 Units	$1,397,400

As previously mentioned, FHA sets its limits in accordance to these conforming loan limits. FHA sets their loan limits to 65% of the national conforming loan limit. Starting January 2019, FHA's loan limit is $314,827 for a single unit property. For high-cost areas, FHA sets is maximum loan limit ceiling at 150% of the national conforming limit. Starting January 2019, FHA high-cost loan limit is $726,525 for a single unit property. FHA lending amounts are meant to be a little higher than the median home price within a particular area in order to make it easier for buyers seeking a modest sales price. Below are the FHA loan limits broken down by property units:

1 Unit	$314,827
2 Units	$403,125
3 Units	$487,250
4 Units	$605,525

For high-cost areas, FHA loan limits broken down by units are as follows:

1 Unit	$726,525
2 Units	$930,300
3 Units	$1,124,475
4 Units	$1,397,400

73 counties in the United States fall under the category of the loan ceiling for high-cost areas.

Department of Veterans Affairs Loan Programs

Like FHA loan programs, the Veteran Affairs (VA) loan programs are associated with the government. The VA loan program was established to help veterans finance the purchase of their homes and offers several advantages over conventional loan programs.

VA loans are guaranteed loans. What this means is that a portion of the loan financing is guaranteed by the Department of Veterans Affairs and, therefore, protects the lender from losses due to default.

A VA loan can be used to purchase or construct a one-to-four-unit property. However, the VA does not guaranty investor loans and a requisite to receive financing is that the Veteran must occupy the property.

VA loans have very key characteristics:

- No down payment required
- No maximum loan amounts
- No maximum income limits
- Least stringent qualifying standards
- Can be fixed-rate or ARM loans
- No mortgage insurance required
- No maximum interest rates
- Lender may charge flat fee of no more than 1% for administrative costs
- No prepayment penalties
- Forbearance extended to veterans with financial difficulties
- Can be assumed by creditworthy buyer, veteran or non-veteran

United States Department of Agriculture Rural Loans

Aside from FHA loans and VA loans, there are also United States Department of Agriculture Rural Loans (USDA). These provide homeownership opportunities to rural Americans. USDA loans include programs for home renovations and programs for the elderly, disabled or low-income.

Some of the key characteristics of these types of loans are that they allow for 100% financing. Therefore, they do not necessitate a down payment. This can be a great resource for those who do not have enough for a down payment saved.

Some of the USDA Loan highlights are as follows:

- 100% Financing
- Broad location guidelines
- No mortgage insurance requirement
- No seller contribution limit
- 100% of closing costs can be gift
- Loan amount can include closing costs and repairs up to actual value

USDA direct loan programs are made for low-income families that cannot qualify for a conventional mortgage. To be eligible for this program, applicants must make between 50-80 percent of the median income for their area, adjusted for household size. For these loans, USDA is the lender for the loan.

USDA guaranteed loan programs are made for moderate income groups. To be eligible for this type of loan program, the applicants can have an income of up to 115% of the median income for the area. For these loans, the lenders are private lenders and they fund the mortgage with USDA guaranteed loans. The government secures these loans so that there is no risk for the lender.

For both of these programs through the USDA, borrowers must have a good credit history and the ability to repay the mortgage.

But what happens to those applicants that do not make the cut for these government loans? This is where lenders turn to non-traditional loan products. We will turn to these and their risks next.

<u>Nontraditional Mortgage Products</u>

Non-traditional mortgage products serve the purpose of financing borrowers that do not have perfect financial standing and, therefore, do not qualify for loans under the traditional mortgage product rubric. Of course, if you are dealing with people that have lower credit scores and finances that do not enable them to qualify for traditional mortgage products, the lender is running a higher risk when financing the loan. Due to the higher risk of default, these products come at a high cost, which inevitably makes the risk of default even higher.

In an effort to protect the consumer in these scenarios, guidance exists on how to properly lend nontraditional products to applicable consumers. We will discuss this guidance below.

<u>**Conference of State Bank Supervisors/American Association of Residential Mortgage Regulators- Guidance of Nontraditional Mortgage Product Risk**</u>

The Conference of State Bank Supervisors and American Association of Residential Mortgage Regulators (CSBS/AARMR) created the Guidance of Nontraditional Mortgage Product Risk in order to help state regulators of mortgage brokers and mortgage companies not affiliated with a bank holding company or an insured financial institutions to promote consistent regulation in the mortgage market and clarify how providers can offer nontraditional mortgage products in a way that clearly discloses the risks that borrowers may assume. The guidance was meant to fill a gap in the already existing interagency guidance that applied to all banks and their subsidiaries, bank holding companies and their nonbank subsidiaries, savings associations and their subsidiaries, savings and loan holding companies and their subsidiaries, and credit unions. This guidance was written in 2006 but is still important in what it states when managing the risk associated with nontraditional mortgage products.

This particular guidance addresses risks associated with the growing use of mortgage products that allow borrowers to defer payment of the principal and, sometimes, interest as well. These types of products are recognized as “nontraditional” mortgage loans. These include:

- Interest-only mortgages or
- Payment option adjustable-rate mortgages

Interest-only mortgage loans are a nontraditional mortgage product that offers the borrower the ability to only pay interest on the loan for a number of years. The interest could be fixed or fluctuate. Once the period of time for interest only payments, the rate may be fixed or fluctuate, but the payment will also include both the principal and the interest.

Payment Option ARMs are a nontraditional mortgage product that allows the borrower to choose from a number of different payment options. The borrower could choose a minimum payment option, for instance, where there is an introductory interest rate, an interest-only payment option based on the fully indexed interest rate, or a fully amortizing principal and interest payment option based on a 15- or 30-year term. The minimum payment option can be less than the interest accruing on the loan, resulting in negative amortization. The interest-only option avoids negative amortization but does not provide for principal amortization. After a specified number of years, or if the loan reaches a certain negative amortization cap, the required monthly payment amount is recast to require payments that will fully amortize the outstanding balance over the remaining loan term.

Nontraditional mortgage products enable a borrower to pay lower payments during the beginning part of the loan term in exchange for higher payments later in the loan term. Obviously, these types of mortgages carry with them a larger percentage of risk than those considered traditional mortgage products. A lot of these nontraditional mortgage products are underwritten with less stringent eligibility requirements.

Because of the potential for more risk, the guidance recommends management to carefully consider appropriate ways to mitigate exposures created by these loans. Specifically, to manage such risk management should:

- Ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower's repayment capacity; and
- Ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product choice.

The guidance goes on to state that when a provider offers nontraditional mortgage loan products, underwriting standards should address the effect of a substantial payment increase on the borrower's capacity to repay when loan amortization begins. In order to do so, the qualifying should involve structuring the initial terms to limit the spread between the introductory interest rate and the fully indexed rate. Nevertheless, a provider's qualifying standard should recognize the potential impact of payment shock, especially for those borrowers that have a high loan to value ratio or high debt to income ratio and low credit scores. The guidance itself recommended using multiple factors to during the qualifying process. In fact, it suggested that the analysis of repayment should not rely too heavily on credit scores alone instead of income verification. The guidance also advised the avoidance of loan terms and underwriting practices that heightened the need for a borrower to rely on the sale or refinancing of the property once the amortization begins. Obviously, since the guidance was written, new laws regulating both qualified and nonqualified mortgages have made it part of the law to consider multiple facets of the borrower and the loan product in determining eligibility. Below you will find a brief overview of what the guidance warns about and suggest. You will note that much of the guidance has been rectified with what is now the laws and regulations that govern this industry.

The guidance suggests the following:

- With regards to qualifying borrowers, the potential for payment shock should be taken into consideration
- With regards to collateral-dependent loans, the use of loan terms and underwriting practices that rely on the sale or financing of the property once amortization begins, should be avoided.
- With regards to loans that combine nontraditional features, such as interest only loans, the provider should demonstrate that mitigating factors support the underwriting decision and the borrower's repayment capacity.

- With regards to reduced documentation, those providers that rely on these types of loans should do so with caution. As levels of credit risk increase, the provider should be more diligent when verifying documentation.
- With regards to simultaneous second-lien loans, the guidance warns that as combined loan-to-value ratios rise, so do defaults. Loans with minimal or no owner equity generally should not have a payment structure that allows for delayed or negative amortization without other significant risk mitigating factors.
- With regards to introductory interest rates for payment option ARM products, the provider should consider the spread between the introductory rate and the fully indexed rate. Providers should minimize the likelihood of disruptive early recasting and extraordinary payment shock when setting introductory rates.
- With regards to subprime borrowers, providers should ensure that programs do not feature terms that could become predatory or abusive.
- With regards to non-owner-occupied investor loans, borrowers should qualify for loans based on their ability to service the debt over the course of the loan. Loan terms should reflect an appropriate combined loan-to-value ratio that considers the potential for negative amortization. Underwriting standards should also require evidence that the borrower has sufficient cash reserves to service the loan.

Ultimately the suggestions above were meant to ignite risk management practices for all providers of nontraditional mortgage products. Nontraditional mortgage loans provide flexibility for consumers, but the concern stems from the fact that consumers may not be aware of exactly what they are committing to. In an effort to promote more transparency, the guidance recommends strong control systems to monitor practices and providing promotional materials to consumers that include information on costs, terms, features, and risks of nontraditional mortgages. Consumers should receive information on all of the following:

- Payment shock
- Negative amortization
- Prepayment penalties
- Cost of Reduced Documentation Loans
- Monthly statements on Payment Option ARMs- should include a clear explanation of different payment options

The guidance also provided a list of practices to avoid:

- Providers should avoid practices that obscure significant risk to the consumer
    - If a provider advertises or promotes a nontraditional mortgage by emphasizing the comparatively lower initial payments permitted for these loans, the provider also should give clear and comparably prominent information alerting the consumer of the risks.
        - Information should explain that the payments will increase, that a balloon payment may be due, and that the loan balance will not decrease and may even increase due to deferral of interest or principal payments.
- Providers should avoid promoting payment patterns that are structurally unlikely to occur
- Providers should avoid giving consumers unwarranted assurances or predictions about the future direction of interest rates
- Providers should stop making one-sided representations about the cash savings or expanded buying power to be realized from nontraditional mortgage products in comparison with amortizing mortgages
- Providers should not suggest that initial minimum payments in a payment option ARM will cover accrued interest (or principal and interest) charges

- Providers should stop making misleading claims that interest rates or payment obligations for these products are “fixed”

Overall, the guidance on nontraditional mortgage products aims at providing the consumer with more transparency and knowledge about what they are getting into. This is in the hopes that consumers realize the risk they are taking with these products. There are other laws in place currently that also have this goal in mind. As mentioned in the beginning of this lesson, there is a distinction between non-qualified mortgages and qualified mortgages. According to the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, non-traditional mortgage products are any mortgage products that are not 30-year fixed rate mortgages. This goes beyond what the guidance on nontraditional mortgage products refers to. Let’s review some of these products.

Nontraditional Mortgage Products Available

The most popular nontraditional mortgage product 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 interest rates that are subject to change over time. Interest rates on ARMs change periodically to reflect market conditions.

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 choose 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.

Let’s delve into how these mortgages are structured.

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 3/1 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 6^{th} 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 7^{th} 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.

<u>Why choose an Adjustable Rate Mortgage?</u>

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. However, it is crucial to keep in mind what we discussed earlier in the lesson. It is your job to help protect the consumer, which means you must be diligent in your explanation of how these nontraditional mortgage products work and how they can affect the borrower over time.

In the next lesson, we will take a look at the different types of loans that exist that fall into the category of nonqualified and nontraditional mortgage products. Included are different types of Adjustable Rate Mortgages.

<u>SUMMARY</u>

Qualified vs. Non-Qualified Mortgages

The mandatory requirements for all Qualified Mortgages is as follows:

- The maximum thresholds for total points and fees in 2019 will be 3 percent of the total loan amount for a loan greater than or equal to $107,747.
- no risky features like negative amortization, interest-only, or balloon loans,

- maximum loan term is less than or equal to 30 years.

Non-qualified mortgages are mortgages that do not fit the qualified mortgage criteria.

Most non-qualified mortgages require non-traditional mortgage products.

Federal Housing Administration

FHA is part of HUD and its primary function is to insure mortgage loans in order to compensate lenders for losses from borrower default.

FHA functions on a Mutual Mortgage Insurance Plan, which is the insurance program funded by premiums paid by FHA borrowers. If borrowers' default on a loan, FHA reimburses the lender and the borrower is responsible to repay FHA.

- FHA loans have less stringent qualifying standards than conventional loans
- Minimum credit score at or above 580
- 3.5% down payment
- credit scores between 500-579- limited to 90% LTV
- credit scores less than 500 not eligible
- maximum loan amounts set by local limits and by LTV rules
- mortgage insurance always required
- no prepayment penalties
- property must be owner-occupied

FHA loan limits are determined by county where home is located.

  - Loan limits set to 65% of national conforming loan limit
  - Max loan limit for high-cost area set at 150% of national conforming limit

VA Loans

VA loans are guaranteed loans. Department of Veteran Affairs protect lenders from losses by guaranteeing a portion of the loan financing.

VA loan characteristics:

- No down payment required
- No maximum loan amounts
- No maximum income limits
- Least stringent qualifying standards
- Can be fixed-rate or ARM loans
- No mortgage insurance required
- No maximum interest rates
- Lender may charge flat fee of no more than 1% for administrative costs
- No prepayment penalties
- Forbearance extended to veterans with financial difficulties
- Can be assumed by creditworthy buyer, veteran or non-veteran

USDA Loans

USDA loans provide homeownership opportunities to rural Americans.

USDA characteristics:

- 100% Financing
- Broad location guidelines
- No mortgage insurance requirement
- No seller contribution limit
- 100% of closing costs can be gift
- Loan amount can include closing costs and repairs up to a/v

Conference of State Bank Supervisors/American Association of Residential Mortgage Regulators- Guidance of Nontraditional Mortgage Product Risk

Conference of State Bank Supervisors and American Association of Residential Mortgage Regulators created the Guidance of Non-traditional Mortgage Product Risk in 2006 to fill the gap on existing regulation that did not apply to all financial institutions.

The guidance addresses risk associated with the growing use of mortgage products considered nontraditional.

- Interest-only mortgage
- Payment Option ARMs
- Reduced documentation

The guidance wants to manage risk incurred by:

- Ensuring that loan terms and underwriting standards are consisted with prudent lending practices, including consideration of a borrower's repayment capacity and
- Ensuring that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product choice.

Nontraditional Mortgage Products Available

- ARMs- the most popular nontraditional product
    - Linked to indices
        - LIBOR, 11th District cost of Funds Index, Constant Maturity Treasury, et
    - Index works as a benchmark interest rate that reflects the market
    - Margin is added to index to determine the interest rate
    - Cap-limits how much a rate can go up in a given time
        - Lifetime cap limits the amount interest rate can change during the life of the loan.
        - Periodic cap limits the amount the interest rate can change during each adjustment period.
        - Payment cap limits the amount the monthly payment increases during each adjustment period.
    - ARMS have 3 identifying numbers. Each of the numbers denote what type of cap the mortgage has.
        - If you have a 1/1/6 ARM, the first number means the initial rate is 1%, the second number means that the adjustment cap for the loan is 1%, and the third number means that here is a 6% lifetime cap on the loan.

Lesson 5: Non-Traditional Mortgage Products

LESSON OBJECTIVES

In this lesson we will continue to discuss different Adjustable Rate Mortgages available for consumers. We will also continue our discussion on non-traditional mortgage products.

By the end of this lesson students should:
- Know the different type of ARMs available to consumers
- Have basic knowledge of different lending products available
- Understand the need for nontraditional mortgage products

In the last lesson we discussed the difference between nonqualified mortgage and qualified mortgages. Nonqualified mortgages are those that do not comply with the Consumer Financial Protection Bureau's rules on qualified mortgages. In other words, nonqualified mortgage are mortgage loans that do not meet the standards set forth by the federal government.

