

8 Hour SAFE Comprehensive: Compliance for 2025

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Module 1 Federal Laws

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

Other abbreviations include:

“MMC” – Multi-State Mortgage Committee

“CSBS” – Conference of State Bank Supervisors

“AARMR” – American Association of Residential Mortgage Regulators

“CFPB” – Consumer Financial Protection Bureau

“MME” – Multi-State Mortgage Entities

“NMLS” – Nationwide Mortgage Licensing System

“SAFE Act” - Secure and Fair Enforcement for Mortgage Licensing Act

Federal Law Lesson Objective:

Students will understand how TILA and other advertising rules play an important role in their daily origination activities. We will review the MME violations and discuss how to comply with these TILA violations. The student will understand TILA and MAP rules for advertising compliance, with an understanding of TILA Trigger terms for advertising.

MORTGAGE LICENSEE OVERSIGHT AUTHORITY

With the enactment of the Dodd Frank Wallstreet Reform and Consumer Protection Act (Dodd-Frank Act), mortgage industry regulators have been given authority, even across state and federal government agencies, to enforce current regulations. The government determined that a central agency was needed to provide oversight and enforcement actions so as not to repeat the mortgage crisis of 2008. In response, the Dodd Frank Act created the Consumer Financial Protection Bureau (CFPB) to regulate, oversee and enforce federal laws for the mortgage industry. The CFPB’s focus is on the overall health and safety of US financial markets.¹

The CFPB manages the Nationwide Mortgage Licensing System and Registry (NMLS) to assist state agency with compliance with the Secure and Fair Mortgage Licensing Act (SAFE Act). The CFPB governs mortgage licensed and unlicensed activity to enforce compliance with federal mortgage lending laws and mortgage licensed activities.

The CFPB provides official interpretations of federal regulations to assist mortgage professionals and lenders to better comply with the Truth-in-Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), Equal Credit Opportunity Act (ECOA), Fair Credit Reporting Act (FCRA), and Privacy laws to name a few.

Although CFPB may perform examination of state licensees that receive warranted complaints, its primary focus is on Multi-State Mortgage Entities (MMEs) or large entities. Violations from the MMEs

¹ <https://www.ftc.gov/legal-library/browse/statutes/dodd-frank-wall-street-reform-consumer-protection-act-titles-x-xiv>

happen on a larger scale due to their volume of business and therefore warrant closer scrutiny from regulators.

Multistate Mortgage Committee

In addition to the creation of CFPB, the Dodd Frank Act created additional oversight with the Multistate Mortgage Committee (MMC). MMC is a representative body of state mortgage regulators appointed by the Conference State Bank Supervisors (CSBS) and American Association of Residential Mortgage Regulators (AARMR).

MMC represents the combined efforts under the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision. These protocols and guidance allow Multi-State Mortgage Entities (MMEs) to originate in multiple states while being in compliance across state lines. MMEs no longer need to provide different sets of state specific operational compliance procedures because of state regulator federal law enforcement differences. The MMC provided uniformity in compliance which the MMEs and its Association Lobbyists were demanding.

The Multistate Mortgage Committee is made up of ten members appointed by the boards of the CSBS and AARMR. Its combined role is to provide cooperative protocol between state agencies and the financial industry. To assist in this effort, it created the MMC's Examination Manual. The MMC's examination manual promotes transparency and consistency in its examinations of Multistate Mortgage Entities (MMEs).²

State Agencies

For local protection of consumers, state licensing agencies are responsible for overseeing licensed financial service activities and enforcing compliance to protect their state's consumers from predatory and illegal lending activities. Licensed mortgage lenders and originators are expected to operate in a safe and sound manner, in compliance with all federal and state regulations that govern their originations. The State Agencies' responsibility is to enforce compliance and fines when licensees fail to comply.

State agency regulators have authority to:

- Propose legislative changes
- Interpret state regulations it enforces
- Impose fines for state law violations
- Investigate consumer complaints received by consumers or government agencies
- Issue and supervise NMLS licensees
- Administer regular examinations of licensees
- Impose fines as required by state regulations
- Enforce federal and state consumer protection laws
- Issue state NMLS licensing to entities and mortgage loan originators

State Examinations

An examination completed by State Regulators will determine if a financial institution is operating in compliance with state and federal laws. A review of a financial institution's loans and corporate records are conducted to decide whether the entities are effectively meeting the requirement to operate, monitor, and control risks associated with loan origination activities.

² <https://www.aarmr.org/about-aarmr/committees/>

The MMC Mortgage Examination Manual was developed and is maintained to promote transparency and consistency in examination guidance for state agencies and licensees. This examination manual gave MMEs uniformity across state lines but also provides as a resource for state licensed mortgage bankers and mortgage brokers. The examination manual is the standard for all mortgage entities to stay in compliance and maintain their licenses.

State agencies use the MMC Mortgage Examination Manual for examination guidance. Using this manual for all examinations attempts to eliminate bias among the examiners. The state examiner of the licensee will include a random review of a financial institution's loan files and corporate records to:

1. Identify licensee compliance with required federal and state laws.
2. Establish if they are operating safely for their community.
3. Effectively meet the requirements to operate, monitor, and control risks associated with their mortgage loan origination activities.

State Licensing

State agencies regulate state-licensed mortgage originators, mortgage brokers, and mortgage bankers. Each state legislation determines what is required for mortgage licensing in their state, with a minimum requirement set by federal law - the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). The state agency then enforces state laws and federal regulations regarding initial and renewing of NMLS licensing. If the licensing fails to comply with education or licensing renewal requirements, the state agency will handle licensee on a local level.

State regulators play a critical role in enforcing the laws that govern state licensees.³

Examination Procedural Manual

CFPB provided examiners with the MCC Examination Manual for examination procedures, and the supporting workpapers which are flexible rules that are concepts and tools designed to assist the examiner.

Interviews may clarify misunderstandings or resolve questions that the licensee's management may have during the examination. During the examination, the Examiner in Charge (EIC) may conduct interviews of company employees. A mortgage loan originator may be interviewed by an examiner during an investigation if they are a witness to a violation, or a suspected violator. Licensed MLO will be held accountable for any violations found during an examination or through a consumer complaint. An examiner may interview anyone within the scope of the examination including staff and borrowers.

MMC Violation Findings

The MMC Exam Rating System is incorporated into the examination work program to provide a seamless and continuous evaluation of the components assessed to determine the overall rating of examined MME. Repetitive violations found during the examination are identified and provided to CFPB.

The CFPB then uses the top ten violations found in the MME examinations as a requirement to be covered in its annual NMLS licensing requirements for mortgage loan originators. This year the course covers compliance issues primarily found with the Truth-in-Lending Act (TILA) in the 3rd quarter of 2022. CFPB requires licensees to learn what the compliance issues are on a larger scale, to educate licensees of how to comply with common violations.

³ <https://www.csbs.org/system/files/2019-05/MMC%20Mortgage%20Examination%20Manual%20v2%20-%20May%202019.pdf>

An MLO must adhere to the rules covered in this course during the origination of a loan in order to prevent violations actionable by state or federal regulators.

These violation findings to be reviewed in this course had final action taken per the examination, which may have included:

- Required additional audits
- Required written letters of explanation
- Implementation of a corrective action plan
- Required consumer refunds
- Assess and collect licensee fines and penalties

TILA MORTGAGE COMPLIANCE REVIEW

CONSUMER PROTECTIONS WITH AUTHORITY AND INDEPENDENCE

After the market crash of 2008, regulators passed the Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) which created a new independent watchdog, the Consumer Financial Protection Bureau (CFPB) housed at the Federal Reserve. They were given the authority to ensure American consumers get the clear, accurate information they need to shop for mortgages, credit cards, and other financial products, and protect them from hidden fees, abusive terms, and deceptive practices.

The CFPB's mission is to make consumer financial markets work in a fair manner for consumers with responsible compliant financial providers. CFPB protects consumers from unfair, deceptive, or abusive practices and takes action with enforcement against licensees that break the law.