The standards for Qualified Mortgages are as follows:
- Points and fees are less than or equal to 3% of the loan amount
  - For loans that are less than $100,000, higher percentages are allowed
- No risky features
  - Such as negative amortization, interest-only, or balloon loans
  - Maximum loan term is less than or equal to 30 years
- Debt-to-income ratio of 43% or less
- Meets requirements for purchase, guarantee, or insurance GSE, FHA, or USDA
  - In this case, as long as they do, the debt-to-income ratio can be more flexible

For those borrowers that are not eligible for products displaying the above features, nonqualified or nontraditional mortgage products are available. In the previous lesson we began to discuss one of the most popular nontraditional or nonqualified mortgage product: Adjustable Rate Mortgages. In this lesson we will continue to discuss the different types of Adjustable Rate Mortgages as well as other types of nontraditional mortgage products available to consumers.

Different Types of 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 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. The options the borrower can choose from are a traditional payment of principal and interest and an interest-only 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.

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.

Negative amortization occurs when unpaid interest is added to the principal balance of the loan, increasing the amount that is owed. Rather than normally declining the loan balance, negative amortization causes the balance to go up. Currently, lenders try to avoid providing loan products that may result in negative amortization. If there is any possibility of negative amortization occurring, lenders tend to place limits on it.

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 income 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.

Other Nontraditional Mortgage Products

Reverse Mortgage/HECM:

Reverse Mortgages enable older homeowners to convert equity in their property to a monthly source of income or a line of credit.

Qualifying the borrower:
- Borrower must be at least 62 years of age
- Own the property outright or paid down a significant portion
- Occupy the property as a principal residence
- Not be delinquent on any federal debt

For a reverse mortgage, the property itself must be a single-family home or a 2-4-unit property, where the borrower occupies one of the units. If the property is a condo in a condominium, it must be a HUD approved project. If the property is a manufactured home, the property must meet FHA requirements.

With regards to financial requirements for qualification, all income, assets, and living expenses and credit history must be verified, but there are no income or credit qualification. There must be a history of timely payments for real estate taxes, homeowner’s insurance, and flood insurance. Furthermore, the closing costs can be part of the financing. As long as the person remains in the property as their principal residence, there is no repayment necessary.

Though a Reverse Mortgage is a great product for those who qualify, there are certain costs that go along with the mortgage that should be disclosed clearly to the borrower. Costs involved in closing a reverse mortgage include a mortgage insurance premium, which guarantees the borrower will receive loan advances. The MIP is usually 2% of the maximum claim amount or the appraised value, whichever is lesser. There is also an annual MIP premium that equals 1.25% of the loan balance. Third party charges, such as an appraisal, title search, title insurance, surveys, inspections, recordation and other fees can also apply. There is a servicing fee that can apply as well for sending account statements, disbursing the loan proceeds, tracking taxes and homeowner’s insurance to make sure payments are made and up to date, etc. Furthermore, an origination fee can be charged for things like processing the loan, which can be up to $2,500 if the home is valued at less than $125,000. This fee goes up to 2% of the first $200,000 plus 1% over $200,000.

There is also a version of the reverse mortgage, or HECM Saver, that enables the borrower to borrower a smaller amount. This means that there are lower proceeds in exchange for lower costs. For examples, the initial mortgage insurance premium is .01% of the loan as opposed to the 2% required by the standard HECM. That said, the annual MIP is also 1.25% as is the case with the standard reverse mortgage.

15-Year Loans

Some people prefer to obtain a 15-year loan rather than a 30-year loan. What this means is that the calculations of interest and payment are calculated over a 15-year term rather than a 30-year term. The major advantage being that you owe money for less time and the interest rate is generally lower. However, there are downsides to getting a 15-year loan. Most obviously, aside from the difference in payback time, the monthly payments are higher on a 15-year loan than a 30-year loan. This means that the borrower will have less flexibility with their money if something unexpected were to happen.

Bi-weekly Loans

Bi-Weekly loans are a variant of a fixed rate level annuity loan, which simply increases the frequency of payment, while in the process of reducing the loan's overall interest carry costs. This type of loan may be particularly useful and beneficial for borrowers who are paid every other week, since this payment method might be easier to budget. The calculation for such a payment amount is simply one-half of a monthly payment, paid bi-weekly. For example, if the monthly payment for a 20-year loan amounts to $1,000, the borrower would pay $500 every other week. This amounts to 26 bi-weekly payments over the span of one year, amounting to $13,000. This compared to 12 monthly payments amounting to $12,000.

The additional payments applied to principal reduction in the bi-weekly plan will help pay off the loan in about 17 to 20 years, depending on the contract rate of interest. This type of loan has been approved for purchases by Fannie Mae, thus loan originators can offer this kind of loan and be assured of it being saleable in the secondary market. Many lenders who offer this loan product may require direct drafts of the bi-weekly payments from the borrower's checking account.

Piggyback Loan

A Piggyback Loan is a residential mortgage financing option in which a property is purchased using more than one mortgage from one or more lenders. Very often, a second mortgage is secured from a lender different from the one providing the first mortgage. However, some lenders offer piggybacks involving maximum FNMA/FHLMC loans as the first, with a HELOC (Home Equity Line of Credit) in second position funding the balance of the acquisition price or refinance amount target.

These loans typically work well for and accommodate upper income borrowers with strong net worth positions and earnings potential. Again, this is a loan product designed to meet the needs of specific borrowers engaged in a particular transaction that proves to be beneficial to both parties.

Home Equity Lines of Credit (HELOC's)

Home Equity Lines of Credit (HELOC's) are forms of equity loans which allow borrowers to secure funding on an as needed basis, rather than a lump sum, up to an approved ceiling or maximum LTV. In essence, this provides the consumer with a revolving Line of Credit that can be used for any purposes desired, including making home improvements, but also purchasing consumer goods, taking vacations, fund education and the like.

From a practical standpoint, the borrower has converted home equity into an ATM cash drawer to be used whenever "needed".

Rehab Loans

Rehabilitation loans are very useful for those that want to purchase a home and fix or renovate the property. There are conventional rehab loans as well as FHA rehab loans. The conventional version of a rehab loan is known as the Homestyle Renovation Loan. The FHA version of the rehab loan is known as the FHA 203(k) loan. Let's briefly review both of these loans.

Homestyle Renovation Loan:

- Requires a minimum 20% down payment or borrower equity
- For one-unit primary residences and second homes
- The down payment is based on the calculation of post-improved value rather than the present value
- The maximum loan amount is limited to 50% of the post-improved appraised value and cannot exceed the conforming loan limits.

FHA 203(k) Loan:

- Requires a minimum 3.5% of the post improved value as a down payment.
- Can only finance the rehabilitation of the property that is a primary residence, not investment property or second home.
- The maximum loan amount is limited to FHA county maximums.
- "Streamline" version of the loan enables borrowers making cosmetic and non-structural renovations to obtain a loan in less time. (Improvements cannot exceed $35,000
  - This version does not require the use of a consultant, architect, or engineer and requires fewer inspections, thus making it a faster product.

Portfolio Loans

A portfolio loan is a loan that is serviced by the same institution that issued the financing. This is different from most mortgage loans that are issued by a lender and then sold on the secondary market to another institution that then services the loan. It is called a portfolio loan because the lender keeps the loan as part of their portfolio. Usually, borrowers must have a good credit score to be considered eligible for a portfolio loan. However, eligibility requirements might not be as stringent as with other loans because the lender does not need to worry about what the secondary market demands because he/she will not be selling the loan to them. Thus, this might be good for a person that has a slightly higher debt-to-income ratio, or maybe less money to put down. With a portfolio mortgage, the lender can really set the eligibility standards (of course, within the confines of the law). However, though more flexible in eligibility, portfolio loans may carry with them terms that are less than favorable. For example, a portfolio loan may carry with it a prepayment penalty. If the borrower plans on refinancing or selling in the near future, this may pose a problem.

Seller Financing

Seller financing basically means that the seller is putting up either a portion or all of the money required to purchase a property and the buyers make a deal with the seller to pay him/her back. The buyer and the seller draw up their own contract detailing the interest rate, monthly payment amount and schedule for payment. The buyer then provides a promissory note to the seller agreeing to their terms and the promissory note becomes public record to protect them both. The seller retains title to the property until the buyer has repaid the loan in full. As with portfolio loans, seller financing deals allow for flexibility for the buyers. The terms are completely up to the seller and buyer, aside from some universal laws that must be adhered to. There are no requisite qualifying standards, making the qualification process for the buyer less stringent than the normal process via a financial institution. This can be a plus for the seller because they can set the sales price at a higher price due to the fact that they are offering the financing. Additionally, the loan could carry a higher interest rate, again, because they are offering the financing.

There are different types of seller financing types, but currently what is most popular are lease-purchase agreements. A lease-purchase, or bond for deed, or contract for deed, means that the seller will lease the property to the buyer, giving the buyer equitable title to the property. Once the agreement is met and the buyer has provided the payments necessary, the buyer receives the full title to the property.

More on Nonqualified Loans

OK, we have now reviewed some of the nontraditional mortgage products available. Let's move on to discussing some of the nonqualified loan scenarios that one can encounter.

The guidelines for eligibility of qualified mortgages is strict, but not all consumers fit the mold. For example, consumers that are or have:

- High debt to income ratios, but plenty of reserves
- Self-employed for less than 2 years
- Self-employed and not showing a large income on tax returns
- Credit issues do to unforeseen circumstances

For consumers that fit into one of the above scenarios, nontraditional mortgage products or nonqualified mortgages can enable their purchase of property.

To be clear, please note that the ability to repay requirement for qualified mortgages still applies to nonqualified mortgages. Borrowers that cannot show their ability to repay will not qualify for a mortgage. The Dodd-Frank Act's ability to repay rule requires all lenders to ensure that they can afford a mortgage. Therefore, when lenders offer nonqualified mortgage products, they must still verify a borrower's financial situation. Verification of income, assets, employment, DTI, and credit history is crucial in determining the consumer's ability to repay the loan.

In addition to the loan scenarios that might make a consumer more likely to need a nonqualified mortgage, other factors have created a greater need for these products to exist in the real estate industry. Home prices seem to continue to rise and interest rates are increasing, while there has been a shortage in the availability of homes on the market. This has made the demand for nonqualified products to increase. In an effort to continue to sell loans for the purpose of purchasing property, eligibility standards need to be a little more flexible. Nonqualified mortgages enable flexibility in areas such as credit scores and loan-to-value ratios.

Overall, nonqualified mortgages or nontraditional mortgage products exist to extend the reach for the ability to purchase property. In an effort to help those that might not meet the stringent standards for qualified mortgage eligibility, nontraditional mortgage products are now being offered by more lenders. Becoming familiarized with what these products look like and what they can offer may be a good way to broaden your clientele. However, you must keep in mind that these types of loans carry more risk for the lender and for the borrower; Thus, you must always be as clear as possible when explaining the details of these products when working with the borrower on a nontraditional mortgage.

SUMMARY

Standards for Qualified Mortgages:

- Points and fees are less than or equal to 3% of the loan amount
  - For loans that are less than $100,000, higher percentages are allowed
- No risky features
  - Such as negative amortization, interest-only, or balloon loans
  - Maximum loan term is less than or equal to 30 years
- Debt-to-income ratio of 43% or less
- Meets requirements for purchase, guarantee, or insurance y GSE, FHA, or USDA
  - In this case, as long as they do, the DTI can be more flexible

Nonqualified mortgages do not meet these standards and are great for borrowers that are not eligible for qualified mortgage products.

Adjustable Rate Mortgages

- Hybrid ARMs
  - Mix between fixed-rate and adjustable rate mortgage
  - Fixed interest rate for the first few years, followed a rate that adjusts periodically
    - Ex: 7/1 ARM
      - First seven years interest rate is fixed.
      - Every year after that the interest rate will adjust
- Interest-Only ARMs
  - Borrower can pay only interest for a specified number of years
  - After that, they must pay both interest and principal
  - Payment shock is likely once the initial period is over and borrower begins paying both interest and principal
- Payment-Option ARMs
  - Borrower can choose among different options
- Cash Flow ARMs
  - Minimum payment option
  - Can choose monthly payments from different options
    - Interest-only payment
    - Traditional principal and interest
    - Minimum payment
  - Good for borrowers that do not have a large budget monthly, but will in the future
  - Borrower must proceed with caution, as lower rates may be available initially, but adjust to significantly higher rates later.
- Convertible ARMs
  - An adjustable rate mortgage that can be converted to a fixed rate mortgage
  - Allows for certain point in time where borrower can choose to convert loan to fixed rate for the rest of the term of the mortgage.
  - Initial interest rates and fees are higher than other ARMs

Adjustable Rate Mortgages are risky. Payment caps allow for some protection, but there are other issues that can arise.

- Negative amortization occurs when unpaid interest is added to the principal balance of the loan, increasing what is owed.
    - Amortization cap can alleviate some of this
        - Usually amortization caps are set to limit how much the borrower owes to 125% of the original mortgage
- Payment shock
    - From the increased monthly payment after an adjustment.
- Balloon payments
    - Having to pay an outstanding principal sum at the end of a loan period
- Prepayment penalties
    - Penalties that may apply to borrowers who pay the loan balance in full before the end of the term.
        - Prepayment penalty clause deters the loss of income the lender will collect from interest accrued on a loan if the loan is paid early
            - Two types of clauses
                - Hard prepayment penalty
                    - If house is sold or refinanced before time frame set
                - Soft prepayment penalty
                    - If house Is sold or refinanced within the time frame set

Reverse Mortgage/HECM

Enable older homeowners to convert equity into monthly source of income or line of credit.

- Borrower must be at least 62 years of age
- Own property or paid down significant amount
- Occupy the property as principal residence
- Not be delinquent on federal debt
- Property must be single family or 2-4 unit
- Reverse Mortgage carries with its mortgage insurance premium
    - 2% of claim amount or appraised value
    - Annual MIP equals 1.25% of loan balance
- Mortgage carries a servicing fee and origination fee
- HECM Saver enables borrower to borrow a smaller amount
    - Cost is lower

15-Year Loans

- Interest and monthly payment calculated over 15-year term
- Higher monthly payments

By-weekly loans

- Variant of a fixed rate mortgage
- Make two payments monthly
- Can be risky as it ties op borrower cash

Piggyback Loan

- Using more than one mortgage from one or more lenders
- Sometimes the second mortgage is secured from a lender that is different from the one securing the first mortgage

- Typically, good for borrowers in upper income bracket with strong net worth positions and earnings potentials

Home Equity Lines of Credit
- Forms of equity loans
- Borrowers can secure funding as needed, instead of lump sum
- Can be used for any purpose

Rehab Loans
- Homestyle Renovation Loan:
    - Requires a minimum 20% down payment or borrower equity
    - For one-unit primary residences and second homes
    - The down payment is based on the calculation of post-improved value rather than the present value
    - The maximum loan amount is limited to 50% of the post-improved appraised value and cannot exceed the conforming loan limits.
- FHA 203(k)
    - Requires a minimum 3.5% of the post improved value as a down payment.
    - Can only finance the rehabilitation of the property that is a primary residence, not investment property or second home.
    - The maximum loan amount is limited to FHA county maximums.
    - "Streamline" version of the loan enables borrowers making cosmetic and non-structural renovations to obtain a loan in less time. (Improvements cannot exceed $35,000
        - This version does not require the use of a consultant, architect, or engineer and requires fewer inspections, thus making it a faster product.

Portfolio Loans
- Loans serviced by the same institution that issued the financing.
- More flexible than traditional mortgages because institution sets eligibility standards

Seller Finance
- Seller puts forth a portion or all money required for purchase for buyer
- The buyer and seller draw up their own contract with details on repayment terms

Nonqualified Loans
- Do not fit standards for qualified loans
- Good for people in the following scenarios:
    - High debt to income ratios, but plenty of reserves
    - Self-employed for less than 2 years
    - Self-employed and not showing a large income on tax returns
    - Credit issues do to unforeseen circumstances
- Please note that despite the fact that nonqualified mortgages are less stringent on eligibility requirements, the ability to repay rule must still be followed when extending credit.
    - Verification of all of the following is necessary:
        - Income
        - Assets
        - Employment
        - DTI
        - Credit history

Lesson 6: Ethics in Mortgage Lending Part I

LESSON OBJECTIVES

In this lesson we will go over the importance of the meaning of ethics and ethical behavior in this industry. We will then review some of the risks that are incurred in mortgage lending origination, including identity theft and different types of fraud one can encounter. Finally, we will go over the Identity Theft Rules.