Financial Stability Oversight Council

The Dodd-Frank Act established the Financial Stability Oversight Council (FSOC). It monitors the stability of the US financial system, identifies risks, and promotes market discipline. The FSOC also responds to emerging threats and communicates with the public about these risks.

The Council is charged by statutes with:

- Identifying risks to the financial stability of the United States
- Promoting market discipline
- Responding to emerging threats to the stability of the US financial system

The FSOC meets at least once a quarter and is chaired by the Secretary of the Treasury. The FSOC is made up of ten voting members and five nonvoting members, including federal and state regulators, and an independent insurance expert.

The FSOC is held accountable to Congress and the American people through:

- Annual reports
- Annual Congressional testimony by the Council Chairperson
- Open meetings at least twice each year
- Public meetings
- Oversight by the Council of Inspectors General on Financial Oversight and the Government Accountability Office⁴

⁴ <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc#:~:text=Established%20in%202010%20under%20the,on%20financial%20stability%20related%20matters.>

CFPB AND FSOC REVIEW

The Consumer Financial Protection Bureau (CFPB) and the Financial Stability Oversight Council (FSOC) have different roles and responsibilities.

The CFPB is an independent agency that regulates consumer financial products and services. Its responsibilities include:

- Supervising banks, thrifts, and credit unions with assets over \$10 billion
- Ensuring that federal consumer financial laws are enforced consistently
- Promoting fairness and transparency for mortgages, credit cards, and other consumer financial products and services

FSOC responsibilities include:

- Evaluating CFPB rules for systemic risk implications
- Staying or setting aside CFPB rules with the consent of two-thirds of its members
- Triggering the Fed to apply heightened prudential regulations for designated nonbank financial firms and financial market utilities

The FSOC designates nonbank financial firms and financial market utilities as systemic. A nonbank financial firm is designated as a systemic financial institution if the FSOC determines that its failure or distress could pose a risk to the US financial system. The FSOC designates nonbank financial firms and financial market utilities as systemic financial institutions. This designation provides the Feds with heightened prudential regulation to the firm.

The CFPB director is a voting member of the FSOC. The CFPB is funded through monetary transfers from the Fed and fines collected, while the FSOC has nominal annual membership fee.⁵

OTHER ENTITIES THAT ENFORCE FEDERAL REGULATIONS

Federal Trade Commission

The Federal Trade Commission (FTC) is a US government agency that works to protect consumers by preventing deceptive, unfair, and fraudulent business practices. It promotes competition in the marketplace by enforcing antitrust laws and ensuring fair practices in commerce for both consumers and businesses. Prior to the CFPB, FTC was responsible for many federal laws governing the mortgage industry.

Key functions of the FTC include:

- **Investigating and taking action against deceptive advertising:** This includes scrutinizing claims made about products and services to ensure they are truthful and substantiated.
- **Enforcing consumer protection laws:** Addressing issues like identity theft, telemarketing fraud, and unfair credit practices.
- **Monitoring anti-competitive mergers and business practices:** Investigating potential monopolies and practices that could harm competition in the market.
- **Educating consumers and businesses:** Providing information and resources to help people understand their rights and avoid scams.

⁵ <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations#:~:text=The%20Dodd%2DFrank%20Act%20also%20authorizes%20the%20Council,liquidity%20or%20credit%20problems%20spreading%20among%20financial>

- **Developing regulations:** Creating rules to address emerging consumer protection concerns in areas like online privacy.⁶

Federal Communications Commission

The Communications Act of 1934 combined and organized federal regulation of telephone, telegraph, and radio communications. The Act created the Federal Communications Commission (FCC) to oversee and regulate these industries.⁷

Currently, the Federal Communications Commission (FCC) regulates many aspects of communications, including the key functions of:

- **Radio and television:** Regulates broadcasting, including indecent material that may be broadcast between 6 AM and 10 PM.
- **Telephone, telegraph, and cable:** Regulates the operation of these services, and ensures they are efficient and reasonably priced.
- **Satellite communication:** This includes the use of satellites in space to transmit signals between ground stations and user terminals. Satellites function as relay stations, enabling long-distance communication, large communication capacity, and wide coverage area.
- **Two-way radio and radio operators:** Citizens Band Radio Service (CB) service allows two-way radio communications assigned to any specific individual or organization. The FCC regulates two-way radio communications and radio operators or users.
- **Text messages:** The Telephone Consumer Protection Act (TCPA) prohibits sending text messages before 8 AM and after 9 PM in the recipient's time zone. The FCC regulates what information businesses can send through text messages and requires them to ask for permission from customers to text them messages.
- **Electromagnetic spectrum:** The electromagnetic (EM) spectrum is the range of all types of EM radiation. Radiation is energy that travels and spreads out as it goes. The visible light that comes from a lamp in your house and the radio waves that come from a radio station are two types of electromagnetic radiation. The FCC manages the electromagnetic spectrum, including frequency allocation and spectrum usage.⁸

Housing and Urban Development

The Housing and Urban Development (HUD) provides housing support and uplifts communities to ensure consumers have access to fair housing. HUD enforces fair housing and provides guidance for compliance with fair housing initiatives and federal regulations.

Within HUD is the Office of Fair Housing and Equal Opportunity. The mission of the Office of Fair Housing and Equal Opportunity (FHEO) is to eliminate housing discrimination, promote economic opportunity, and achieve diverse, inclusive communities by leading the nation in enforcement, administration, development, and public understanding of federal fair housing policies and laws.⁹

Key functions of HUD include:

- Strengthening the Nation's Housing Market to Bolster the Economy and Protect Consumers
- Meet the Need for Quality Affordable Rental Homes

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<https://www.ftc.gov/enforcement#:~:text=The%20FTC%20enforces%20federal%20consumer%20protection%20laws,is%20to%20protect%20consumers%20and%20promote%20competition.>

⁷ [https://www.usa.gov/agencies/federal-communications-commission#:~:text=The%20Federal%20Communications%20Commission%20\(FCC,%2C%20television%2C%20satellite%20and%20wire.](https://www.usa.gov/agencies/federal-communications-commission#:~:text=The%20Federal%20Communications%20Commission%20(FCC,%2C%20television%2C%20satellite%20and%20wire.)

⁸ <https://www.fcc.gov/about-fcc/what-we-do>

⁹ <https://www.hud.gov/>

- Utilize Housing as a Platform for Improving Quality of Life
- Building Inclusive and Sustainable Communities Free from Discrimination

Office of the Comptroller of the Currency

The Office of the Comptroller of the Currency (OCC) is in the US Department of the Treasury that regulates and supervises federally insured banks to ensure they operate safely and fairly. The OCC was established in 1863 by Congress to address issues with unreliable paper money and inadequate credit available for consumers.

Key functions of the OCC include:

- **Ensure safety and soundness:** Regulate and supervise national banks, federal savings associations, and foreign bank branches and agencies.
- **Provide fair access:** Ensures that banks provide fair access to financial services and treat customers fairly.
- **Comply with laws:** Ensures that banks comply with applicable laws and regulations. They function much as the CFPB does for non-bank lending institutions.
- **Foster a strong banking system:** The OCC aims to create a safe, sound, and fair banking system that meets the needs of consumers, businesses, and communities. They focus on consumer protections, as all the federal regulating agencies do.¹⁰

Banking Crash 2008

The OCC was the federal watchdog for the mortgage industry prior to 2008. The OCC failed to identify the pending crash of the financial markets, even though they were the regulators of the banks during the worst financial crisis since the Great Depression. The year 2008 saw the first annual decline in housing prices, along with record foreclosure levels and heavy losses on subprime loans, including national banks that had not made the risky loans but still invested in large bundles of them as mortgage-backed securities or loan servicing.

The crisis caused the near collapse of interbank lending markets, and a liquidity freeze for asset-backed commercial paper and commercial investment vehicles. During the crisis, several high-profile financial institutions went under by either failing outright, taken over by the federal government, or acquired in distress sales to other banks.