By the end of this lesson students should:

- Know the definition of ethics and what constitutes ethical behavior
- Define Identity Theft
- Understand Identity Theft Rules and why they 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.

What are 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, others 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 [12 CFR §1026.32] 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.

Some Types of Fraud

For a brief review, let's look at some of the different types of fraud that are found in the real estate industry.

- Straw Borrower refers to fraud in the form of a person acting as though he/she is the consumer or borrower, when in reality the homeowner or occupier will be someone else.

- Builder bailout fraud refers to when a builder uses different illegal tactics in order to move a property.

- Flips fraud refers to illegal flipping, which happens when a home is purchased at an inflated appraised value.

- Air loan fraud refers to a loan that has no underlying collateral securing the loan.

- Credit Fraud refers to fraud within a credit report. A person may have changed information within the report in order to appear more eligible for an extension of credit. Or a person may have forged information on a credit application, which one can note if there are inconsistencies within different documents needed for eligibility.

- Affinity fraud refers to when members of a group are involved in activities such as foreclosure rescues or investment property schemes.

- Sales contract fraud refers when there are fraudulent items on a sales contract.

- Application fraud refers to when somewhere on an application for credit there is erroneous information.

Overall, there are two large categories of fraud in this industry that are recognized by the Federal Bureau of Investigation. The FBI considers these two categories to be Fraud for Profit and Fraud for Housing. Fraud for Profit refers to an individual or individuals that deceive or misrepresent in order to gain something. Fraud for Housing refers to a consumer getting a loan under false pretenses or by falsifying documents needed to obtain a loan. Generally speaking, Fraud for Profit is committed by people in the mortgage lending industry while Fraud for Housing is committed by the consumer as it involves acquiring a house under false pretenses.

Though, as you can see, there are different types of fraud in the lending industry, we will focus heavily on Identity Theft in this lesson. This particular type of fraud is widely known across multiple industries as it occurs all the time. Identity fraud occurs when a person steals another person's identity, including and not limited to a social security number, bank account numbers, credit card number, and other private and sensitive information, for some kind of personal gain.

Merriam-Webster defines identity theft as the illegal use of someone else's personal information especially in order to obtain money or credit. Thus, in the mortgage lending industry you could find identity theft in two specific "ways." The first, you may find that someone is using someone else personal information in order to obtain a mortgage loan. The second, could come about from disclosing a customer's personal information to a third party and that third party using the information for financial gain. The first scenario means that as a loan officer you must be weary of the information you are given and make sure you check for any inconsistencies in the supporting documentation a client provides in the process of obtaining a loan. The second scenario means that as a loan officer you, your company, and your clients must be well aware of privacy policies and practices.

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. We spent some time discussing some of these in our last lesson regarding privacy policies and practices. In this lesson we will review what are known as Identity Theft Rules, which help detect and prevent identity theft.

Identity Theft Rules

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 CFR §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 CFR §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 CFR §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 CFR §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 16 CFR §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 16 CFR §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.

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:

- Straw Borrower
- Credit Fraud
- Application Fraud
- Builder Bailout
- Flips Fraud
- Sales Contract Fraud
- Affinity Fraud
- Air loan Fraud
- Identity Theft/Fraud

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

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.

Lesson 7: Ethics in Mortgage Lending Part II

LESSON OBJECTIVES

In this lesson we will review other regulations in the mortgage lending industry that pertain to ethical behavior.

By the end of this lesson students should:

- Understand the provisions included in the Telemarketing and Consumer Fraud and Abuse Prevention Act
- Be able to prevent prohibited advertising
- Know the provisions in the Bank Secrecy Act/Anti-Money Laundering Act

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.

Telemarketing and Consumer Fraud and Abusive Prevention Act

Aside from the provisions on Identity Theft Rules that we reviewed in the last lesson, 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. As we mentioned in the previous lesson, the privacy of personal information is crucial and a point of focus in the financial industry. 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 section we will go over some of the other laws in place that also aim at providing consumer protection and prevent the incidence of fraud.

Mortgage Acts and Practices

Behaving ethically and avoiding prohibited practices does not necessarily just apply to how you behave with consumers directly in an office environment, or by telephone or email communication; it also has to do with how you position yourself to receive new business via advertising. There are certain regulations in place that determine how people in this business should appropriately advertise with the aim at providing transparency for the consumer. We will review some of these next.

Regulation N, or Mortgage Acts and Practices, issued in 2009 and enforced by the CFPB starting in 2011, provides an Advertising Final Rule that applies to those under FTC jurisdiction for advertising mortgages. Regulation N defines a mortgage credit product as:

> Any form of credit that is secured by real property or a dwelling and that is offered or extended to a consumer primarily for personal, family, or household purposes.

The Rule states specific deceptive acts and practices that are prohibited and expresses that misrepresentation in any commercial communication is prohibited. This includes making misrepresentations of: [12 CFR §1014.3]

- the existence, number, amount or timing of minimum or required payments;
- the interest charged for the product;
- any comparison between a rate or payment that will be available for a period less than the full length of the mortgage credit product or an actual or hypothetical rate or payment;
- the association of the provider of the mortgage credit product with any other person or program;
- the consumer’s ability or likelihood to obtain any mortgage credit or product or term;
- the availability, nature, or substance of counseling services or any other expert advice offered to the consumer regarding any mortgage credit product or term;
- the right of a consumer to reside in the dwelling that is subject of the mortgage credit product;
- the potential for default under the mortgage;
- the effectiveness of the mortgage in helping pay down debts; or
- that the mortgage is or relates to a government benefit, endorsed, or sponsored by, or affiliated with any government program.

These rules apply to any commercial message in any medium that promotes directly or indirectly, a credit transaction. These include messages on Internet websites and social media. Regulation N expands the definition of a commercial communication to include any written or oral statement, illustration, or depiction designed to result in a sale or create interest in purchasing goods or services, whether it appears on or in certain media. Again, the term media here includes Internet network or social media application. [12 CFR §1014.2]
The exact definition of commercial communication stated in the regulation is as follows:

Commercial communication means any written or oral statement, illustration, or depiction, whether in English or any other language, that is designated 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 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. Promotional materials and items and web pages are included in the term commercial communication. [12 CFR §1014.2]

As you can see, the regulation is mean to be as inclusive as possible to any materials a person in the mortgage lending industry may use to advertise his or her business. This, of course, is in an effort to offer more consumer protection. And for the purposes of this regulation, a consumer means a natural person to whom a mortgage credit product is offered or extended.

Please note, that Regulation N makes clear that it is a violation of the law to obtain, or even attempt to obtain, a waiver form from any consumer of any protection provided by or any right of the consumer provided by this violation. [12 CFR §1014.4] Therefore, it is crucial that, no matter what, if you are to create some sort of commercial communication, you follow this advertising rule.

Regulation N also requires certain records be kept of commercial communications created and used. It states that:

- For a period of 24 months from the last date the person made or disseminated the applicable commercial communication regarding any term of any mortgage credit product, must keep the following evidence of compliance with this part of the regulation: [12 CFR §1014.5(a)(1)(2)(3)(b)]
    - Copies of all materially different commercial communications as well as sales scripts, training materials, and marketing materials, regarding any term of any mortgage credit product, that the person made or disseminated during the relevant time period;
    - Documents describing or evidencing all mortgage credit products available to consumers during the time period in which the person made or disseminated each commercial communication regarding any term of any mortgage credit product, including but not limited to the names and terms of each such mortgage credit product available to consumers; and
    - Documents describing or evidencing all additional products or services (such as credit insurance or credit disability insurance) that are or may be offered or provided with the mortgage credit products available to consumers during the time period for which the person made or disseminated each commercial communication regarding any term for any mortgage credit product, including but not limited to the names and terms of each such additional product or service available to consumers.
- Any person subject to this regulation may keep the records required above in any legible from, and in the same manner, format, or place as they keep such records in the ordinary course of business. Failure to keep all records required will be considered a violation of this law.

Thus, Regulation N provides protection to the consumer by way of prohibiting advertising that may misrepresent all or part of the mortgage lending transaction. If you are to advertise for more business, you must be sure that none of what you provide in your advertisement could be misconstrued as a misrepresentation of information. You must also make sure to keep good records of those advertisements.

Let's now change gears and look at another law that deals with the possibility of fraud in the mortgage lending industry.

Bank Secrecy Act/Anti-Money Laundering (BSA/AML)

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 USC §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 USC §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 USC §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 USC §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 a 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 USC §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 USC §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 USC §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 USC §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.

SUMMARY

Telemarketing and Consumer Fraud and Abusive Prevention Act

- Telemarketers are viewed as being able to deceive and obtain personal information easily.
- Congress created laws to protect consumers from telemarketing deception and abuse.
- Of those most vulnerable of this deception and abuse are senior citizens. They seem to be the target often.
  - 56% of the people telemarketers list as persons vulnerable to fraud are 50 years of age or older.
  - TRIAD program is in place to aid in the prevention of criminal victimization of the elderly.
- Rules prohibiting deceptive and abusive telemarketing practices:
  - Include 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 of abusive of such consumer's rights to privacy

- A requirement that any person engaged in telemarketing for the sale of goods and services shall promptly and clearly disclose to the person receiving the call that the purpose of the call is to sell goods and services.

Regulation N or Mortgage Acts and Practices

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

- Commercial communication means any written or oral statement, illustration, or depiction, whether in English or any other language, that is designated 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 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. Promotional materials and items and web pages are included in the term commercial communication.

- It is a violation of the law to obtain or attempt to obtain a waiver form from any consumer of any protection provided by Regulation N.

- 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.

The Bank Secrecy Act and Anti-Money Laundering

- 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, underpricing 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.

Lesson 8: Review of Georgia Mortgage Laws (Elective)

LEARNING OBJECTIVES

- Identify definitions and terms
  - Know those exempt from licensing
  - Have knowledge of the following:
  - Registration, financials and bonds, education, disclosures, annual fees, advertisements, renewal of licenses, record maintenance and applying for licenses
- Understand the automated licensing system

INTRODUCTION

- The contents of this lesson are provided through the Georgia Residential Mortgage Act and the Georgia Mortgage Division Rules.
- The full text of these statutes is available within the resources area of this lesson. Students are strongly encouraged to download and print a copy for further review.
- The Official Codes of Georgia Annotated will be referenced throughout this text as O.C.G.A.

DEFINITIONS [O.C.G.A. §7-1-1000]

Considering there is a lot of jargon when it comes to regulations in the lending industry, it is important to review how some of the terminology used is defined. Section 7-1-1000 of the Official Codes of Georgia Annotated defines the following terminology:

(1) **'Affiliate'** or **'person affiliated with'** means, when used with reference to a specified person, a person who directly, indirectly, or through one or more intermediaries controls, is controlled by, or is under common control with the person specified. Any beneficial owner of 10 percent or more of the securities of a person or any executive officer, director, trustee, joint venturer, or general partner of a person is an affiliate of such person unless the shareholder, executive officer, director, trustee, joint venturer, or general partner shall prove that he or she in fact does not control, is not controlled by, or is not under common control with such person.
(2) **'Audited financial statement'** means the product of the examination of financial statements in accordance with generally accepted auditing standards by an independent certified public accountant, which product consists of an opinion on the financial statements indicating their conformity with generally accepted accounting principles.
(3) **'Commissioner'** means the commissioner of banking and finance.
(4) **'Commitment' or 'commitment agreement'** means a statement by a lender required to be licensed or registered under this article that sets forth the terms and conditions upon which the lender is willing to make a particular mortgage loan to a particular borrower.
(5) **'Control,'** including **'controlling,' 'controlled by,' and 'under common control with,'** means the direct or indirect possession of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting or nonvoting securities, by contract, or otherwise.
(6) **'Department'** means the Department of Banking and Finance.
(7) **'Depository institution'** has the same meaning as in Section 3 of the Federal Deposit Insurance Act, 12 U.S.C. Section 1813(c), and includes any credit union.

(8) **'Dwelling'** means a residential structure that contains one to four units, whether or not that structure is attached to real property pursuant to Regulation Z Section 226.2(a)(19). The term includes an individual condominium unit, cooperative unit, mobile home, and trailer if it is used as a residence.

(9) **'Executive officer'** means the chief executive officer, the president, the principal financial officer, the principal operating officer, each vice president with responsibility involving policy-making functions for a significant aspect of a person's business, the secretary, the treasurer, or any other person performing similar managerial or supervisory functions with respect to any organization whether incorporated or unincorporated.

(10) **'Extortionate means'** means the use or the threat of violence or other criminal means to cause harm to the person, reputation of the person, or property of the person.

(11) **'Federal banking agencies'** means the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the National Credit Union Administration, and the Federal Deposit Insurance Corporation. Such term shall also include the Board of Governors of the Federal Reserve System.

(12) **'Georgia Residential Mortgage Act'** means this article, which also includes certain provisions in order to implement the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008.

(13) '**Individual'** means a natural person.

(14) **'License'** means a license issued by the department under this article to act as a mortgage loan originator, mortgage lender, or mortgage broker.

(15) **'Loan processor or underwriter'** means an individual who performs clerical or support duties as an employee at the direction of and subject to the supervision and instruction of a person licensed or exempt from licensing. For purposes of this paragraph, 'clerical or support duties' may include, subsequent to the receipt of an application, the receipt, collection, distribution, and analysis of information common for the processing or underwriting of a residential mortgage loan; and communicating with a consumer to obtain the information necessary for the processing or underwriting of a loan, to the extent that such communication does not include offering or negotiating loan rates or terms or counseling consumers about residential mortgage loan rates or terms. An individual engaging solely in loan processor or underwriter activities shall not represent to the public, through advertising or other means of communicating or providing information, including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items, that such individual can or will perform any of the activities of a mortgage loan originator.

(16) **'Lock-in agreement'** means a written agreement whereby a lender or a broker required to be licensed or registered under this article guarantees for a specified number of days or until a specified date the availability of a specified rate of interest for a mortgage loan, a specified formula by which the rate of interest will be determined, or a specific number of discount points if the mortgage loan is approved and closed within the stated period of time.

(17) **'Makes a mortgage loan'** means to advance funds, offer to advance funds, or make a commitment to advance funds to an applicant for a mortgage loan.

(18) **'Misrepresent**' means to make a false statement of a substantive fact. Misrepresent may also mean to intentionally engage in any conduct which leads to a false belief which is material to the transaction.

(19) **'Mortgage broker'** means any person who directly or indirectly solicits, processes, places, or negotiates mortgage loans for others, or offers to solicit, process, place, or negotiate mortgage loans for others or who closes mortgage loans which may be in the mortgage broker's own name with funds provided by others and which loans are assigned within 24 hours of the funding of the loans to the mortgage lenders providing the funding of such loans.

(20) **'Mortgage lender**' means any person who directly or indirectly makes, originates, underwrites, or purchases mortgage loans or who services mortgage loans.

(21) **'Mortgage loan'** means a loan or agreement to extend credit made to a natural person, which loan is secured by a deed to secure debt, security deed, mortgage, security instrument, deed of trust, or other document representing a security interest or lien upon any interest in one-to-four family residential property located in Georgia, regardless of where made, including the renewal or refinancing of any such loan.

(22) **'Mortgage loan originator'** means an individual who for compensation or gain or in the expectation of compensation or gain takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan. Generally, this does not include an individual engaged solely as a loan processor or underwriter except as otherwise provided in paragraph (5) of subsection (a) of Code Section 7-1-1002; a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with Georgia law unless the person or entity is compensated by a mortgage lender, mortgage broker, or other mortgage loan originator or by any agent of such mortgage lender, mortgage broker, or other mortgage loan originator; and does not include a person or entity solely involved in extensions of credit relating to time-share plans, as that term is defined in 11 U.S.C. Section 101(53D).