For example, Bank of America acquired one of the largest failing lenders in the nation, Countrywide Financial.

The OCC played an important role in the government-wide effort to stabilize the banking system, restore the flow of credit, and assist victims of the financial crisis. The agency was deeply involved in the Troubled Asset Relief Program (TARP) which was the capital assistance program both in regard to the largest nine institutions that received TARP support and in making recommendations about which smaller institutions should also receive capital.¹¹

In 2016, the OCC created a position for Senior Deputy for Compliance and Community. One "lesson learned" from the financial crisis was the need to treat compliance (including consumer protection and anti-money laundering) as a matter of safety and soundness. Deficiencies in compliance risk management were no less of a threat to the condition of banks than liquidity shortages and poor underwriting.

¹⁰ <https://www.occ.gov/about/who-we-are/index-who-we-are.html#:~:text=The%20Office%20of%20the%20Comptroller,and%20agencies%20of%20foreign%20banks.>

¹¹ <https://www.occ.gov/about/who-we-are/history/2008-present/index-occ-history-2008-present.html>

POTENTIAL TRUMP REGULATION CHANGES TO CFPB

The incoming Washington administration is discussing reducing government oversight, with CFPB in the center of interest. As of the writing of this course, CFPB is still responsible for compliance in the mortgage lending industry. If CFPB is eliminated, which federal agency would manage mortgage lending compliance?

- Would laws be regulated by multiple agencies as it was prior to the Dodd-Frank Act?
- Would FSOC be expanded to manage the duties?
- Will HUD step in to oversee mortgage compliance?
- What laws would the Federal Trade Commission regulate?
- Is the mortgage industry targeted by the administration for major legislation changes like the Dodd-Frank Act? The biggest change in the industry since the Great Depression.

Prior to the creation of CFPB, the FTC regulated TILA and FCRA, HUD regulated RESPA, OCC regulated anti-money laundering regulations including Bank Secrecy Act, and Federal Communication Commissions regulated the lenders and mortgage originators use of telephone solicitations. Lenders were tasked to comply with the regulations as interpreted by all the different agencies. Differences in interpretations were common, and often the agencies were too busy to concern themselves with a small mortgage broker shop violating TILA.

We recommend you stay informed about changes in the mortgage industry over the next few years. One thing is for certain in the mortgage industry, change is constant.

DODD FRANK ACT IMPACT

In 2010, the Dodd Frank Act added an 'ability to repay' debt section to require lenders to verify with a good-faith assessment the owner occupying consumer qualifies for the mortgage loan. Ability to repay TILA violations include a consumer's recourse right to recoup the money they invested in the transaction.

The Dodd Frank Act has been phased in over the last decade as it continues to place restrictions on banking and mortgage lending to prevent excessive risk-taking that led to the financial crisis of 2008. The following are some of the large impact Dodd Frank Act had on the finance industry.

Ended Too Big to Fail Bailouts

The Dodd Frank Act ended the possibility that taxpayers will be asked to write a check to bail out financial firms that threaten the economy. This regulation:

- Created a safe way to liquidate failed financial firms
- Imposed tough new capital and leverage requirements that make it undesirable to get too big
- Updated the Fed's authority to allow system-wide support but no longer prop up individual firms
- Established rigorous standards and supervision to protect the economy and American consumers, investors, and businesses.

Advance Warning System

Created the Multi-state Mortgage Committee to identify and address systemic risks posed by large, complex companies, products, and activities before they threaten the stability of the economy. With the MMC monitoring industry leaders, noncompliant trends can be recognized, corrected, and educated to all state-licensees for compliance.

Transparency & Accountability for Exotic Loan Programs

Eliminated loopholes that allowed risky and abusive practices to go on unnoticed and unregulated including loopholes for over-the-counter derivatives, asset backed securities, hedge funds, mortgage brokers and payday lenders.

Executive Compensation and Corporate Governance

Provided shareholders with a say on pay and corporate affairs with a non-binding vote on executive compensation and golden parachutes.

Protected Investors

Provided tough new rules for transparency and accountability for credit rating agencies to protect investors and businesses. Secondary market investors depend on the rating agencies to be accurate with the quality of the mortgage-backed securities they are purchasing.

Enforced Regulations on the Books

Strengthens oversight and empowers regulators to aggressively pursue financial fraud, conflicts of interest and manipulation of the system that benefits special interests at the expense of US families and businesses.¹²

The Consumer Financial Protection Bureau (CFPB) works to ensure that markets for consumer financial products are fair, transparent, and competitive. The CFPB provides consumers with educational information sources to help them make financial decisions. It provides consumers with a compliant platform to get their voices heard with regulator monitoring compliant response.

The CFPB encourages consumer beneficial competition in financial services. Consumers are encouraged to shop for their mortgage loan to obtain the best loan transaction for their needs.

ADDITIONAL TILA REGULATION CHANGES

Prohibited Unfair Lending Practices

TILA provisions prohibit financial incentives for subprime loans that encourage lenders to steer borrowers into more costly loans, including the bonuses known as "yield spread premiums" that lenders paid to brokers to inflate the cost of loans. The licensee is required to provide the best loan program available for all borrowers that request a home loan. When a licensee puts a borrower into a loan program that has a higher commission to them, and not necessarily the best loan terms for the borrower, this is prohibited and a violation of TILA.

TILA identified prepayment penalties as a borrower trap into unaffordable loans. TILA prohibited prepayment penalties on owner occupied first mortgage loans.

Established Penalties for Irresponsible Lending

Lenders and mortgage brokers who do not comply with TILA standards will be held accountable by consumers for as much as three years of interest payments and damages plus attorney's fees (if any). TILA protections include violations to borrowers in foreclosure positions.

¹² https://www.dpc.senate.gov/pdf/wall_street_reform_summary.pdf

Expanded Consumer Protections for High-Cost Mortgages

Expanded the protections on high-cost loans (Section 32) lowering the interest rate, points and fee triggers that define high-cost loans. Violations for high-cost loans are steep including potential forgiveness of the loan if not properly disclosed to the consumer.

Section 35 of Regulation Z generally requires creditors to establish an escrow account for higher-priced mortgage loans unless they qualify for an exception. This measure is to ensure that property taxes and mortgage-related insurance premiums are paid on time.

Additional Disclosures to Consumers on ARM

Lenders must provide clear disclosure of the maximum a consumer could pay on a variable rate or adjustable-rate mortgage (ARM), with a warning that payments will vary based on an index which changes the interest rate over the term of the loan. The TILA-RESPA Integrated Disclosure Rule (TRID Rule) provided updates to old, outdated forms consolidating and improving current forms with the new Loan Estimate and Closing Disclosure forms.

Housing Counseling

Established an Office of Housing Counseling (OHC) within HUD to boost homeownership and rental housing counseling. The OHC provides support to a nationwide network of Housing Counseling Agencies (HCA) and counselors. HCAs are trained and approved to provide tools to current and prospective homeowners and renters so they can make responsible choices for their housing needs based on their financial situations.

Regulation Z

There were two key regulations to implement TILA. Regulation M applies to consumer leasing and credit card industry, and Regulation Z applies to the mortgage industry. Regulation Z promotes informed use of consumer credit when there is a written agreement between the borrower and the lender. It covers credit agreements that charge the borrower finance charges, require more than four installments, and the loan proceeds will be used for family, personal or household purposes.