(23) **'Nationwide Mortgage Licensing System and Registry'** means a mortgage licensing system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the licensing and registration of licensed mortgage loan originators, mortgage loan brokers, and mortgage loan lenders.

(24) **'Nontraditional mortgage product'** means any mortgage product other than a 30 year fixed rate mortgage.

(25) **'Person'** means any individual, sole proprietorship, corporation, limited liability company, partnership, trust, or any other group of individuals, however organized.

(26) **'Real estate brokerage activity'** means any activity that involves offering or providing real estate brokerage services to the public, including acting as a real estate agent or real estate broker for a buyer, seller, lessor, or lessee of real property; bringing together parties interested in the sale, purchase, lease, rental, or exchange of real property; negotiating, on behalf of any party, any portion of a contract relating to the sale, purchase, lease, rental, or exchange of real property, other than in connection with providing financing with respect to any such transaction; engaging in any activity for which a person engaged in the activity is required to be registered or licensed as a real estate agent or real estate broker under any applicable law; and offering to engage in any activity or act in any capacity described herein.

(27) **'Registered mortgage loan originator'** means any individual who meets the definition of mortgage loan originator, is registered with and maintains a unique identifier through the Nationwide Mortgage Licensing System and Registry, and is an employee of:

    a. A depository institution;
    b. A subsidiary that is:
        i. Owned and controlled by a depository institution; and
        ii. Regulated by a federal banking agency; or
    c. An institution regulated by the Farm Credit Administration.

(28) **'Registrant'** means any person required to register pursuant to Code Sections 7-1-1001 and 7-1-1003.2.

(29) **'Residential property'** means improved real property used or occupied, or intended to be used or occupied, as the primary residence of a natural person. Such term does not include rental property or second homes. A natural person can have only one primary residence.

(30) **'Residential mortgage loan'** means any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling, as defined in Section 103(v) of the Truth in Lending Act, or residential real estate upon which is constructed or intended to be constructed a dwelling.

(31) **'Residential real estate'** means any real property located in Georgia upon which is constructed or intended to be constructed a dwelling.

(32) **'Service a mortgage loan'** means the collection or remittance for another or the right to collect or remit for another of payments of principal, interest, trust items such as insurance and taxes, and any other payments pursuant to a mortgage loan.

(33) **'Ultimate equitable owner'** means a natural person who, directly or indirectly, owns or controls an ownership interest in a corporation or any other form of business organization, regardless of whether such natural person owns or controls such ownership interest through one or more natural persons or one or more proxies, powers of attorney, nominees, corporations, associations, limited liability companies, partnerships, trusts, joint-stock companies, other entities or devices, or any combination thereof.

(34) **'Unique identifier'** means a number or other identifier assigned by protocols established by the Nationwide Mortgage Licensing System and Registry.

DEFINITIONS [O.C.G.A. §7-6A-2]

In addition, Section 7-6A-2 defines the following terminology:

(1) **'Acceleration'** means a demand for immediate repayment of the entire balance of a home loan.

(2) **'Affiliate'** means any company that controls, is controlled by, or is under common control with another company, as set forth in 12 U.S.C. Section 1841, et seq.

(3) **'Annual percentage rate'** means the annual percentage rate for the loan calculated at closing according to the provisions of 15 U.S.C. Section 1606, the regulations promulgated thereunder by the Board of Governors of the Federal Reserve System, and the Official Staff Commentary on Regulation Z published by the Board of Governors of the Federal Reserve System.

(4) **'Bona fide discount points'** means loan discount points knowingly paid by the borrower for the express purpose of reducing, and which in fact do result in a bona fide reduction of, the interest rate applicable to the home loan; provided, however, that the undiscounted interest rate for the home loan does not exceed by more than one percentage point the required net yield for a 90 day standard mandatory delivery commitment for a home loan with a reasonably comparable term from either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, whichever is greater.

(5) **'Borrower'** means any natural person obligated to repay the loan including a co-borrower or cosigner.

(6) '**Creditor'** means a person who both regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments and is a person to whom the debt arising from the home loan transaction is initially payable. Creditor shall also mean any person brokering a home loan, which shall include any person who directly or indirectly for compensation solicits, processes, places, or negotiates home loans for others or offers to solicit, process, place, or negotiate home loans for others or who closes home loans which may be in the person's own name with funds provided by others and which loans are thereafter assigned to the person providing the funding of such loans, provided that creditor shall not include a person who is an attorney providing legal services in association with the closing of a home loan. A creditor shall not include: (A) a servicer; (B) an assignee; (C) a purchaser; or (D) any state or local housing finance agency or any other state or local governmental or quasi-governmental entity.

(7) **'High-cost home loan'** means a home loan in which the terms of the loan meet or exceed one or more of the thresholds as defined in paragraph (17) of this Code section.

(8) **'Home loan'** means a loan, including an open-end credit plan where the principal amount does not exceed the conforming loan size limit for a single-family dwelling as established by the Federal National Mortgage Association and the loan is secured by a mortgage, security deed, or deed to secure debt on real estate located in this state upon which there is located or there is to be located a structure or structures, including a manufactured home, designed principally for occupancy of from one to four families and which is or will be occupied by a borrower as the borrower's principal dwelling, except that home loan shall not include:

A. A reverse mortgage transaction;
B. A loan that provides temporary financing for the acquisition of land by the borrower and initial construction of a borrower's dwelling thereon or the initial construction of a borrower's dwelling on land owned by the borrower;
C. A bridge loan made to a borrower pending the sale of the borrower's principal dwelling or a temporary loan made to a borrower and secured by the borrower's principal dwelling pending the borrower's obtaining permanent financing for such principal dwelling;
D. A loan secured by personal property including, but not limited to, a motor vehicle, motor home, boat, or watercraft and also secured by the borrower's principal dwelling to provide the borrower with potential income tax advantages when such personal property is the primary collateral for such loan;
E. A new loan secured by a borrower's principal dwelling as a result of a lien taken in connection with a debt previously contracted or incurred when the loan documents for such new loan do not include a mortgage, security deed, or deed to secure debt expressly securing such new loan; or
F. A loan primarily for business, agricultural, or commercial purposes.

(9) **'Make' or 'makes'** means to originate a loan or to engage in brokering of a home loan including the soliciting, processing, placing, or negotiating of a home loan made or offered by a person brokering a home loan.

(10) **'Manufactured home'** means a structure, transportable in one or more sections, which in the traveling mode is eight body feet or more in width or 40 body feet or more in length or, when erected on site is 320 or more square feet and which is built on a permanent chassis and designed to be used as a dwelling with a permanent foundation when erected on land secured in conjunction with the real property on which the manufactured home is located and connected to the required utilities and includes the plumbing, heating, air-conditioning, and electrical systems contained therein; except that such term shall include any structure which meets all the requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the secretary of the United States Department of Housing and Urban Development and complies with the standards established under the National Manufactured Housing Construction and Safety Standards Act of 1974, 42 U.S.C. Section 5401, et seq. Such term does not include rental property or second homes or manufactured homes when not secured in conjunction with the real property on which the manufactured home is located.

(11) **'Open-end credit plan' or 'open-end loan'** means a loan in which (A) a creditor reasonably contemplates repeated transactions; (B) the creditor may impose a finance charge from time to time on an outstanding balance; and (C) the amount of credit that may be extended to the borrower during the term of the loan, up to any limit set by the creditor, is generally made available to the extent that any outstanding balance is repaid.

(12) **'Points and fees'** means:

A. All items included in the definition of finance charge in 12 C.F.R. 226.4(a) and 12 C.F.R. 226.4(b) except interest or the time price differential. All items excluded under 12 C.F.R. 226.4(c) are excluded from points and fees, provided that for items under 12 C.F.R. 226.4(c)(7) the creditor does not receive direct or indirect compensation in connection with the charge and the charge is not paid to an affiliate of the creditor;

B. All compensation paid directly or indirectly to a mortgage broker from any source, including a broker that originates a loan in its own name in a table funded transaction, including but not limited to yield spread premiums, yield differentials, and service release fees, provided that the portion of any yield spread premium that is both disclosed to the borrower in writing and used to pay bona fide and reasonable fees to a person other than the creditor or an affiliate of the creditor for the following purposes is exempt from inclusion in points and fees: fees for tax payment services; fees for flood certification; fees for pest infestation and flood determination; appraisal fees; fees for inspection performed prior to closing; credit reports; surveys; attorneys' fees, if the borrower has the right to select the attorney from an approved list or otherwise; notary fees; escrow charges, so long as not otherwise included under subparagraph (A) of this paragraph; title insurance premiums; and fire and hazard insurance and flood insurance premiums, provided that the conditions set forth in 12 C.F.R. 226.4(d)(2) are met;
C. Premiums or other charges for credit life, credit accident, credit health, credit personal property, or credit loss-of-income insurance, debt suspension coverage or debt cancellation coverage, whether or not such coverage is insurance under applicable law, that provides for cancellation of all or part of a borrower's liability in the event of loss of life, health, personal property, or income or in the case of accident written in connection with a home loan and premiums or other charges for life, accident, health, or loss-of-income insurance without regard to the identity of the ultimate beneficiary of such insurance. In determining points and fees for the purposes of this paragraph, premiums or other charges shall only include those payable at or before loan closing and are included whether they are paid in cash or financed and whether the amount represents the entire premium for the coverage or an initial payment.
D. The maximum prepayment fees and penalties that may be charged or collected under the terms of the loan documents. Mortgage 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, shall not be considered to be a prepayment fee or penalty;
E. All prepayment fees or penalties that are charged to the borrower if the loan refinances a previous loan made or currently held by the same creditor or an affiliate of the creditor;
F. For open-end loans, points and fees are calculated in the same manner as for loans other than open-end loans, based on the minimum points and fees that a borrower would be required to pay in order to draw on the open-end loan an amount equal to the total credit line; and
G. Points and fees shall not include:
    i. Taxes, filing fees, recording, and other charges and fees paid or to be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest;
    ii. Bona fide and reasonable fees paid to a person other than the creditor or an affiliate of the creditor for the following: fees for tax payment services; fees for flood certification; fees for pest infestation and flood determination; appraisal fees; fees for inspections performed prior to closing; credit reports; surveys; attorneys' fees, if the borrower has the right to select the attorney from an approved list or otherwise; notary fees; escrow charges, so long as not otherwise included under subparagraph (A) of this paragraph; title insurance premiums; and fire and hazard insurance and flood insurance premiums, provided that the conditions in 12 C.F.R. 226.4(d)(2) are met;

iii. Bona fide fees paid to a federal or state government agency that insures payment of some portion of a home loan, including, but not limited to, the Federal Housing Administration, the Department of Veterans Affairs, the United States Department of Agriculture for rural development loans, or the Georgia Housing and Finance Authority; and
iv. Notwithstanding any provision to the contrary in this chapter, compensation in the form of premiums, commissions, or similar charges paid to a creditor or any affiliate of a creditor for the sale of: (I) title insurance; or (II) insurance against loss of or damage to property or against liability arising out of the ownership or use of property, provided that the conditions in 12 C.F.R. 226.4(d)(2) are met.

(13) 'Process,' 'processes,' or 'processing' means to act as a processor.

(14) 'Processor' means any person that prepares paperwork necessary for or associated with the closing of a home loan, including but not limited to promissory notes, disclosures, deeds, and closing statements, provided that processor shall not include persons on the grounds that they are engaged in data processing or statement generation services for home loans.

(15) 'Servicer' means the same as set forth in 24 C.F.R. 3500.2.

(16) 'Servicing' means the same as set forth in 24 C.F.R. 3500.2.

(17) 'Threshold' means:

A. Without regard to whether the loan transaction is or may be a 'residential mortgage transaction' as that term is defined in 12 C.F.R. 226.2(a)(24), the annual percentage rate of the loan is such that it equals or exceeds that set out in Section 152 of the Home Ownership and Equity Protection Act of 1994, 15 U.S.C. Section 1602(aa), and the regulations adopted pursuant thereto by the Federal Reserve Board, including Section 12 C.F.R. 226.32; or
B. The total points and fees payable in connection with the loan, excluding not more than two bona fide discount points, exceed: (i) 5 percent of the total loan amount if the total loan amount is $20,000.00 or more or (ii) the lesser of 8 percent of the total loan amount or $1,000.00 if the total loan amount is less than $20,000.00.

(18) 'Total loan amount' means the amount calculated as set forth in 12 C.F.R. 226.32(a) and under the Official Staff Commentary of the Board of Governors of the Federal Reserve System. For open-end loans, the total loan amount shall be calculated using the total credit line available under the terms of the home loan as the amount financed.

Now that we have reviewed relevant terminology, we should move on to determine what the law specifically states regarding registration and licensing.

Exemptions: Registration Requirements [O.C.G.A. §7-1-1001]

According to the law, the following persons shall not be required to obtain a mortgage loan originator, broker, or mortgage lender license. However, they may be subject to registration requirements, unless otherwise stated:

1. Any lender authorized to engage in business as a bank, credit card bank, savings institution, building and loan association, or credit union under the laws of the United States, any state or territory of the United States, or the District of Columbia, the deposits of which are federally insured;
2. Any wholly owned subsidiary of any lender described in paragraph (1) of this Code section. Any subsidiary that violates any applicable law of this article may be subject to a cease and desist order as provided for in Code Section 7-1-1018; Any wholly owned subsidiary of any bank holding company; provided, however, that such subsidiary shall be subject to registration requirements in order to facilitate the department's handling of consumer inquiries. Such requirements are contained in Code Section 7-1-1003.3;

3. Registered mortgage loan originators, when acting for an entity described in paragraphs (1) or (2) of this Code section. To qualify for this exemption, an individual shall be registered with and maintain a unique identifier through registration with the Nationwide Mortgage Licensing System and Registry;
4. Any individual who offers or negotiates terms of a residential mortgage loan with or on behalf of an immediate family member of such individual. For purposes of this exemption, the term 'immediate family member' means a spouse, child, sibling, parent, grandparent, or grandchild. Immediate family members shall include stepparents, stepchildren, stepsiblings, and adoptive relationships;
5. A licensed attorney who negotiates the terms of a residential mortgage loan on behalf of a client as an ancillary matter to the attorney's representation of the client, unless the attorney is compensated by a lender, a mortgage broker, or other mortgage loan originator or by any agent of such lender, mortgage broker, or other mortgage loan originator;
6. A Georgia licensed real estate broker or real estate salesperson not actively engaged in the business of negotiating mortgage loans; however, a real estate broker or real estate salesperson who directly or indirectly negotiates, places, or finds a mortgage for others shall not be exempt from the provisions of this article;
7. Any person performing any act relating to mortgage loans under order of any court;
8. Any natural person or the estate of or trust created by a natural person making a mortgage loan with his or her own funds for his or her own investment, including those natural persons or the estates of or trusts created by such natural persons who make a purchase money mortgage for financing sales of their own property;
9. The United States of America, the State of Georgia or any other state, and any agency, division, or corporate instrumentality of any governmental entity, including without limitation: the Georgia Housing and Finance Authority, the Georgia Development Authority, the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), the Government National Mortgage Association (GNMA), the United States Department of Housing and Urban Development (HUD), the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the Farmers Home Administration (FmHA), and the Farm Credit Administration and its chartered agricultural credit associations;
10. Any individual who offers or negotiates terms of a residential mortgage loan secured by a dwelling that serves as the individual's residence;
11. Any person who makes a mortgage loan to an employee of such person as an employment benefit;
12. Any licensee under Chapter 3 of this title, the "Georgia Industrial Loan Act," provided that any mortgage loan made by such licensee is for $3,000.00 or less;
13. Nonprofit corporations making mortgage loans to promote home ownership or improvements for the disadvantaged.
14. A natural person employed by a licensed or registered mortgage broker, a licensed or registered mortgage lender, or any person exempted from the mortgage broker or mortgage lender licensing requirements of this article when acting within the scope of employment and under the supervision of the mortgage broker or mortgage lender or exempted person as an employee and not as an independent contractor, except those natural persons exempt from licensure as a mortgage broker or mortgage lender under paragraph (17) of this Code section. To be exempt from licensure as a mortgage broker or mortgage lender, a natural person shall be employed by only one such employer and shall be at all times eligible for employment in compliance with the provisions and prohibitions of Code Section 7-1-1004. Such natural person, who meets the definition of mortgage loan originator provided in paragraph (22) of Code Section 7-1-1000, shall be

subject to mortgage loan originator licensing requirements. A natural person against whom a cease and desist order has become final shall not qualify for this exemption while under the employment time restrictions of subsection (o) of Code Section 7-1-1004 if such order was based on a violation of Code Section 7-1-1002 or 7-1-1013 or whose license was revoked within five years of the date such person was hired;

15. Any person who purchases mortgage loans from a mortgage broker or mortgage lender solely as an investment and who is not in the business of brokering, making, purchasing, or servicing mortgage loans;
16. Any natural person who makes five or fewer mortgage loans in any one calendar year. A person other than a natural person who makes five or fewer mortgage loans in any one calendar year shall not be exempt from the licensing requirements of this article; or
17. (A) A natural person otherwise required to be licensed as a mortgage lender or mortgage broker, who is under an exclusive written independent contractor agreement with any person that is a wholly owned subsidiary of a financial holding company or bank holding company, savings bank holding company, or thrift holding company, which subsidiary also meets the following requirements, subject to the review and approval of the department:
    i. The subsidiary has provided an undertaking of accountability supported by a surety bond equal to the lesser of $1 million or $50,000.00 per exempt person, to cover all of its persons exempted by this paragraph, that includes full and direct financial responsibility for the mortgage broker activities of each such exempted person, and also provides for the education of the exempt persons, the handling of consumer complaints related to the exempt persons, and the supervision of the mortgage broker activities of the exempt persons;
    ii. The subsidiary has applied for and been granted a mortgage broker or mortgage lender license, consistent with the provisions of this article and renewable annually; and
    iii. The subsidiary has paid applicable fees for this license, which license fees shall be the lesser of one-half of the sum of the cost of the individual licenses or $100,000.00.

    (B) To maintain the exemption, a natural person shall:
    i. Solicit, process, place, or negotiate a mortgage loan to be made only by the licensed subsidiary or its affiliate; and
    ii. Be at all times in compliance with the provisions and prohibitions of Code Section 7-1-1013 and the provisions and prohibitions applicable to employees under Code Section 7-1-1004.

    (C) For purposes of this paragraph, the term "financial holding company" means a financial holding company as defined in the Bank Holding Company Act of 1956, as amended.

    (D) The commissioner shall provide by rule or regulation for the implementation of this paragraph.
18. (A) An employee of a bona fide nonprofit corporation who acts as a mortgage loan originator only with respect to his or her work duties with the bona fide nonprofit corporation and who acts as a mortgage loan originator only with respect to mortgage loans with terms that are favorable to the borrower shall be exempt from obtaining a mortgage loan originator license. In order for a corporation to be considered a bona fide nonprofit corporation under this paragraph, the department shall determine, under criteria and pursuant to processes established by the department, that the nonprofit corporation:

i. Has the status of a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code of 1986;
ii. Promotes affordable housing;
iii. Conducts its activities in a manner that serves public or charitable purposes, rather than commercial purposes;
iv. Receives funding and revenue and charges fees in a manner that does not incentivize it or its employees to act other than in the best interests of its clients;
v. Compensates its employees in a manner that does not incentivize employees to act other than in the best interests of its clients;
vi. Provides or identifies for the borrower mortgage loans with terms favorable to the borrower and comparable to mortgage loans and housing assistance provided under government housing assistance programs. In order for mortgage loans to have terms that are favorable to the borrower, the department shall determine that the terms are consistent with loan origination in a public or charitable context, rather than in a commercial context; and
vii. Satisfies the exemption from licensure set forth in paragraph (13) of this subsection.

(B) The department shall periodically examine the books and activities of an organization it has previously identified as a bona fide nonprofit corporation for purposes of this paragraph in order to determine if it continues to meet the criteria for such status under subparagraph (A) of this paragraph. In conducting such an examination, the department shall have all of the powers set forth in Code Section 7-1-1009. In the event the nonprofit corporation no longer qualifies for such status, then the employee exemption from having a mortgage loan originator license shall no longer be applicable.

The above lists the type of people that are not legally required to obtain a license in order to do conduct their activities. Let's now turn to those which the law imposes a license requirement.

Requirements for MLO License [O.C.G.A. §7-1-1001.1]

To comply with the federal requirements contained in the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, also known as the S.A.F.E. Mortgage Licensing Act of 2008, it is now prohibited for any person to engage in the activities of a mortgage loan originator without first obtaining and maintaining a mortgage loan originator license.

The department has the broad administrative authority to administer, interpret, and enforce the SAFE Mortgage Licensing Act of 2008, and promulgate rules and regulations implementing it. The provisions in the SAFE Act apply to the activities of retail sellers of manufactured homes to the extent determined by the United States Department of Housing and Urban Development through written guidelines, rules, regulations, or interpretive letters.

Therefore, since one must be licensed in order to conduct mortgage loan originator duties, it is no surprise that the law goes on to state the following:

a. It shall be prohibited for any person to transact business in this state directly or indirectly as a mortgage broker, a mortgage lender, or a mortgage loan originator unless such person:
    1. Is licensed or registered as such by the department utilizing the Nationwide Mortgage Licensing System and Registry;
    2. Is a person exempted from the licensing or registration requirements pursuant to Code Section 7-1-1001;

3. In the case of an employee of a mortgage broker or mortgage lender, such person has qualified to be relieved of the necessity for a license under the employee exemption in paragraph (11) of subsection (a) of Code Section 7-1-1001;
4. In the case of a mortgage loan originator, such person is supervised by a mortgage broker, mortgage lender, or exemptee on a daily basis while performing mortgage functions; is employed by and works exclusively for only one mortgage broker, mortgage lender, or exemptee; and is paid on a W-2 basis by the employing mortgage broker, mortgage lender, or exemptee, except those natural persons exempt from licensure as a mortgage broker or mortgage lender under paragraph (17) of subsection (a) of Code Section 7-1-1001. Each licensed mortgage loan originator shall register with and maintain a valid unique identifier issued by the Nationwide Mortgage Licensing System and Registry. For the purposes of implementing an orderly and efficient mortgage loan originator process, the department may establish licensing rules or regulations and interim procedures for licensing and acceptance of applications; or

b. A loan processor or underwriter who is an independent contractor shall not engage in the activities of a loan processor or underwriter unless such independent contractor loan processor or underwriter obtains and maintains a mortgage broker or mortgage lender license. Each independent contractor loan processor or underwriter licensed as a mortgage broker or mortgage lender shall have and maintain a valid unique identifier issued by the Nationwide Mortgage Licensing System and Registry.
c. It shall be prohibited for any person, as defined in Code Section 7-1-1000, to purchase, sell, or transfer one or more mortgage loans or loan applications from or to a mortgage loan originator, mortgage broker, or mortgage lender who is neither licensed nor exempt from the licensing or registration provisions of this article. Such a purchase shall not affect the obligation of the borrower under the terms of the mortgage loan. The department shall provide for distribution or availability of information regarding approved or revoked licenses.
d. Every person who directly or indirectly controls a person who violates subsection (a) or (b) of this Code section, every general partner, executive officer, joint venturer, or director of such person, and every person occupying a similar status or performing similar functions as such person violates with and to the same extent as such person, unless the person whose violation arises under this subsection sustains the burden of proof that he or she did not know and, in the exercise of reasonable care, could not have known of the existence of the facts by reason of which the original violation is alleged to exist.

As you can see, the law is very specific regarding who must be licensed and who is exempted from this requirement. It is crucial that a person understand what mortgage loan originator activities are in order to determine whether they must be licensed or registered to continue conducting certain activities or whether they are not required to be licensed or registered in order to continue doing what they are doing. If a person is caught conducting mortgage loan originator activities without a license, that person will subject to punishment by law.

Application for Licenses [O.C.G.A. §7-1-1003]

As mentioned previously, the department has authority to prescribe licenses. As such, they are responsible for reviewing applications. The law states that applications for licensure must include the following:

1. The legal name and address of the applicant and, if the applicant is a partnership, association, corporation, or other business entity, of every member, officer, and director thereof;
2. All names, including, but not limited to, website domain names (URLs), under which the applicant will conduct business in Georgia;
3. For mortgage brokers and mortgage lenders, the address of the main office or principal place of business where books and records are located and any other locations at which the applicant will engage in any business activity covered by the provisions of this article, together with the mailing address where the department shall send all correspondence, orders, or notices. Any changes in this mailing address shall be delivered in writing to the department before the change is effective;
4. For mortgage brokers and mortgage lenders, the complete name and address of the applicant's initial registered agent and registered office for service of process in Georgia. If the applicant is a Georgia corporation, this registered agent shall be the same as the agent recorded with the Secretary of State. Any changes in the registered agent or registered office shall be delivered in writing to the department and the Secretary of State, if applicable, before the change is effective. The registered agent may, but is not required to, be an officer of the applicant, and the registered office shall be a Georgia location where the registered agent may be served;
5. For mortgage brokers and mortgage lenders, the general plan and character of the business;
6. For mortgage brokers and mortgage lenders, a financial statement of the applicant;
7. For mortgage brokers and mortgage lenders, such other data, financial statements, and pertinent information as the department may require with respect to the applicant, its directors, trustees, officers, members, agents, or ultimate equitable owners of 10 percent or more of the applicant; and
8. For mortgage brokers and mortgage loan originators, evidence of satisfaction of experience or education requirements, as required by regulations of the department.

b. All applications filed under this Code section shall be filed together with:
    1. Investigation and supervision fees established by regulation;
    2. The items required by Code Section 7-1-1003.2;
    3. Other information as may be required by the department.

Physical Place of Business [O.C.G.A. §7-1-1003.1]

Generally, applicants for licensure are persons with a physical place of business in Georgia, but what happens if an applicant does not have a physical place of business in Georgia?

If the applicant for a mortgage broker license or a renewal of such license does not have a physical place of business in Georgia, a license or renewal shall only be issued if the applicant's home state does not require that in order to be licensed a mortgage broker shall have a physical place of business in such home state. In either case, an applicant shall have a registered agent and a registered office in this state.

Financial Requirements; Bond Requirements [O.C.G.A. §7-1-1003.2]

The law imposes certain financial requirements on those that want to become licensed. The law states the following:

a. Each licensed or registered mortgage broker shall provide the department with a bond. The bond for a mortgage broker shall be in the principal sum of $150,000.00 or such greater sum as the department may require as set forth by regulation based on an amount that reflects the dollar amount of loans originated, and the bond shall meet the other requirements of subsection (d) of this Code section.
b. Except as otherwise provided in subsection (d) of this Code section, the department shall not license or register any mortgage lender unless the applicant or registrant provides the department with a bond. The bond for a mortgage lender shall be in the principal sum of $250,000.00 or such greater sum as the department may require as set forth by regulation based on an amount that reflects the dollar amount of loans originated, and which bond shall meet the other requirements of subsection (d) of this Code section.
c. Each mortgage loan originator shall be covered by a surety bond of his or her sponsoring licensed or registered mortgage broker or lender. In the event that the mortgage loan originator is an employee of a licensed or registered mortgage broker or lender or under an exclusive written independent contractor agreement as described in paragraph (17) of Code Section 7-1-1001, the surety bond of such licensed or registered mortgage broker or lender may be used in lieu of the mortgage loan originator's surety bond requirement.
d. General bond requirements:
    1. The bond requirements for mortgage loan originators, mortgage brokers, and mortgage lenders are continuous in nature and shall be maintained at all times as a condition of licensure;
    2. The corporate surety bond shall be for a term and in a form satisfactory to the department, shall be issued by a bonding company or insurance company authorized to do business in this state and approved by the department, and shall run to the State of Georgia for the benefit of any person damaged by noncompliance of a licensee with this article, the 'Georgia Residential Mortgage Act,' or with any condition of such bond. Damages under the bond shall include moneys owed to the department for fees, fines, or penalties. Such bond shall be continuously maintained thereafter in full force. Such bond shall be conditioned upon the applicant or the licensee conducting his or her licensed business in conformity with this article and all applicable laws;
    3. When an action is commenced on a licensee's bond, the department may require the filing of a new bond; and
    4. Immediately upon recovery of any action on the bond, the licensee shall file a new bond.
e. Any person including the department who may be damaged by noncompliance of a licensee with any condition of a bond or this article, the 'Georgia Residential Mortgage Act,' may proceed on such bond against the principal or surety thereon, or both, to recover damages.

Application for Registration [O.C.G.A. §7-1-1003.3]

According to law, any application to register as a mortgage lender or broker must be made annually in writing, under oath, and on a form provided by the department. The application is subject to requirements specified by rules and regulations of the department.

Therefore, if you are already registered, you must apply to be registered yearly.

This process is different for those applying for licensure as mortgage loan originators, mortgage brokers, and mortgage lenders.

We will discuss the application and renewal process for mortgage loan originators, brokers, and lenders later. We will next review the extent of the authority given to the department by law with regards to licensing.

Automated Licensing System for MLOs, Mortgage Brokers and Mortgage Lenders [O.C.G.A. §7-1-1003.5]

The law states that the department is authorized to do all of the following:

1. Participate in a nation-wide residential mortgage licensing system established to facilitate the sharing of information and standardization of the licensing and application processes for mortgage loan originators, mortgage brokers, and mortgage lenders by electronic or other means;
2. Enter into operating agreements, information sharing agreements, interstate cooperative agreements, and other contracts necessary for the department's participation in the nation-wide residential mortgage licensing system and registry;
3. Request that the nation-wide mortgage licensing system and registry adopts an appropriate privacy, data security, and security breach notification policy that is in full compliance with existing state and federal law;
4. Disclose or cause to be disclosed without liability via the Nationwide Mortgage Licensing System and Registry applicant and licensee information, including, but not limited to, violations of this article and enforcement actions, via the nation-wide residential mortgage licensing system to facilitate regulatory oversight of mortgage loan originators, mortgage brokers, and mortgage lenders across state jurisdictional lines;
5. Establish and adopt, by rule or regulation, requirements for participation by applicants and licensees in the nation-wide residential mortgage licensing system upon the department's determination that each new or amended requirement is consistent with both the public interest and the purposes of this article; and
6. Pay all fees received from licensees and applicants related to applications, licenses, and renewals to the Office of Treasury and Fiscal Services; provided, however, that the department may net such fees to recover the cost of participation in the Nationwide Mortgage Licensing System and Registry; and

As you can see, the department has a lot of power when it comes to the licensing of mortgage loan originators, brokers, and lenders. In fact, the law also makes clear how much power the department has by stating that regardless of the department's participation in NMLS&R, it retains full and exclusive determinations whether to grant, renew, suspend, or revoke licenses issued to mortgage loan originators, mortgage brokers, and mortgage lenders. Nothing in this section of Georgia law can reduce this authority.