As discussed, TILA has become more complicated with legislative changes leaving confusion on how to comply. During this NMLS licensing course, we will cover TILA legislation and CFPB Official Interpretations to provide compliance guidance. CFPB is the federal agency that governs TILA Regulation Z for the mortgage industry.¹³

Regulation Z does not apply when credit is extended to:

- Business loans taken out for commercial use
- Non-natural persons loans to entities like corporations or LLCs
- Certain exceptionally large loans may be excluded depending on specific regulations
- Public utility services loans for public utilities are usually exempt
- Securities transactions offered by the Securities and Exchange Commission are not covered¹⁴

MCC EXAMINATION TOPICS

As found in the MMC examinations, the Multi-State Mortgage Entities (MMEs) are struggling to comply with the Truth-in-Lending Act (TILA). TILA is a consumer protection law that has large fines and penalties for violations. The continuous updates to the laws and agency interpretations of TILA keep Mortgage Compliance Officers and Legal Departments in a constant state of panic that their

¹³ <https://www.consumerfinance.gov/rules-policy/regulations/1026/>

¹⁴ <https://finred.usalearning.gov/assets/downloads/FINRED-TruthLendingAct-FS.pdf>

company's origination procedures are not in 100% compliance. An almost impossible task to achieve 100% compliance with all federal laws, even for the most diligent of companies.

The Truth-in-Lending Act (TILA) was enacted in 1968 by Congress, as a part of the Consumer Protection Act Title 1. While TILA law governs many financial facets, for this course we will focus on the portion of TILA law which covers mortgage lending on a consumer's primary residence. This does not include a consumer's timeshare transaction, HELOC (even if secured by primary residence), reverse mortgage, bridge loan or construction loan.¹⁵

The law was enacted to protect consumers in credit transactions by requiring clear disclosure of the lending terms including all the origination financing costs involved in the transaction. This was accomplished by establishing the use of an annual percentage rate (APR) or annual cost of borrowing money. The APR is required to be disclosed to the consumer to understand their cost of borrowing the money.

TILA provided the borrower with the right of rescission which gives borrowers the ability to cancel certain loans within a specified time frame. This allowed the borrower to cancel the transaction without permission from the lender. For example, in the 1990's lenders charged borrowers a loan origination fee once the loan was approved, even if the borrower cancelled their loan files, the consumer was charged for the lender to originate the loan. TILA does not allow the lender to charge the consumer any fees when they exercise their right to cancel the transaction. A violation of the right to cancel has a three-year violation protection recourse.

TILA attempted to provide consumer protections against 'bait and switch' scams. Bait and switch scams became common place as lenders would advertise low interest rates but not disclose the number of discount points the consumer would pay to achieve the favorable interest rate. With an APR, the cost of the interest rate is calculated into the formula to provide the true cost of the money expressed as an annual rate. The lender with the lowest APR was assumed to be the least expensive option for the consumer's home financing needs.

Since 1968, TILA has been amended continuously, all in an effort to provide consumers with clear and efficient ways to compare credit offers and protect them from predatory lending. For the lender, it provided the regulators with a path to imposing large fines and penalties for violations of TILA.

In the 1990's TILA added Section 32 to its Regulation Z. If a lender violates TILA Section 32 while originating a high-cost mortgage the legislation provides the consumer with recourse including the right to cancel the mortgage loan request.

The following are the required topics NMLS Mortgage Loan Originators must learn to meet 2025 licensing requirements based on the findings of MMC examination of MMEs.

EXAMINATION FINDINGS #1

Appraisal Fee Overcharge

During an MMC examination, the examiner discovered a consumer was charged an appraisal fee on a Closing Disclosure that the consumer's previous lender had already paid for. The residential appraisal report was ordered by the consumer's previous lender and used for the loan by the funding lender. The funding lender's appraisal fee charge caused the borrower to pay double for the appraisal fee.

¹⁵ <https://www.ecfr.gov/current/title-12/chapter-X/part-1026/subpart-E/section-1026.43>

Only the exact fee of a third-party provider of services may be assessed to consumers. If the funding lender provided a desk review or other confirmation of the appraisal value and properly disclosed the fee according to TILA to the borrower, they may have been able to pass that fee onto the consumer.

For TILA compliance, to charge an additional appraisal fee would need to be disclosed on the initial Loan Estimate, fee must be paid to third-party and be a justified need to obtain an additional appraisal report to meet the loan program.¹⁶

If the lender makes a clerical error on the disclosures that do not contain the actual terms of the transaction, the creditor does not violate TILA if the creditor provides corrected disclosures that contain the actual terms of the transaction within the TILA timing requirements.¹⁷ The fee change must comply with TILA-RESPA Integrated Disclosure Rule change of circumstances, timing and type of fee limitations.

The TRID Rule is a set of guidelines created by the CFPB to improve mortgage disclosure forms. The rules are intended to help consumers understand their loans and closing costs.¹⁸ TRID rules have restrictions on specific fee changes between the initial Loan Estimate disclosure and final Closing Disclosure, termed TRID Disclosures.

When a lender makes an allowable change, the lender must meet the change of circumstance requirements and handle within three business days of the discovery of the change. All of TILA timing requirements are precise.

For example, if the creditor provides the required TRID disclosures on Monday, June 1, but the consumer requests to add a mobile notary service to the terms of the transaction on Tuesday June 2, the creditor complies with TILA timing requirements if it provides revised TRID disclosures reflecting the notary fee before end of day Friday, June 5th.¹⁹

This change meets the timing requirement and is a justified need (borrower requested) for the loan transaction and meets TRID disclosure guidelines for change of circumstances.

Best Information Reasonably Available

It can happen that a lender cannot get the actual fees from a third-party provider within the TILA time limits required for sending out the TRID disclosures. The law provides for this occurrence by allowing Creditors to estimate a fee for initial disclosures provided they are using the best available information when the actual term is unknown at the time disclosures are made.²⁰ When would this be acceptable:

- When an actual term (fee) is unknown, and it is not reasonably available to the creditor at the time the disclosures are made.
- The “reasonably available” standard requires that the creditor, acting in good faith, exercise due diligence in obtaining the information. The file must document the lender’s attempts to obtain the actual fee prior to use of ‘best estimate available.’

For example, the creditor might look to the consumer for the date and time of consummation, to insurance companies for the cost of insurance policy, to title agents for taxes and escrow fees, or to a settlement agent for homeowner's association dues or other information in connection with a real

¹⁶ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#f>

¹⁷ TILA ¹⁷ 12 C.F.R. §1026.19(f)(1)(ii) and (f)(2)

¹⁸ <https://www.consumerfinance.gov/compliance/compliance-resources/mortgage-resources/tila-respa-integrated-disclosures/>

¹⁹ TILA – 12 C.F.R. §1026.19(f)(3)

²⁰ TILA 12 C.F.R. §1026.19(f)(1)(ii)(A) and (f)(2)(ii)

estate settlement. If these fees are not provided by these parties within the required timeframe, then the creditor has a standard method of complying.

Per CFPB, the following are examples to illustrate the 'reasonably available standard' for TILA compliance:

- Assume a creditor provides the required disclosure for a transaction in which the title insurance company providing the title insurance policies is acting as the settlement agent in the transaction. The creditor does not request the actual cost of the lender's title insurance policy from the settlement agent. Instead, the creditor discloses an estimate based on information from a different loan transaction. In this instance, the creditor **has not** exercised due diligence in obtaining the information on the cost of the lender's title insurance policy. Their actions failed to meet the "reasonably available" standard in connection with the estimate disclosed for the lender's title insurance policy.
- Assume that in the prior example the creditor requested and obtained the fee information for the terms of the consumer's transaction from the settlement agent. The creditor has exercised due diligence in obtaining the information about the costs for purposes of the "reasonably available" standard.
- Assume that the settlement agent fails to provide the actual cost of the lender's title policy after several documented request by the creditor to obtain, the creditor must then document the file with their attempts and may use a reasonable estimate based on previous closings with that settlement agent or similar settlement agent in the area.

The difference between compliance and non-compliance is the creditors' efforts to obtain the required information to properly comply. A creditor must attempt to receive the information in a timely manner.

Upon receipt of the accurate fee charged, the creditor is then required to provide corrected disclosures containing the actual terms and fees of the transaction within three business days of discovery or before consummation, whichever is first.

Denied or Withdrawn Applications

The creditor is not required to provide the disclosures if, before the time the creditor is required to provide the disclosures, the creditor determines the consumer's application will not or cannot be approved on the terms requested, or the consumer has withdrawn the application, and, as such, the transaction will not be consummated.²¹

EXAMINATION FINDINGS #2

Overcharge Borrower at Closing

The MMC examination found the closing costs collected from the borrower at closing exceeded the estimated closing cost disclosed to the borrower in the Loan Estimate (LE).

Good Faith Determination

A lender provides the borrower a LE with a good faith determination of the closing costs and is then required to provide a Closing Disclosure (CD) with final figures that are within the variances allowed. After consummation, when differences are found between the LE and the CD which exceed the TRID allowable variances, the creditor is provided with a period of time to find and correct the error. TRID allows creditors to correct CD errors found within 30 days of consummation, with the borrower notified of correction and receipt of any refund no later than 60 days after consummation.

²¹ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-f-1-i-Interp-2-iii>

Per TILA, an estimate of closing cost disclosed **is in good faith** if the charge paid by or imposed on the consumer does not exceed the amount originally disclosed. The general rule provides that an estimated closing cost disclosed **is not in good faith** if the charge paid by or imposed on the consumer exceeds the amount originally disclosed on the Loan Estimate.²²

Although TILA provides some exceptions to the TRID general rule,²³ the charges that are subject to no variance for change after disclosure include, but are not limited to, the following:

- Fees paid to the creditor
- Fees paid to a mortgage broker
- Fees paid to an affiliate of the creditor or a mortgage broker
- 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
- Transfer taxes

Fees “paid by or imposed on the Consumer”

Per TILA, a charge “paid by or imposed on the consumer” refers to the final amount for the charge paid by or imposed on the consumer at consummation or settlement, whichever is later.

For example, at consummation, the consumer pays the creditor \$100 for recording fees. The settlement of the transaction concludes five days after consummation, and the actual recording fees are \$70. The creditor refunds the consumer \$30 immediately after recording. The recording fee paid by and disclosed to the consumer is \$70.²⁴

Fees “paid to” a Person

Per TILA, a fee is not considered “paid to” a person if the person does not retain the fee.

For example, if a consumer pays the creditor transfer taxes and recording fees at the real estate closing and the creditor subsequently uses those funds to pay the county that imposed these charges, then the transfer taxes and recording fees are not “paid to” the creditor. The fees are paid to government agencies.

Similarly, if a consumer pays the creditor an appraisal fee in advance of the real estate closing and the creditor subsequently uses those funds to pay another party for an appraisal, then the appraisal fee is not “paid to” the creditor. The fee is paid to the appraiser.

A fee is also not considered “paid to” a person if the person retains the fee as reimbursement for an amount it has already paid to another party. If a creditor pays for an appraisal in advance of the real estate closing and the consumer pays the creditor an appraisal fee at the real estate closing, then the fee is not “paid to” the creditor even though the creditor retains the fee, because the payment is a reimbursement for an amount already paid to a third-party.²⁵

In our MMC examination findings, the issue was that the borrower was charged twice for the appraisal fee, but the appraiser was not paid twice for the appraisal. The retention of the appraisal fee by the lender increases their origination costs of the loan which has a zero tolerance for change. Even if the appraiser were paid twice, it would be the lender that would need to retrieve the over payment and provide the funds to the borrower within the TILA required timeframe. It would not be acceptable for the lender to make the borrower collect their fee from the appraiser or wait for the

²² TILA 12 C.F.R. §1026.19(e)(3)(i)

²³ TILA 12 C.F.R. §1026.19(e)(3)(ii) and (iii)

²⁴ TILA 12 C.F.R. §1026.19(e)

²⁵ TILA 12 C.F.R. §1026.19(e)

appraiser to reimburse them to make the payment to the borrower. The responsibility for TILA compliance stays with the funding lender.

Lender Credits

The disclosure of “lender credits” represents the sum of non-specific lender credits and specific lender credits. Non-specific lender credits are generalized payments from the creditor to the consumer that do not pay for a particular fee on the TRID disclosures. Specific lender credits are specific payments, such as credit, rebate, or reimbursement, from a creditor to the consumer to pay for a specific fee. Often this may be the lender paying for the appraisal when the loan closes as an incentive to borrowers to use their services.

Non-specific lender credits and specific lender credits are negative charges to the consumer. The actual total amount of lender credits, whether specific or non-specific, provided by the creditor that is less than the estimated “lender credits” identified and disclosed is an increased charge to the consumer for purposes of determining good faith.

For example, if the creditor discloses a \$750 estimate for “lender credits”, but only \$500 of lender credits is actually provided to the consumer, the creditor has not complied with TILA regulation Z because the actual amount of lender credits provided is less than the estimated “lender credits” disclosed on TRID disclosures. Therefore, the difference is an increased charge to the consumer for purposes of determining good faith.

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

However, if the creditor discloses a \$750 estimate for “lender credits” to cover the cost of a \$750 appraisal fee but subsequently reduces the credit by \$50 because the appraisal fee was only \$700 a decrease by \$50, then the requirements have been violated because, although the amount of the appraisal fee decreased, the amount of the lender credit decreased. This does not benefit the borrower.²⁶

Lender Credits Good Faith Analysis

For purposes of conducting the good faith analysis required for lender credits, the total amount of lender credits, whether specific or non-specific, actually provided to the consumer is compared to the amount of the “lender credits” disclosed on the TRID disclosures. The total amount of lender credits actually provided to the consumer is determined by aggregating the amount of the “lender credits” with the amounts paid by the creditor that are attributable to a specific loan cost or other cost disclosed.²⁷

Unrounded Numbers

TILA requires that the dollar amounts of certain charges disclosed on the Loan Estimate and Closing Disclosure should be rounded to the nearest whole dollar. However, to conduct the good faith analysis required, the creditor should use unrounded numbers to compare the actual charge paid by or imposed on the consumer for a settlement service with the estimated cost of the service.²⁸

²⁶ TILA 12 C.F.R. §1026.37(g)(6)(ii) and § 1026.19(e)(1)(i)

²⁷ TILA 12 C.F.R. §1026.19(e)(3)(i)

²⁸ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-3-i-Interp-6>

Consummation

The standard state government definition of consummation means the time that a consumer becomes contractually obligated to a credit transaction.²⁹ CFPB official interpretations cover how to manage state laws that may conflict with TILA regulations.

State Law Governs

When a contractual obligation on the consumer's part is created it is a matter to be determined under applicable law. Regulation Z does not make this determination.

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

Credit v. Sale

Consummation does not occur when the consumer becomes contractually committed to a sale transaction unless the consumer also becomes legally obligated to accept a particular credit arrangement.

For example, when a consumer pays a nonrefundable deposit to purchase an automobile, a purchase contract may be created, but consummation for purposes of the regulation does not occur unless the consumer also contracts for financing at that time.³⁰

Settlement

Regulation Z definition of settlement means the process of executing legally binding documents regarding a lien on property that is subject to a federally related mortgage loan. This process may also be called “closing” or “escrow” in different jurisdictions.³¹

EXAMINATION FINDINGS #3

Inaccurate Loan Estimates

The MMC examination identified the creditor failed to disclose accurate information by not properly completing the information required on the Loan Estimate (LE). The loan estimate provided inaccurate and incomplete information to the borrower. The LE is not just a disclosure of the fees, but disclosure of all the terms of the loan transaction.

The LE provides a section the creditor completes to identify if the interest rate is locked or not, and if locked, the terms of the lock period. In addition, the LE must provide the borrower with a statement detailing any charge that may be imposed for a late payment, and the number of days that the payment may be late before it triggers a late payment fee.

Rate Lock

Is defined as a statement of whether the interest rate disclosed is locked for a specific period of time, labeled “Rate Lock.”

For transactions in which the interest rate is locked for a specific period of time, the creditor must provide the date and time (including the applicable time zone) when that period ends.