Investigations; Education and Other Requirements [O.C.G.A. §7-1-1004]

The law also specifically provides the department with the authority to establish any requirements it deems necessary for the application for license or registration:

a. Upon receipt of an application for license or registration, the department shall conduct such investigation as it deems necessary to determine that the mortgage broker and mortgage lender applicant and the individuals who direct the affairs or establish policy for the mortgage broker and mortgage lender applicant, including the officers, directors, or the equivalent, are of good character and ethical reputation; that the mortgage broker and mortgage lender applicant is not disqualified for licensure as a result of adverse administrative civil or criminal findings in any jurisdiction; that the mortgage broker and mortgage lender applicant and such persons meet the requirements of subsection (h) of this Code section; that the mortgage broker and mortgage lender applicant and such persons demonstrate reasonable financial responsibility; that the mortgage broker and mortgage lender applicant has reasonable policies and procedures to receive and process customer grievances and inquiries promptly and fairly; and that the mortgage broker and mortgage lender applicant has and maintains a registered agent for service in this state.

b. The department shall not license or register any mortgage broker and mortgage lender applicant unless it is satisfied that the mortgage broker and mortgage lender applicant may be expected to operate its mortgage lending or brokerage activities in compliance with the laws of this state and in a manner which protects the contractual and property rights of the citizens of this state.
c. The department may establish by rule or regulation minimum education or experience requirements for an applicant for a mortgage broker license or renewal of such a license.
d. To this end, the law provides that the department must do whatever is necessary to determine that the applicant has completed all requirements for licensure. Once an application for a mortgage loan originator license is submitted, the department must make sure that the applicant:
    1. Has never had a mortgage loan originator license revoked in any governmental jurisdiction, except that a subsequent formal vacation of such revocation shall not be deemed a revocation;
    2. Has not been convicted of, or pled guilty or nolo contendere to, a felony in a domestic, foreign, or military court; provided, however, that any pardon of a conviction shall not be a conviction for purposes of this subsection;
    3. Has demonstrated financial responsibility, character, and general fitness such as to command the confidence of the community and to warrant a determination that the mortgage loan originator will operate honestly, fairly, and efficiently within the purposes of this article;
    4. Has completed the pre-licensing education requirement described in subsection (e) of this Code section;
    5. Has passed a written test that meets the test requirement described in subsection (f) of this Code section; and
e. (1) An individual shall complete at least 20 hours of pre-licensing education courses reviewed and approved by the Nationwide Mortgage Licensing System and Registry based upon reasonable standards. Review and approval of a pre-licensing education course shall include review and approval of the course provider. The 20 hours of pre-licensing education shall include at least:
        A. Three hours of federal law and regulations;
        B. Three hours of ethics, which shall include instruction on fraud, consumer protection, and fair lending issues; and
        C. Two hours of training related to lending standards for the nontraditional mortgage product marketplace.
    2. Nothing in this subsection shall preclude any pre-licensing education course, as approved by the Nationwide Mortgage Licensing System and Registry, that is provided by the employer of the mortgage loan originator applicant or an entity which is affiliated with the applicant by an agency contract, or any subsidiary or affiliate of such employer or entity.
    3. Pre-licensing education may be offered either in a classroom, online, or by any other means approved by the Nationwide Mortgage Licensing System and Registry.
    4. The pre-licensing education requirements approved by the Nationwide Mortgage Licensing System and Registry in paragraph (1) of this Code section for any state shall be accepted as credit towards completion of pre-licensing education requirements in

Georgia.

5. A person previously licensed under this article subsequent to January 1, 2010, applying to be licensed again shall prove that they have completed all of the continuing education requirements for the year in which the license was last held.
6. The department is authorized to enact rules and regulations related to the expiration of pre-licensing education

f.

1. In order to meet the written test requirement referred to in subsection (d) of this Code section for mortgage loan originators, an individual shall pass, in accordance with the standards established under this subsection, a qualified written test developed by the Nationwide Mortgage Licensing System and Registry and administered by a test provider approved by the Nationwide Mortgage Licensing System and Registry based upon reasonable standards.
2. A written test shall not be treated as a qualified written test for purposes of this subsection unless the test adequately measures the applicant's knowledge and comprehension in appropriate subject areas, including:
    - A. Ethics;
    - B. Federal law and regulation pertaining to mortgage origination;
    - C. State law and regulation pertaining to mortgage origination; and
    - D. Federal and state law and regulation, including instruction on fraud, consumer protection, the nontraditional mortgage marketplace, and fair lending issues.
3. Nothing in this subsection shall prohibit a test provider approved by the Nationwide Mortgage Licensing System and Registry from providing a test at the location of the employer of the applicant or the location of any subsidiary or affiliate of the employer of the applicant or the location of any entity with which the applicant holds an exclusive arrangement to conduct the business of a mortgage loan originator.
4. (A) An individual shall not be considered to have passed a qualified written test unless the individual achieves a test score of not less than 75 percent correct answers to questions.
    - B. An individual may retake a test three consecutive times with each consecutive taking occurring at least 30 days after the preceding test.
    - C. After failing three consecutive tests, an individual shall wait at least six months before taking the test again.
    - D. A licensed mortgage loan originator who fails to maintain a valid license for a period of five years or longer shall retake the test, not taking into account any time during which such individual is a registered mortgage loan originator.

<u>Uniform State Test (UST)</u>

- The Uniform State Test (UST)
    - This is a section within the National Test
    - Georgia has a UST state test with only one exam for licensing
    - Will include 25 questions
        - National Test with UST will contain 125 questions total
        - Grade is a total of all questions
    - This material will test an applicant's knowledge of state-related content and CSBS/AARMR Model State Law (MSL)
    - Replaces the state-specific test section for those states choosing to

implement it
- A person who passes the National Test with UST content or the Stand-alone UST will have satisfied requirements for a license in that state

Points “d,” “e,” and “f”” list the requirements necessary in order to obtain a mortgage loan originator license. If the department finds that any of these requirements have not been met, then the department reserves the right to deny the application for licensure.

This section of the law also provides the requirements necessary to renew a license after having obtained one.

g. (1) In order to meet the annual continuing education requirements referred to in paragraph (2) of subsection (e) of Code Section 7-1-1005, a licensed mortgage loan originator shall complete at least eight hours of education approved in accordance with paragraph (2) of this subsection which shall include at least:
    A. Three hours of federal law and regulations;
    B. Two hours of ethics, which shall include instruction on fraud, consumer protection, and fair lending issues; and
    C. Two hours of training related to lending standards for the nontraditional mortgage product marketplace.
  2. For purposes of paragraph (1) of this subsection, continuing education courses shall be reviewed and approved by the Nation-wide Multistate Licensing System and Registry based upon reasonable standards. Review and approval of a continuing education course shall include review and approval of the course provider.
  3. Nothing in this subsection shall preclude any education course from approval by the Nation-wide Multistate Licensing System and Registry that is provided by the employer of the mortgage loan originator or any entity which is affiliated with the mortgage loan originator by an agency contact, or any subsidiary or affiliate of such employer or entity.
  4. Continuing education may be offered either in a classroom, online, or by any other means approved by the Nationwide Mortgage Licensing System and Registry.
  5. A licensed mortgage loan originator, except for as provided for in paragraph (9) of this subsection and subsection (f) of Code Section 7-1-1005, shall only receive credit for a continuing education course in the year in which the course is taken and shall not take the same approved course in the same or successive years to meet the annual requirements for continuing education.
  6. A licensed mortgage loan originator who is an approved instructor of an approved continuing education course may receive credit for the licensed mortgage loan originator's own annual continuing education requirement at the rate of two hours of credit for every one hour taught.
  7. An individual having successfully completed the education requirements approved by the Nationwide Mortgage Licensing System and Registry in paragraph (1) of this subsection for any state shall be accepted as credit towards completion of continuing education requirements in Georgia.
  8. A licensed mortgage loan originator who subsequently becomes unlicensed shall complete the continuing education requirements for the last year in which the license was held prior to issuance of a new or renewed license.
  9. An individual meeting the requirements of subsection (e) of Code Section 7-1-1005 may make up any deficiency in continuing education as established by rule or regulation of the department.

h. The department shall not issue or may revoke a license or registration if it finds that the mortgage loan originator, mortgage broker, or mortgage lender applicant or licensee, or any person who is a director, officer, partner, agent, employee, or ultimate equitable owner of 10 percent or more of the mortgage broker or mortgage lender applicant, registrant, or licensee or any individual who directs the affairs or establishes policy for the mortgage broker or mortgage lender applicant, registrant, or licensee, has been convicted of a felony in any jurisdiction or of a crime which, if committed within this state, would constitute a felony under the laws of this state.

i. Fees for background checks that the department administers shall be sent to the department by applicants and licensees together with the fingerprints. Mortgage broker and mortgage lender applicants, licensees, and registrants shall have the primary responsibility for obtaining background checks of covered employees which are defined as employees who work in this state and also have the authority to enter, delete, or verify any information on any mortgage loan application form or document. The department shall, however, retain the right to obtain conviction data on covered employees.

j. In connection with an application for licensing with respect to any mortgage loan originator applicant, mortgage broker, or lender applicant, at the direction of the department, the applicant shall at a minimum, furnish to the Nationwide Mortgage Licensing System and Registry information concerning the applicant's identity, including:

    1. Fingerprints for submission to the Federal Bureau of Investigation, and any governmental agency or entity authorized to receive such information for a state, national, and international criminal history background check; and
    2. Personal history and experience in a form prescribed by the Nationwide Mortgage Licensing System and Registry, including the submission of authorization for the Nationwide Mortgage Licensing System and Registry and the department to obtain;
        A. An independent credit report obtained from a consumer reporting agency described in section 603(p) of the Fair Credit Reporting Act, 15 U.S.C. Section 1681a(f); and
        B. Information related to any administrative, civil, or criminal findings by any governmental jurisdiction.
    3. For the purposes set forth in this subsection and in order to reduce the points of contact which the Federal Bureau of Investigation may have to maintain for purposes of such section, the department may use the Nationwide Multistate Licensing System and Registry as a channeling agent for requesting information from and distributing information to the Department of Justice or any governmental agency; and
    4. For the purposes of this subsection and in order to reduce the points of contact which the department may have to maintain for purposes of such subsection, the department may use the Nationwide Multistate Licensing System and Registry as a channeling agent for requesting and distributing information to and from any source so directed by the department.

k. Every mortgage broker and mortgage lender licensee, registrant, and applicant shall be authorized and required to obtain background checks on covered employees. Such background checks shall be handled by the Georgia Crime Information Center pursuant to Code Section 35-3-34 and the rules and regulations of the Georgia Crime Information Center. Licensees, registrants, and applicants shall be responsible for any applicable fees charged by the center. A background check shall be initiated for a person in the employ of a licensee, registrant, or applicant within ten days of the date of initial hire and be completed with satisfactory results within the first 90 days of employment. This provision shall not apply to directors, officers, partners, agents, or ultimate equitable owners of 10 percent or more or to persons who direct the company's affairs or establish policy, whose background shall have been investigated through the department before taking office, beginning employment, or securing ownership. Upon receipt of information from the Georgia Crime Information Center that is incomplete or that indicates an employee has a criminal record in any state other than Georgia, the employer shall submit to the department two complete sets of fingerprints of such person, together with the applicable fees and any other required information. The department shall submit such fingerprints as provided in subsection (i) of this Code section.

l. Upon receipt of fingerprints, fees, and other required information, the Georgia Crime Information Center shall promptly transmit one set of fingerprints to the Federal Bureau of Investigation for a search of bureau records and an appropriate report and shall retain the other set and promptly conduct a search of its own records and records to which it has access. The Georgia Crime Information Center shall notify the department in writing of any derogatory finding, including, but not limited to, any conviction data regarding the fingerprint records check, or if there is no such finding. All conviction data received by the department or by the applicant, registrant, or licensee shall be used by the party requesting such data for the exclusive purpose of carrying out the responsibilities of this article, shall not be a public record, shall be privileged, and shall not be disclosed to any other person or agency except to any person or agency which otherwise has a legal right to inspect the file. The department shall be entitled to review any applicant's, registrant's, or licensee's files to determine whether the required background checks have been run and whether all covered employees are qualified. The department shall be authorized to discuss the status of employee background checks with licensees. All such records shall be maintained by the department and the applicant or licensee or registrant pursuant to laws regarding such records and the rules and regulations of the Federal Bureau of Investigation and the Georgia Crime Information Center, as applicable. As used in this subsection, "conviction data" means a record of a finding, verdict, or plea of guilty or plea of nolo contendere with regard to any crime, regardless of whether an appeal of the conviction has been sought, subject to the conditions set forth in subsection (h) of this Code section. Violation of this Code section may subject a licensee or registrant to the revocation of its license or registration.
m. In connection with an application for licensing or registration under this Code section, the department may use the Nation-wide Multistate Licensing System and Registry, when such service is available, as a channeling agent for the submission of fingerprints to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive such information for a state, national, and international criminal history background check. The department is authorized to set forth rules and regulations in order to implement the provisions of this subsection.
n. The department may deny or revoke a license or registration or otherwise restrict a license or registration if it finds that the mortgage broker or mortgage lender applicant or any person who is a director, officer, partner, or ultimate equitable owner of 10 percent or more or person who directs the company's affairs or who establishes policy of the applicant has been in one or more of these roles as a mortgage lender, broker, or registrant whose license or registration has been denied, revoked, or suspended within five years of the date of the application.
o. The department shall not issue a license or registration to and may revoke a license or registration from a mortgage broker or mortgage lender applicant, licensee, or registrant if such person:
    1. Has been the recipient of a final cease and desist order issued within the preceding five years if such order was based on a violation of subsection (h) of this Code section or Code Section 7-1-1002 or 7-1-1013;
    2. Employs any other person against whom a final cease and desist order has been issued within the preceding five years if such order was based on a violation of subsection (h) of this Code section or Code Section 7-1-1002 or 7-1-1013; or
    3. Has had his or her license revoked within five years of the date such person was hired or employs any other person who has had his or her license revoked within five years of the date such person was hired.
p. Each mortgage broker and mortgage lender applicant, licensee, and registrant shall, before hiring an employee, examine the department's public records to determine that such employee is not subject to the type of cease and desist order described of this Code section.

q. Within 90 days after receipt of a completed application and payment of licensing fees prescribed by this article, the department shall either grant or deny the request for license or registration.
r. A person shall not be indemnified for any act covered by this article or for any fine or penalty incurred pursuant to this article as a result of any violation of the law or regulations contained in this article, due to the legal form, corporate structure, or choice of organization of such person, including, but not limited to, a limited liability company.

So there you have it, folks! What we just went over spells out the specific requirements to obtain a license and retain one as a mortgage loan originator, mortgage broker, or mortgage lender. For the purposes of doing so, the department is granted full authority in the decision making of granting, renewing, or revoking licensure.

Of course, the Nationwide Mortgage Licensing System and Registry is in place for a reason and the law does place responsibilities on borkers and lenders to provide certain thing to the NMLS&R. For example, the law requires that Each mortgage broker and mortgage lender shall submit to the Nationwide Mortgage Licensing System and Registry reports of condition, which shall be in such form and shall contain such information as the department and the Nationwide Mortgage Licensing System and Registry may require. **[O.C.G.A. §7-1-1004.1]**

The law also places responsibility on the department to establish a process whereby licensees may challenge information that is entered in the Nationwide Mortgage Licensing System and Registry by the department. **[O.C.G.A. §7-1-1004.2]**

For the purposes of ensuring that accountability is met and in order to make the NMLS&R function as it is intended, it is important that the unique identifier of any person originating a residential mortgage loan shall be clearly shown on all residential mortgage loan application forms, solicitations, or advertisements, including business cards, websites, and any other documents as established by rule, regulation, or order of the department. **[O.C.G.A. §7-1-1004.3]**

We already discussed some of the requirements purported by law for the renewal of a license or registration. However, the law does pose additional requirements regarding the timeframe for renewal. We will review this next.

Renewal of Licenses and Registrations [O.C.G.A. 7-1-1005]

a. All licenses and registrations issued pursuant to this article shall expire on December 31 of each year, and application for renewal shall be made annually on or before December 1 of each year.
b. Any licensee or registrant making proper application on or before December 1 for the renewal of a license or registration for the following calendar year shall be permitted to continue to operate pending final approval or disapproval of the application if the application for the license or registration is not acted upon prior to January 1. For purposes of this subsection, a 'proper application' shall include a requirement that all documentation requesting a renewal has been completed, the requisite continuing education has been successfully obtained, and payment has been made of all outstanding fines and applicable fees required by this article.

c. No investigation fee shall be payable in connection with the renewal application, but an annual license or registration fee established by regulation of the department to defray the cost of supervision shall be paid with each renewal application, which fee shall not be refunded.
d. Any person holding a license or registration pursuant to this article who fails to file a proper application for a license or registration renewal for the following license year, including the proper fee accompanying the application, on or before December 1 and who files an application after December 1 may be required to pay, in addition to the license or registration fees, a fine in an amount to be established by regulations promulgated by the department.
e. The minimum standards for license renewal for mortgage loan originators shall include:
    1. The mortgage loan originator continues to meet the minimum standards for license issuance;
    2. The mortgage loan originator has satisfied the annual continuing education requirements; and
    3. The mortgage loan originator has paid all required fees for renewal of the license;
    4. The mortgage loan originator is in compliance with any and all written orders issued by the department.
f. The department may adopt procedures for the reinstatement of expired licenses consistent with the standards established by the Nationwide Mortgage Licensing System and Registry.