²⁹ TILA 12 C.F.R. §1026.2(a)(13)

³⁰ <https://www.consumerfinance.gov/rules-policy/regulations/1026/interp-2/#2-a-13-Interp>

³¹ <https://www.consumerfinance.gov/rules-policy/regulations/1024/2/#b-27>

The “Rate Lock” statement required must be accompanied by a statement that the interest rate, any points, and any lender credits may change unless the interest rate has been locked, and the date and time (including the applicable time zone) at which estimated closing costs expire.³²

Interest Rate

In compliance with TILA, the interest rate is locked for a specific period of time if the creditor has agreed to extend credit to the consumer at a given rate, subject to contingencies that are described in any rate lock agreement between the creditor and consumer.³³

Expiration Date

If the loan is locked the LE must disclose the date the interest rate lock period will expire.

Time Zone

TRID disclosures require the applicable time zone for all times provided, as determined by the creditor.

For example, if the creditor is located in New York and determines that the Loan Estimate will expire at 5:00 p.m. in the time zone applicable to its location, the disclosure must include a reference to the Eastern time zone. For example, 5:00 p.m. EST.

Expiration of Loan Estimate Fees

The creditor is bound by the initial fees disclosed in the loan estimate until closing, when the consumer indicates an intent to proceed with the transaction within ten business days of disclosures. If the borrower takes more than ten business days after the disclosures were delivered, the creditor may change the fees disclosed without limitations of the TILA variances. The closing costs disclosed have expired according to TILA.

However, the lender at their discretion may accept the LE and honor all fees quoted after ten days. Alternatively, after 10 business days, the creditor may issue New LE to the borrower with accurate fees and new TILA timing period starting upon delivery of disclosures to the borrower.

Delayed Settlement Date - Construction Loan

In transactions involving new construction, where the creditor reasonably expects that settlement will occur more than 60 days after the initial disclosures required are provided, the creditor may provide revised disclosures to the consumer if the original disclosures stated **clearly and conspicuously** that at any time prior to 60 days before consummation, the creditor may issue revised disclosures. If no such statement is provided on the initial Loan Estimate, the creditor may not issue revised disclosures regardless of the length of time to build the home, except as allowed by a change of circumstance.³⁴

Comparisons Section

Under the master heading, “Additional Information About This Loan” the borrower is provided information in a separate table under the heading “Comparisons” along with the statement “Use these measures to compare this loan with other loans”. The creditor must complete all the areas provided as follows:

³² <https://www.consumerfinance.gov/rules-policy/regulations/1026/37/#a-11-ii>

³³ TILA 12 C.F.R. §1026.37(a)(13)

³⁴ Official interpretation of 19(e)(3)(iv)(F) Delayed settlement date on a construction loan

- **In five years:** Using the label “In 5 Years” requires the creditor disclose the total principal, interest, mortgage insurance, and loan costs scheduled to be paid through the end of the 60th month after the due date of the first periodic payment, expressed as a dollar amount.
 - It must include the statement “Total you will have paid in principal, interest, mortgage insurance, and loan costs”; and
 - The principal scheduled to be paid through the end of the 60th month after the due date of the first periodic payment, expressed as a dollar amount, along with the statement “Principal you will have paid off.”
- **Annual percentage rate:** The “Annual Percentage Rate,” using that term and the abbreviation “APR” and expressed as a percentage, and the following statement: “Your costs over the loan term expressed as a rate. This is not your interest rate.”
- **Total interest percentage:** The total amount of interest that the consumer will pay over the life of the loan, expressed as a percentage of the amount of credit extended, using the term “Total Interest Percentage,” the abbreviation “TIP,” and the statement “The total amount of interest that you will pay over the loan term as a percentage of your loan amount.”
- **Late payment:** A statement detailing any charge that may be imposed for a late payment, stated as a dollar amount or percentage charge of the late payment amount, and the number of days that a payment must be late to trigger the late payment fee, labeled “Late Payment.”³⁵

For mortgage loans, TRID requires a disclosure of late payment charges which do not include:

- The right of acceleration
- Fees imposed on actual collection costs, such as repossession charges or attorney fees
- Referral and extension charges
- The continued accrual of simple interest at the contract rate after the payment due date

Applicability of State Law

Many State laws authorize the calculation of late charges as either a percentage of the delinquent payment amount or a specified dollar amount and permit the imposition of the lesser or greater of the two calculations. The language provided in the disclosure may reflect the requirements and alternatives allowed under State law.³⁶

Committed to Loan Estimate

Once the consumer indicates an intent to proceed within the ten day time period specified by the creditor, the date and time at which estimated closing costs expire are left blank on any subsequent revised disclosures. The creditor at their discretion may extend the period of fees availability beyond the expired time disclosed. If the consumer indicates an intent to proceed within that longer time period, the date and time at which estimated closing costs expire are left blank on subsequent revised disclosures.³⁷

For transactions in which the interest rate is locked for a specific period of time, the creditor must provide the date and time (including the applicable time zone) when lock period ends.

Revised Disclosure with Corrections

Creditors are bound by the original Loan Estimate and must determine the estimate’s good faith by calculating the difference between the estimated charges originally provided and the actual charges paid by the consumer. Creditors may provide a revised Loan Estimate for informational purposes.

³⁵ <https://www.consumerfinance.gov/rules-policy/regulations/1026/37/#m-4>

³⁶ <https://www.consumerfinance.gov/rules-policy/regulations/1026/interp-37/#37-m-4-Interp>

³⁷ <https://www.consumerfinance.gov/rules-policy/regulations/1026/interp-37/#37-a-13-Interp>

Regardless of whether a creditor provides a revised Loan Estimate to reset tolerances or for informational purposes only, any disclosures on the revised Loan Estimate must be based on the best information reasonably available to the creditor at the time the revised disclosures are provided.³⁸

EXAMINATION FINDINGS #4

Charges Exceeded Allowable Variances & Timing Failure

The MMC examination found the creditor increased the appraisal fee and recording fee for a borrower without a valid change of circumstances.

In addition, the examiner found a failure to disclose within the required three business days a final inspection fee and the state tax charged to the borrower.

As previously discussed, the creditor is considered to have exercised good faith if the estimated closing costs provided in the initial TRID disclosures (Loan Estimate) do not exceed the final amount disclosed on CD. TILA provides certain fee changes after disclosure, but only if the fee change is allowable, and if the creditor provides a revised disclosure while documenting the loan file for the allowable reason for the change circumstance. Once the creditor is aware a fee will change or the fee will be added to the borrower's closing costs, it must provide a revised disclosure to the borrower within three business days.³⁹

Changed Circumstances Affecting Settlement Charges

A "changed circumstance" refers to a situation where information specific to the consumer or transaction that the lender relied on when providing the initial loan estimate was inaccurate or changed after the disclosures were provided. This change of circumstance allows the lender to issue a revised Loan Estimate with updated settlement charges. Some loans may have a significant, unforeseen event that impacts the cost of closing, creditors are allowed to adjust the estimated charges accordingly.⁴⁰

Per CFPB Official Interpretation, changed circumstance means:

- An extraordinary event beyond the control of any interested party or other unexpected event specific to the consumer or transaction
- Information specific to the consumer or transaction that the creditor relied upon when providing the disclosures required and that was inaccurate or changed after the disclosures were provided; or
- New information specific to the consumer or transaction that the creditor did not rely on when providing the original disclosures.⁴¹

Change Circumstance Limitations

Not all fees disclosed on the LE may be changed. Accuracy is mandatory when sending out TRID disclosures, as creditors are given limited ability to change the borrower's transaction fees after initial disclosure. Depending on the specific circumstances, the creditor may not charge more than the amounts disclosed on the LE. For certain charges, there are different tolerances when charges exceed the amounts disclosed.

³⁸ <https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/truth-in-lending-act/pub-ch-tila.pdf>

³⁹ TILA 12 CFR §1026.19(e)(3) and (4)

⁴⁰ TILA 12 CFR §1026.19(e)(3)(iv)(A)

⁴¹ Official interpretation of 19(e)(3)(iv)(A) Changed circumstance affecting settlement charges

Zero Tolerance

The zero tolerance for change charges include but are not limited to the following:

- Fees for required services paid to the creditor, mortgage broker, or an affiliate of either
- Fees paid to an unaffiliated third-party, the creditor did not permit the consumer to shop for the third-party service provider for settlement service or transfer taxes.⁴²

10% Cumulative Tolerance

Charges for third-party services and recording fees paid by or imposed on the consumer are grouped together and are subject to 10% cumulative tolerance. This means the creditor may charge the consumer more than the amount disclosed on the Loan Estimate for any of these charges so long as the total sum of the charges does not exceed the sum of all such charges disclosed on the Loan Estimate by more than 10%.

These charges are:

- Recording fees paid to record the mortgage (lien) and title transfer (deed). These fees must be noted as separate line items on the disclosure.
- Charges for required third-party services if:
 - The charge is not paid to the creditor or the creditor's affiliate; and
 - The consumer is permitted by the creditor to shop for the third-party service.

A changed circumstance that causes the initial estimated charges to increase or the fee added in this category, are allowable to a 10% variance limit which is determined by using the aggregate amount of such charges in this category and not an individual fee change. In this category of allowable fees, the fees may change or be added by the creditor provided the aggregate change does not increase by more than 10% from initial or revised disclosures.

Variances Without Tolerance Limits

Creditors may charge consumers more than the amount disclosed on the Loan Estimate without any tolerance limitation for allowable costs or terms, but only if the original estimated charge, or lack of an estimated charge for a particular service, was based on the best information reasonably available to the creditor at the time the disclosure was provided. These charges may be paid to the creditor or the creditor's affiliates as long as the charges are bona fide.⁴³

Unlimited change to charges is as follows:

- Prepaid interest, property insurance premiums, amounts placed into an escrow, impound, reserve, or similar account.
- Charges paid to third-party service providers for services required by the creditor if the creditor permits the consumer to shop and the consumer selects a third-party service provider not on the creditor's written list of service providers.
- Property taxes and other charges are paid to third-party service providers for services not required by the creditor.

For these type of charges, a creditor generally has no control over the cost to the consumer. The creditor needs to use a good faith best estimate until the actual cost is provided by the consumer or other party to the transaction chosen by the consumer without influence by the creditor.

⁴² TILA 12 CFR 1026.19(e)(3)(i), Comment 19(e)(3)(i)-1(i)-(iii))

⁴³ TILA 12 CFR 1026.19(e)(3)(iii)

Services Consumer May Shop For

In addition to the Loan Estimate, if the consumer is permitted to shop for a settlement service, the creditor, no later than three business days after receiving the application, must provide the consumer with a written list of settlement service providers for which the consumer can shop.

The settlement service provider list from the creditor must:

- Identify at least one available settlement service provider for each service; and
- State that the consumer may choose a different provider of that service.

Determining whether the charges for required services were disclosed in good faith will depend on whether the creditor permitted the consumer to shop for those services as documented in the loan file.⁴⁴

Changed Circumstance Affecting Eligibility

A creditor may find that a change circumstance may disqualify the borrower for the loan program they applied for. In this instance, the consumer becomes ineligible for an estimated charge previously disclosed because a changed circumstance affects the consumer's creditworthiness or the home value which is the security for the loan.

For example, the COVID-19 pandemic could be considered a changed circumstance that allowed creditors to use revised estimates of settlement charges when the consumer lost their job, and the lender changed the loan program for which they would now qualify.

Revisions Requested by the Consumer

The consumer requests revisions to the credit terms or the settlement that cause an estimated charge to increase or be added. A consumer request for change is outside the creditor's control. For example, the consumer requests to change their loan request to an FHA insured loan instead of a Fannie Mae conventional loan.

Interest Rate Dependent Charges

Often when the initial TRID disclosures are being provided, the mortgage loan rate is not locked. The Loan Estimate provided within three business days of application may be revised for an allowable change of circumstances when the borrower locks their interest rate. When the loan is locked, the points or lender credits may change from the initial disclosure. The creditor must provide the borrower with revised disclosures no later than three business days after the interest rate is locked. The revised Loan Estimate must disclose to the consumer the locked interest rate, any points charged for the rate, lender credits, and any other interest rate dependent charges and terms.

For example, the borrower may choose to pay discount points to buy their Note rate down.

Receipt of Revised Disclosures

With this examination finding, the creditor failed to disclose within the required three business days a final inspection fee and the state tax charged to the borrower. If a creditor uses a revised estimate for the purpose of determining good faith, the creditor must provide the required revised version of the disclosures reflecting the revised estimate within three business days of receiving information sufficient to establish that one of the reasons for allowable revision applies.⁴⁵

⁴⁴ <https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/truth-in-lending-act/pub-ch-tila.pdf>

⁴⁵ Official interpretation of 19(e)(4) Provision and receipt of revised disclosures

For example, upon the knowledge that loan approval will require a final inspection due to the appraiser requiring repairs, the creditor must provide a revised loan estimate within three business days of discovery that a final inspection fee will be needed to close the loan.

Actual Charge

The amount imposed upon the consumer for any settlements may not exceed the amount actually received by the settlement service provider. The creditor may not keep the amount collected from the borrower for a third-party fee, which exceeds the amount the creditor paid to the third-party vendor.⁴⁶

As discussed, if the error was discovered after closing the loan (consummation), the lender is required to reimburse the borrower the overcharged amount not paid to the intended third-party settlement service provider. The correction of an error after consummation must also be completed within TILA timing requirements.

As with this examination finding, the creditor charging an inspection fee or state tax charged without providing the borrower with a change of circumstances is a violation. The discovery of this fact after closing does not allow the creditor to correct the error after closing with just a change of circumstance revised disclosure. The creditor must also reimburse any mistakes in fees on the closing disclosure within the TILA timing requirements. The creditor is not allowed to bill the borrower for additional fees they failed to properly disclose and collect at closing.

EXAMINATION TOPIC #5

Loan File Support Documentation Missing

The MMC examination found the MMEs did not identify and document the loan file to support the amount the borrower was charged for a credit report. To ensure compliance, the loan file must provide supporting documentation for the fees charged to the borrower from third parties.⁴⁷

As discussed, the amount imposed upon the consumer for any settlement service may not exceed the amount actually received by the settlement service provider.⁴⁸ For TILA compliance, the creditor must document proof with copies of invoices and other paid receipts in their loan files to support the charge paid to the third-party provider disclosed on the CD.

EXAMINATION TOPIC #6

Closing Disclosure Timing Violation

The MMC examination found the creditors did not provide the loan closing disclosures within the TILA required timeframe. In a transaction subject to TILA, the creditor must provide the closing disclosures to the consumer no less than three business days prior to signing the closing documents (consummation).⁴⁹

Revised Loan Estimates and Closing Disclosures

The creditor may not provide a revised LE disclosure on or after the date on which the creditor provided the closing disclosure. The consumer must receive any revised version of the LE disclosure no later than four business days prior to consummation, to allow for the closing disclosure be provided no less than three-business day prior to closing.⁵⁰ When the closing disclosure has already

⁴⁶ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#285e7624c501a4cff1c3b3fc916d5ce61ddca06e99af4b022e5db2ae>

⁴⁷ TILA 12 CFR § 1026.19(f)(3)(i)

⁴⁸ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#285e7624c501a4cff1c3b3fc916d5ce61ddca06e99af4b022e5db2ae>

⁴⁹ TILA 12 CFR § 1026.19(f)(1)(ii)(A)

⁵⁰ Official interpretation of 19(e)(4)(ii) Relationship Between Revised Loan Estimates and Closing Disclosures

been provided to the borrower, the creditor must use a corrected closing disclosure to reset tolerances, not a revised LE.

TILA prohibits a creditor from providing a revised version of the loan estimate after the date the creditor has provided the borrower with the closing disclosure. If the creditor finds the need to correct a fee disclosed on the loan estimate as the loan approaches the closing stage, they will need to provide the borrower with a revised LE in compliance with TILA delivery requirements or disclose the fee correction on the closing disclosure within TILA tolerance requirements.