We now know the necessary requirements for license renewal. Let's move on to discussing some of the responsibilities licensees have once they have obtained their license.

Contents of License; Posting of License; etc. [O.C.G.A. §7-1-1006]

All licenses must have the name of the person who possesses the license. Once obtained, the licensee must do the following:

a. A licensee shall post a copy of such license in a conspicuous place in each place of business of the licensee.
b. A license shall not be transferred or assigned.
c. No licensee shall transact business under any name or names other than those designated in the records of the department.
d. For mortgage brokers and mortgage lenders, each licensee shall notify the department in writing of any change in the address of the principal place of business or of any additional location of business in Georgia, any change in registered agent or registered office, any change of executive officer, contact person for consumer complaints, or ultimate equitable owner of 10 percent or more of any corporation or other entity licensed under this article, or of any material change in the licensee's financial statement. Notice of changes shall be received by the department no later than 30 business days after the change is effective.
e. No mortgage broker or mortgage lender shall open a new additional office in Georgia without prior approval of the department. Applications for such additional office shall be made in writing on a form prescribed by the department and shall be accompanied by payment of a $350.00 nonrefundable application fee. The application shall be approved unless the department finds that the applicant has not conducted business under this article efficiently, fairly, in the public interest, and in accordance with law. The application shall be deemed approved if notice to the contrary has not been mailed by the department to the applicant within 45 days of the date the application is received by the department.
f. All branch managers in Georgia shall be approved by the department. A mortgage broker or

mortgage lender may place a new branch manager subject to the department's approval but shall file for approval within 15 days of the placement and shall remove the person immediately should the department deny approval.

Licensee To Give Notice of Certain Actions [O.C.G.A. §7-1-1007]

Additionally, the law requires licensees to provide notice to the department of certain actions

For example, a licensee must give the department notice to via registered or certified mail or statutory overnight delivery of any action which may be brought against it by any creditor or borrower where such action is brought under this article, involves a claim against the bond filed with the department for the purposes of compliance with Code Section 7-1-1003.2 or 7-1-1004, or involves a claim for damages in excess of $25,000.00 for a mortgage broker or mortgage loan originator and $250,000.00 for a lender and of any judgment which may be entered against it by any creditor or any borrower or prospective borrower, with details sufficient to identify the action or judgment, within 30 days after the commencement of any such action or the entry of any such judgment.

The same is the case for a corporate surety. A corporate surety shall, within ten days after it pays any claim to any claimant, give notice to the department by registered or certified mail or statutory overnight delivery of such payment with details sufficient to identify the claimant and the claim or judgment so paid. Whenever the principal sum of such bond is reduced by one or more recoveries or payments thereon, the mortgage loan originator, mortgage broker, or mortgage lender shall furnish a new or additional bond so that the total or aggregate principal sum of such bond or bonds shall equal the sum required under Code Section 7-1-1003.2 or 7-1-1004 or shall furnish an endorsement duly executed by the corporate surety reinstating the bond to the required principal sum thereof.

Also, if a bond filed must be canceled by either the mortgage loan originator, mortgage broker, or mortgage lender or the corporate surety, the department must be notified before doing so. The department must be notified by registered or certified mail, statutory overnight delivery with return receipt requested, or electronically through the Nationwide Multistate Licensing System and Registry, the cancellation to be effective not less than 30 days after receipt by the department of such notice and only with respect to any breach of condition occurring after the effective date of such cancellation.

Additionally, the law states that:

a. A licensee or registrant shall, within ten days after knowledge of the event, report in writing to the department:
    1. Any knowledge or discovery of an act prohibited by Code Section 7-1-1013;
    2. The discharge of any employee for dishonest or fraudulent acts; and
    3. Any administrative, civil, or criminal action initiated against the licensee, registrant, or any of its control persons by any government entity.

   Any person reporting such an event shall be protected from civil liability as provided in Code Section 7-1-1009.

Record Maintenance [O.C.G.A. §7-1-1009]

As you know, there are certain record keeping requirements for licensees. This section of the law states the following regarding record maintenance:

a. Mortgage brokers and mortgage lenders required to be licensed or registered under this article shall maintain at their offices or such other location as the department shall permit such books, accounts, and records as the department may reasonably require in order to determine whether such mortgage brokers and mortgage lenders are complying with the provisions of this article and rules and regulations adopted in furtherance thereof. Such books, accounts, and records shall be maintained separately and distinctly from any other personal or unrelated business matters in which the mortgage brokers and mortgage lenders are involved.
b. The department may, by its designated officers and employees, as often as it deems necessary, but at least once every 24 months, investigate and examine the affairs, business, premises, and records of any mortgage broker or mortgage lender required to be licensed or registered under this article insofar as such affairs, business, premises, and records pertain to any business for which a license or registration is required by this article. Notwithstanding the provisions of this subsection, the department has the discretion to examine a mortgage broker or mortgage lender less frequently, provided that its record of complaints, comments, or other information demonstrates that mortgage broker's or mortgage lender's ability to meet the standards of Code Sections 7-1-1003, 7-1-1003.2, and 7-1-1004. In the case of registrants, the department shall not be required to conduct such examinations if it determines that the registrant has been adequately examined by another bank regulatory agency. In order to avoid unnecessary duplication of examinations, the department may accept examination reports performed and produced by other state or federal agencies, unless the department determines that the examinations are not available or do not provide information necessary to fulfill the responsibilities of the department under this article.
c. In addition to any authority allowed under this article, the department shall be authorized to conduct investigations and examinations of mortgage loan originators as follows:
    1. For purposes of initial licensing, license renewal, license suspension, license conditioning, license revocation or termination, or general or specific inquiry or investigation to determine compliance with this article, the department shall have the authority to access, receive, and use any books, accounts, records, files, documents, information, or evidence, including, but not limited to:
        A. Criminal, civil, and administrative history information, including nonconviction data;
        B. Personal history and experience information, including independent credit reports obtained from a consumer reporting agency described in section 603(p) of the Fair Credit Reporting Act, 15 U.S.C. Section 1681a(f); and
        C. Any other documents, information, or evidence the department deems relevant to the inquiry or investigation regardless of the location, possession, control, or custody of such documents, information, or evidence;
    2. For the purposes of investigating violations or complaints, or for the purposes of examination, the department may review, investigate, or examine any mortgage loan originator licensee, individual, or person subject to this article as often as necessary in order to carry out the purposes of this article. The department may direct, subpoena, or order the attendance of and examine under oath all persons whose testimony may be required about the loans or the business or subject matter of any such examination or investigation and may direct, subpoena, or order such person to produce books, accounts, records, files, and any other documents the department deems relevant to the

inquiry;

3. Each mortgage loan originator licensee, individual, or person subject to this article shall make available to the department upon request the books and records relating to the activities of a mortgage loan originator;
4. Each mortgage loan originator subject to this article shall make or compile reports or prepare other information as directed by the commissioner in order to carry out the purposes of this subsection, including, but not limited to:
   A. Accounting compilations;
   B. Information lists and data concerning loan transactions in a format prescribed by the department; or
   C. Use, hire, contract, or employ public or privately available analytical systems, methods, or software to examine or investigate a mortgage loan originator;
5. In making any examination or investigation authorized by this article, the department may control access to any documents and records of the licensee or person under investigation. In order to carry out the purposes of this Code section, the department may:
   A. Enter into agreements or relationships with other government officials or regulatory associations in order to improve efficiencies and reduce regulatory burden by sharing resources, standardized or uniform methods or procedures, and documents, records, information, or evidence obtained under this Code section;
   B. Accept and rely on examination or investigation reports made by other government officials, within or without this state; and
   C. Accept audit reports made by an independent certified public accountant for the licensee, individual, or person subject to this article in the course of that part of the examination covering the same general subject matter as the audit and may incorporate the audit report in the report of examination, report of investigation, or other writing of the department;
6. The authority to investigate provided for in this subsection shall remain in effect whether such licensee, individual, or person subject to this article acts or claims to act under any licensing or registration law of this state or claims to act without such authority; and
7. No mortgage loan originator licensee, individual, or person subject to investigation or examination under this article shall knowingly withhold, abstract, remove, mutilate, destroy, or secrete any books, records, computer records, or other information.

Annual Financial Statements [O.C.G.A. §7-1-1010]

In addition to having to keep certain records in case of investigation, certain records must be created and kept for delivery to the department.

For example:

a. If a mortgage broker is a United States Department of Housing and Urban Development loan correspondent, such broker shall also submit to the department the audit that is required for the United States Department of Housing and Urban Development. The department may require the mortgage broker to have made an audit of the books and affairs of the licensed or registered business and submit to the department an audited financial statement if the department finds that such an audit is necessary to determine whether the mortgage broker is complying with the provisions of this article and the rules and regulations adopted in furtherance of this article.

b. Each mortgage lender licensed or registered under this article shall at least once each year have made an audit of the books and affairs of the licensed or registered business and submit to the department at renewal an audited financial statement, except that a mortgage lender licensed or registered under this article which is a subsidiary shall comply with this provision by annually providing a consolidated audited financial statement of its parent company and a financial statement, which may be unaudited, of the licensee or registrant which is prepared in

   accordance with generally accepted accounting principles. A lender who utilizes a bond in lieu of an audit need not supply such audit, unless specially required by the department. An audit shall be less than 15 months old to be acceptable. The department may by regulation establish additional minimum standards for audits and reports under this Code section.

Annual Fees [O.C.G.A. §7-1-1011]

As with everything, obtaining, retaining, and using a license does come with certain financial obligations.

The law enables the department to prescribe annual fees to be paid by licensees and registrants, which fees shall be set at levels necessary to defray costs and expenses incurred by the state in providing the examinations and supervision required by this article and its federally mandated participation in the Nationwide Mortgage Licensing System and Registry.

The law also imposes certain fees to the borrower instead of the mortgage loan originator, broker, or lender:

The law imposes a fee on the borrower during the closing of every mortgage loan subject to regulation under this article which, as defined in Code Section 7-1-1000, includes all mortgage loans, whether or not closed by a mortgage broker or mortgage lender licensee or registrant, a fee of
$10.00. The fee shall be paid by the borrower to the collecting agent at the time of closing of the mortgage loan transaction. The collecting agent shall remit the fee to the department at the time and in the manner specified by regulation of the department. Revenue collected by the department pursuant to this subsection shall be deposited in the general fund of the state.

- As used in this subsection, the term "collecting agent" means the person listed as the secured party on a security deed or other loan document that establishes a lien on the residential real property taken as collateral at the time of the closing of the mortgage loan transaction.
- The fee mentioned above included in the closing of a loan is meant to be a debt from the borrower to the collecting agent until such assessment is paid and shall be recoverable at law in the same manner as authorized for the recovery of other debts. Any collecting agent who neglects, fails, or refuses to collect the fee imposed by this subsection shall be liable for the payment of the fee.

<u>Disclosure Requirements</u> [O.C.G.A. §7-1-1014]

Aside from other rules, regulations, and policies that the department may promulgate to effectuate the purpose of this article, the department can also promulgate regulations governing the disclosures that must be provided for applicants for mortgage loans, including the following requirements:

1. Any person required to be licensed or registered under this article shall provide to each applicant for a mortgage loan prior to accepting an application fee or any third-party fee such as a property appraisal fee, credit report fee, or any other similar fee a disclosure of the fees payable and the conditions under which such fees may be refundable;
2. Any mortgage lender required to be licensed or registered under this article shall make available to each applicant for a mortgage loan at or before the time a commitment to make a mortgage loan is given a written disclosure of the fees to be paid in connection with the commitment and the loan, or the manner in which such fees shall be determined and the conditions under which such fees may be refundable; and
3. Any mortgage lender required to be licensed or registered under this article shall disclose to each borrower of a mortgage loan that failure to meet every condition of the mortgage loan may result in the loss of the borrower's property through foreclosure. The borrower shall be required to sign the disclosure at or before the time of the closing of the mortgage loan.

The department may prescribe standards regarding the accuracy of required disclosures and may provide for applicable administrative or civil penalties or fines for failure to provide the disclosures or to meet the prescribed standards.

<u>Regulations Relative to Advertising</u> [O.C.G.A. §7-1-1016]

There are also specific provisions regarding advertising that the department has the authority to create and enforce. The department shall prescribe regulations governing the advertising of mortgage loans, including, without limitation, the following requirements:

1. (A) Advertisements for loans regulated under this article shall not be false, misleading, or deceptive. No person whose activities are regulated under this article shall advertise in any manner so as to indicate or imply that its interest rates or charges for loans are in any way recommended,' 'approved,' 'set,' or 'established' by the state or this article.
   B. An advertisement shall not include an individual's loan number, loan amount, or other publicly available information unless it is clearly and conspicuously stated in boldface type at the beginning of the advertisement that the person disseminating it is not authorized by, in sponsorship with, or otherwise affiliated with the individual's lender, which shall be identified by name. Such an advertisement shall also state that the loan information contained therein was not provided by the recipient's lender;
2. All advertisements, including websites, disseminated by a licensee or a registrant in this state by any means shall contain the name, license number, Nationwide Mortgage Licensing System and Registry unique identifier, and an office address of such licensee or registrant, which shall conform to a name and address on record with the department; and
3. No mortgage broker or mortgage lender licensee shall advertise its services in Georgia in any media disseminated in this state, whether print or electronic, without the words 'Georgia Residential Mortgage Licensee' or, for those advertisers licensed in more than one state, a listing of Georgia as a state in which the advertiser is licensed.

Advertising Requirements

[Georgia Department of Banking and Finance-Mortgage Division Rules 80-11-1-.02]

There is a lot of advertising involved in the lending industry, therefore making it crucial for proper consumer protection laws to be available and easily enforced. These provisions exist on the federal level. With regards to provisions in the state of Georgia, the following provisions are in place in an effort to protect the consumer:

a. Advertisements for mortgage loans shall not be false, misleading, or deceptive.
b. Advertisements for mortgage loans shall not indicate in any manner that the interest rates or charges for loans are in any way recommended, approved, set or established by the state or by any law of the state.
c. All solicitations or advertisements, including business cards and websites, for mortgage loans disseminated in this state by persons required to be licensed or registered under O.C.G.A. Title 7, Chapter 1, Article 13 shall contain the name, license number, valid unique Nationwide Multistate Licensing System and Registry (NMLSR) identifier, and an office address of the licensee or registrant advertising the mortgage loan, which name, address, and license number shall conform with the name, license number, valid unique NMLSR identifier and office address on record with the Department of Banking and Finance.
d. All advertisements disseminated in this state by persons required to be licensed under O.C.G.A. Title 7, Chapter 1, Article 13 in any media, whether print or electronic, shall contain the words "Georgia Residential Mortgage Licensee" or, if an entity is licensed in more than one state, the licensee's advertisement may list Georgia as a state in which the licensee is licensed.
e. All advertisements for mortgage loans shall comply with all applicable federal and state laws.
f. For purposes of this Rule, "advertisement" means material used or intended to be used to induce the public to apply for a mortgage loan. Such term shall include any printed or published material, audio or visual material, website, or descriptive literature concerning a mortgage loan subject to regulation under O.C.G.A. Title 7, Chapter 1, Article 13 whether disseminated by direct mail, newspaper, magazine, radio or television broadcast, electronic, billboard or similar display. The term advertisement shall not include promotional materials containing fifteen words or fewer relating to the mortgage business of the entity which material does not contain references to a specific rate or product, such as balloons, hats, pencils or pens, and calendars.
g. Every mortgage broker or mortgage lender required to be licensed or registered shall maintain a record of samples of its advertisements (including commercial scripts of all radio and television broadcasts) for examination by the Department of Banking and Finance.
h. An advertisement shall not include an individual’s loan number, loan amount, or other publicly available information unless it is clearly and conspicuously stated in bold-faced type at the beginning of the advertisement that the person disseminating it is not authorized by, acting on behalf of, or otherwise affiliated with the individual’s lender, which shall be identified by name. Such an advertisement shall also state that the loan information contained therein was not provided by the recipient’s lender.

Case Studies

CASE STUDY #1

You have a new client who wants to obtain a mortgage loan and purchase a primary residence. After working with her and obtaining all qualification materials, the client's credit application is denied. You telephone her and state the cause for this decision. You discuss ways she can improve her credit issues, counsel her on her right to receive a free credit report and suggest that she try to apply for a mortgage loan in one year to give time for her establishment of a favorable credit history.

Two months later, you still think about your potential borrower and send her a letter stating that her application is denied in the hopes that she will continue to remember that she has some work to do in order to become a borrower. You do not want to lose this client and want her to come back once she is more qualified.

Please answer the following multiple-choice questions regarding the scenario:

Question # 1:
What kind of letter should a mortgage loan originator send a person whose application has been denied?

a. A notification of adverse action
b. A letter is not needed if the loan originator communicates via telephone
c. A counteroffer letter
d. A conditional approval letter

Answer: A

Question # 2:

What, if anything, is wrong with the scenario?

a. The loan originator did not send the denial letter right away
b. The loan originator waited too long to send the denial letter
c. The loan originator told the client about her denial via telephone instead of in person
d. The loan originator does not have the authority to speak to a client regarding the approval or denial of an application

Answer: B

Question # 3:

Within how many days of a denial must a notification of adverse action be provided to the consumer?

a. 30 days
b. 60 days
c. 10 days
d. 3 days

Answer: A

Case Study #1 Answer/ Explanation

In this scenario, you must comply with the guidelines found in the Equal Credit Opportunity Act (ECOA). The consumer came to you in order to obtain a mortgage loan, and, unfortunately, she did not qualify for one. Therefore, according to the law, 30 days after the denial of her mortgage loan application, she is entitled to a Notice of Adverse Action. In this case, this particular disclosure provides an explanation as to why her mortgage loan application was denied.

Though, in the scenario, you sent her a letter explaining her denial, you did so two months after the denial, which is in direct violation of the law. The applicant must receive the letter within 30 days of the decision regarding the application. The law states that not only should the applicant receive the disclosure, the disclosure should contain clear and concise reasons for the denial, as indefinite or vague reasons are illegal. The only time a creditor is exempt from issuing a notification is if the application was taken by telephone and the applicant did not provide their address as requested by the creditor. In all other cases, the law requires the disclosure be provided to the consumer.

CASE STUDY #2

You have a new potential borrower that walked into your office requesting a meeting to find out what he needs to do to obtain a mortgage loan. You provide him a list of documents you will need from him in order to determine whether he will qualify for a mortgage loan. A few days later he comes back to meet with you with documents and ready to fill out a mortgage loan application.

You have gone through most of the loan application with the potential borrower. All you have left to fill out prior to submitting to underwriting is the section requesting data for purposes of HMDA. You ask your client to complete the section requesting data on his race and national origin, his ethnicity, and gender prior to signing the loan application. He expresses he is not comfortable providing such information. You tell him that in order for you to submit a completed loan application, he must answer these questions, as they cannot be left blank. After explaining this to him, he answers the questions and you are able to complete his loan application.

Please answer the following multiple-choice questions regarding the scenario:

Question # 1:
Did you correctly handle this situation?

a. Yes, an application must be completed prior to submitting.
b. No, the client should not feel obligated to provide such information.
c. Yes, the information must be included in the loan application for approval.
d. No, the client should have felt comfortable to give you the information to begin with.

Answer: B

Question # 2:

Which of the following is most accurate?

a. A mortgage loan applicant is obligated to provide information regarding his race and national origin, his ethnicity, and gender.
b. A mortgage loan originator must provide the information regarding the race and national origin, ethnicity, and gender of the potential borrower on the application.
c. The section of the loan application regarding the race and national origin, ethnicity, and gender of the potential borrower can be left blank.

d. If a mortgage loan originator does not provide the information on the applicant's race and national origin, ethnicity, and gender, the application will be denied.

Answer: B

Question # 3:

If the applicant does not want to provide information regarding his or her race or national origin, ethnicity, or gender, what is true?

a. The mortgage loan originator must fill out the information based on observation or surname.
b. The mortgage loan originator must leave it blank.
c. The mortgage loan originator must notify the applicant that the application will be denied.
d. The mortgage loan originator must provide the borrower with a notice of adverse action.

Answer: A

Case Study #2 Answer/ Explanation

In this scenario, you did not follow what is required of you by law. The Home Mortgage Disclosure Act is a law that requires financial institutions provide certain data to the public. Specifically, HMDA data collection about demographics on the loan application includes the collection of information on the applicant's ethnicity, sex, and race or national origin. While completing a loan application, the loan originator must ask the applicant to choose from the following categories and options:

Ethnicity

- Hispanic or Latino
  - Mexican
  - Puerto Rican
  - Cuban
  - Other Hispanic or Latino (print origin)
- Not Hispanic or Latino

Sex

- Female
- Male
- I do not wish to provide this information

Race

- American Indian or Alaska Native (print name of enrolled or principal tribe)
- Asian
  - Asian Indian
  - Chinese
  - Filipino
  - Japanese
  - Korean
  - Vietnamese
  - Other Asian (print race)
- Black or African American
- Native Hawaiian or Other Pacific Islander
  - Native Hawaiian
  - Guamanian or Chamorro
  - Samoan
  - Other Pacific Islander (print race)

- White
- I do not wish to provide this information

However, though the mortgage loan originator must ask the applicant for this information, the applicant is under no legal obligation to provide this information. If the applicant does not want to provide this information, the loan originator must make note of the fact and, to the best of his or her ability, provide the information based on visual observation and surname.

In this scenario, you made the client feel obliged to furnish information he did not want to furnish. This is not what is legally required of you. Proper behavior in this case would have been to tell the applicant that he is not obligated to answer, taken note of the fact, and later filled out this section on the application on your own based on visual observation or the applicant's name.

CASE STUDY #3

You are working with a borrower to help her purchase her first home. You've been helping her get everything ready in order to qualify for a mortgage loan for almost a year. She finally found a property she likes and starts the process to obtain a mortgage loan. You really like this client and want to make sure that all goes smoothly during the purchasing process.

It is finally time to order an appraisal. Luckily, you have been in contact with the appraiser before and feel comfortable calling him to chat about this particular appraisal. You make it clear that the buyer and the sellers are both willing parties and have agreed that the property should sell for $235,000. You explain to the appraiser that the value of the property on the appraisal report must come in at $235,000 or the deal will not go through. You also mention that there are two real estate agents involved in the sale and they both agree that this figure is an accurate one for the property. The appraiser responds positively and a few weeks later delivers what you requested.

Everything else works out well and your client closes the loan and purchases her first home. A week after the loan closes, the borrower writes a letter requesting a copy of her appraisal report. You know you have some time to send it to her, so you wait but forget to send it. Finally, a couple of months later you remember and send her the copy knowing that legally she is entitled to a copy of the appraisal.

Please answer the following multiple-choice questions regarding the scenario:

Question # 1:
After reading the scenario, what is most accurate?

a. You are a good loan originator for caring enough about your client to contact the appraiser in order to make sure she can purchase her first home.
b. What you have done is illegal and you should be subject to disciplinary action.
c. So long as you provide the borrower with a copy of the appraisal, you have not violated the law.
d. By taking such an interest in making sure the client obtains the mortgage loan, you have appropriately completed your fiduciary duties.

Answer: B

Question # 2:

Your client requested a copy of her appraisal. What should you have done?

a. Consumers have a right to a copy of their appraisal. A copy should be provided to them when requested.
b. If the request for the copy of an appraisal is written and not oral, then you must provide a copy of the appraisal.
c. A copy of the appraisal can only be given before the loan closes.
d. The only person that needs a copy of the appraisal is the lender. You are not under any obligation to provide an appraisal report to the consumer.

Answer: A

Question # 3:

According to the law, a creditor need not provide a copy of the appraisal when the request is received 90 days after notice from the creditor or 90 days after the application is withdrawn. If the borrower requests in writing a copy of the appraisal 2 weeks after the loan closes, how many days do you have to provide the copy?

a. 90
b. 10
c. 30
d. 60

Answer: C

Case Study #3 Answer/ Explanation
In this scenario you have violated the law as a mortgage loan originator. According to the Valuation Independence Rule brought forth by the Federal Reserve, a person involved in a mortgage loan transaction is prohibited form directly or indirectly coercing, extorting, inducing, bribing, intimidating, compensating, or colluding with a person preparing real estate valuations. It is illegal for an appraiser to base the appraised value of a property on factors other than their independent judgment.
Having spoken directly with the appraiser in an attempt to get a specific appraised value for the subject property is illegal. Both you and the appraiser are liable for this behavior. Though by law you are required to act in the best interest of your client, you cannot collude with an appraiser in order for your client to obtain a loan.

With regards to your client's request of a copy of her appraisal, the law states that a client is entitled to one. The law is also specific regarding the timing of the copy's delivery. The Equal Credit Opportunity Act states that mortgage lenders are required to notify applicants of their right to receive a copy of their appraisal. The copy may be provided to the consumer, whether credit is granted or denied. If a consumer requests in writing that they want a copy of their appraisal, the creditor shall provide it within 30 days of the written request. However, if the request is provided 90 days after a notice from the creditor of a denial or if the application has been withdrawn, there is no obligation to provide a copy of an appraisal. In the case, the applicant requested the copy two weeks after the closing. This means that you should have provided the copy within 30 days of her request. Because you did not do so, you are in violation of the law.

CASE STUDY #4

Claire goes to a mortgage lending institution to meet with a mortgage loan originator. She wants to purchase a property and would like to obtain a mortgage loan in order to do so. Ted is a mortgage loan originator that currently is not busy; therefore, he invites her into his office. After a few minutes of conversation, Ted learns that Claire has already found a property that she likes, and she wants to put an offer on that property but would like to make sure that she qualifies for a mortgage loan before presenting the offer.

Ted starts filling out a mortgage loan application with Claire. He asks her various questions and requests that she bring some supporting documents regarding her financial standing, such as bank statements and retirement account statements. Ted also downloads Claire's credit report. Overall, it appears that Claire will qualify for a mortgage. She notifies Ted that the current selling price is $187,000 and that she can put down a 10% down payment. After reviewing her application and running some numbers, Ted is able to pre-qualify Claire for a conventional loan of $168,300. She will have to put $18,700 as a down payment. To continue on with the mortgage loan application Ted asks Claire about her race or national origin. Claire answers that she is White. Ted asks Claire about her ethnicity and Claire responds by saying she is Hispanic or Latino. Ted asks Claire about her gender, and she responds that she is a female. Lastly, Ted asks Claire whether she intends to have a family in the near future. She responds yes. Ted follows this question by asking whether Claire is able to bear children. She responds that luckily, she is able to bear children and she can't wait to do so.

Claire and her real estate agent send her offer to the seller and the seller accepts the offer. Within the next month Claire and Ted work together and close on the loan. After the closing date, Claire moves to her new house and begins the next chapter of her life as a homeowner.

Please answer the following multiple-choice questions relating to the scenario:

Question # 1:
Has Ted acted in violation of the law in any way during the course of his time with Claire?

a. No, Ted seems to have acted as a good loan originator throughout the lending process.
b. Yes, Ted has violated the law.
c. No, Ted has not violated any law, but has acted unethically.
d. We do not have enough information about their interaction to note whether Ted has acted in violation of the law.

Answer: B

Question # 2:

If Ted has acted in violation of the law, what law has he violated?

a. Ted has not violated any law.
b. Ted has violated ECOA guidelines.
c. Ted has violated RESPA guidelines.
d. Ted has violated TILA guidelines.

Answer: B

Question # 3:

In what way has the law been violated?

a. ECOA laws specifically state that a loan originator cannot inquire about a consumer's ability to bear children.
b. TILA specifically provides that loan originators cannot inquire about the consumer's ethnicity.
c. RESPA specifically provides that loan originators cannot inquire about a consumer's race.
d. Fair Lending Laws state that a loan originator cannot ask a consumer about their gender.

Answer: A

Case Study #4 Answer/ Explanation
In this scenario Ted has violated federal law. According to ECOA, though a mortgage loan originator can ask an applicant about their age, marital status, and number of dependents, they cannot ask about the applicant's childbearing plans. An applicant's childbearing plans, or ability, should in no way affect an applicant's chances for the extension of credit. Considering that this is both illegal and unethical, Ted should be subjected to disciplinary action.

<u>CASE STUDY #5</u>

Sallie and Thomas Epstein are about to have their first child and have decided that they would like to purchase a house in Atlanta instead of continuing to rent. In preparation for this, one of their friends suggests they go to the GAA Credit Union and meet with Samantha, a loan originator that will be able to help them get financing for their purchase. Samantha meets with the Epsteins and discusses their options and determines their maximum loan amount. With that information, the Epsteins visit their local real estate agency and begin their property search. After two months they finally find the perfect house in a perfect family friendly neighborhood and put in an offer. The offer is accepted and the Epsteins return to Samantha with a property agreement and begin the mortgage lending process.

After collecting necessary documents and signing disclosures, the underwriter at the GAA Credit Union gives them a clear to close. The following week, they complete the transaction and are able to move into their very own home. After being there for about one month, Thomas begins to feel somewhat overwhelmed regarding their finances. The mortgage is higher than their rent was and they are about to have a child. He begins to ponder ways of getting out of their purchase. After speaking to his friend Steve, who used to work in the real estate industry, Steve asks whether he has the loan originator's full name or unique identifier number in order to look her up on the Nationwide Mortgage Licensing System and Registry. Thomas and Steve run a quick search on the computer and realize that Samantha is not a licensed mortgage loan originator. Samantha is only *registered* as a mortgage loan originator on the NMLS system. Steve tells Thomas that all mortgage loan originators must be licensed. With this information, Thomas decides to file a complaint against her in an effort to rescind their property purchase.

Please respond the following questions relating to the scenario:

Question # 1:
Which of the following statements is most accurate regarding the above scenario?

A. Thomas has the grounds to file a complaint against Samantha for lacking a MLO license.
B. Thomas does not have the grounds to file a complaint against Samantha for not having her license.
C. Thomas would have had the grounds to file a complaint against Samantha had he not closed on the loan.
D. Thomas only has 15 days after the closing date to file a complaint against Samantha.

Answer: B

Question # 2:

Which of the following statements is most accurate regarding Georgia law?

A. If a person is registered and acting for a Credit Union, they do not need to be licensed.
B. If a person is registered and works for a licensed financing institution, they do not need to be licensed.
C. All persons performing mortgage loan originator duties must be licensed.
D. Persons performing mortgage loan originator duties in Georgia need not be licensed.

Answer: A

Question # 3:

True or False
In the above scenario, not having a license means that Samantha has acted illegally.
Answer: FALSE

Case Study #5 Answer/ Explanation

No, Thomas cannot get Samantha in trouble for lacking a mortgage loan originator license. According to the Official Code of Georgia Annotated (O.C.G.A. 7-1-1001), certain persons and entities are exempt from needing license. More specifically, any mortgage loan originators that are registered, when acting for an entity that does not require a lender license, such as a Credit Union, does not need to have a license. Since Samantha was registered with the Nationwide Mortgage Licensing System and Registry with a unique identifier, and works and was acting as a loan originator for a credit union, she is not at fault, as she has not acted illegally.