For example:

- If the creditor is scheduled to meet with the consumer and provide the TRID disclosures required on Wednesday, June 3, and the APR becomes inaccurate on Tuesday, June 2, the creditor complies with the requirements by providing the corrected LE disclosures to reflect the revised APR on Wednesday, June 3.
 - However, the creditor does not comply with the requirements if it provides both a revised version of the loan estimate disclosure reflecting the revised APR on Wednesday, June 3, and also provides the closing disclosures on Wednesday, June 3.
- If the creditor is scheduled to email the disclosures required to the consumer on Wednesday, June 3, and the consumer requests a change to the loan that would result in revised disclosures on Tuesday, June 2, the creditor complies with the requirements by providing the revised loan estimate disclosure with the changes on Wednesday, June 3.
 - However, the creditor does not comply with the requirements if it provides disclosures reflecting the consumer-requested changes using both the revised version of the loan estimate on Wednesday, June 3, and also the closing disclosure on Wednesday, June 3.⁵¹

Receipt of Disclosures

Mailing Disclosures

If any disclosures required are not provided to the consumer in person, the consumer is considered to have received the disclosures three business days after they are delivered or placed in the mail (mailing period). Creditors must have proof of receipt from the consumer to use less days than TILA requires for mailing.⁵²

E-Sign Act

The Electronic Consent and Signing Act (E-Sign Act's) provisions include the use of electronic records to provide disclosures in electronic format rather than written form. When it comes to the CFPB and the E-Sign Act, the key point for creditors is to:

- Document consumers are informed about their right to receive paper copies of documents and how to request.
- Clearly obtain electronic consent to use electronic signatures prior to e-signing.
- Maintain proper recordkeeping of electronically signed documents while adhering to the general principles of the E-Sign Act regarding validity of electronic signatures.

The E-Sign Act allows the issuance of electronic records to satisfy any statute or regulation requiring such information to be in writing and provided in a timely manner, provided the consumer has

⁵¹ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#19-e-4-ii-Interp-1-v>

⁵² TILA 12 CFR § 1026.19(e)(3)(iv)

previously agreed to accept the disclosures electronically. The use of the electronic signature provision must be a choice of the consumer.

Before consent for electronic disclosures is given, CFPB regulators require creditors to provide their consumer with the following information prior to obtaining an e-signature on TILA required documents.

- **Consumer Consent:** Clearly disclose to consumers that they are agreeing to receive documents electronically and explain the consequences of withdrawing consent.
- **Access to Electronic Records:** Provide consumers with the necessary hardware and software information to access and retain electronic records. Electronic records of compliance with TILA must be readily available for examiner reviews.
- **Opt-Out Provision:** Allow consumers to opt-out of receiving documents electronically if they wish to receive paper copies. The consumer may choose to obtain all documents in writing and sign them with a pen. In that instance, the creditor would use the mailing timeframe to determine TILA timing compliance.
- **Delivery Service:** CFPB does allow delivery services faster than mail if the creditor needs to expedite the mailing timeframe. The delivery service proof of delivery receipt documented in the loan file will meet the TILA proof of receipt.
- **Record Retention:** Maintain electronic records in a format that accurately reproduces the original information and complies with applicable record retention periods.
- **Signature Attribution:** The consumer must consent electronically or confirm consent in a manner that “reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent.”⁵³

Consumer's Waiver of Waiting Period

If the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency, the consumer may modify or waive the three-business-day waiting period, after receiving the disclosures required. To modify or waive the waiting period, the consumer may give the creditor a dated written statement that describes the emergency, specifically modifies, or waives the waiting period, and bears the signature of all consumers who are primarily liable on the legal obligation. Pre-printed forms for this purpose are prohibited.⁵⁴

EXAMINATION FINDINGS #7 & #8

Failure to Document TILA Corrections

The MMC examination found the creditors loan files failed to provide sufficient evidence to show a corrected Closing Disclosure and refund was issued to consumer within TILA 60 days of consummation requirement. It was noted by the examiner that there was a failure to clearly document how the creditor corrected the TILA violations. Loan file documentation must be clear and support the evidence of compliance.

For example, the loan file documentation may include an invoice, corrected closing disclosure, proof of correction or refunds sent to the borrower with explanation letter.

For example, during the MMC examination, on one loan, two invoices were billed to the borrower for \$900 for an initial appraisal and \$200 for supplemental appraisal review. The consumer was charged \$1,300 on the final Closing Disclosure. The loan file did not provide evidence of the correction to

⁵³ <https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/documents/10/x-3-1.pdf>

⁵⁴ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#f-1-iv>

refund the overcharge of \$200. The total amount charged to the consumer \$1300 – less \$900 and \$200 appraisal invoices paid to the appraiser (\$1100 total). The creditor needs to document the loan file that \$200 overcharge was provided to the borrower along with a corrected closing disclosure.

In addition, the examiner found some refunds were provided more than 60 days after consummation.

Finding #8. Other examination findings showed some files failed to provide evidence of the corrected Closing Disclosure and/or refund to the borrower within the 60-day timing requirement after consummation. Loan files were unclear if the borrower received the required refund for the overpayment of recording fees.

Refunds Related to the Good Faith Analysis

If the amounts paid by the consumer at closing exceed the amounts disclosed by more than the applicable tolerance threshold, the creditor must provide a corrected CD and provide a cure for a tolerance violation no later than 60 calendar days after consummation. The refund need not be in the form of a cash refund to the consumer.

Loan files must contain documentation of their findings and actions so that the creditor is in compliance. If the credit finds the amounts paid by the consumer exceed the amounts specified on the disclosures provided, the creditor must identify the CD error within 30 days of consummation and notify the borrower of correction and receipt of the refund no later than 60 days after consummation as required for TILA compliance. This 60-day period is termed a 'cure period' to comply with TILA.⁵⁵

EXAMINATION FINDINGS #9

The MMC examination found the creditors loans where the recording fees were incorrectly disclosed as seller-paid at closing on the consumer's final CD.

In addition, there was a failure to disclose the transfer tax on the final CD provided to the borrowers.

Closing Cost Details

Under the master heading "Closing Cost Details" on the closing disclosure, columns are provided to state whether the charge was borrower-paid at or before closing, seller-paid at or before closing, or paid by others, all costs in connection with the transaction. This information provides the consumer with the total costs charged and if they are obligated to pay for the fee and when the fee will be collected. What party in the transaction and when they will pay the fees are important to balance the transaction, and ensure all fees required in the APR are included.

Taxes and Other Government Fees

On the closing disclosure, under the subheading "Taxes and Other Government Fees," is an itemization of each amount that is expected to be paid to State and local governments for taxes and government fees. In addition, the disclosure informs the borrower of the total of all such itemized amounts that are designated borrower-paid at or before closing, as follows:

On the first line:

- Beneath the column's descriptions, the total amount of fees for recording deeds and separately, the total amount of fees for recording security instruments.
- In the applicable column, the total amounts paid for recording fees.

⁵⁵ <https://www.consumerfinance.gov/rules-policy/regulations/1026/19/#f-2-iv>

The creditor must disclose the total fees expected to be paid to the State and local governments for recording deeds and provide separate line item on the closing disclosure for each amount paid to State and local governments for recording security instruments and deeds. On the lines the fees should be labeled “Recording Fees” with the additional labels “Deed” and “Mortgage,” respectively. Identification of fees on the disclosures should be clear and conspicuous. TILA does not allow the recording fees for the deed and mortgage to be lumped together as bulk total of “Recording Fees.”

Transfer Taxes

The creditor may itemize the transfer taxes paid on as many lines as necessary in order to disclose all of the transfer taxes paid as part of the transaction. The taxes should be allocated in the applicable columns such as borrower-paid at or before closing, seller-paid at or before closing, or paid by others, as provided by State or local law, the terms of the legal obligation, or the real estate purchase contract. The creditor must provide the name of the government entity assessing the transfer tax.⁵⁶ As a reminder, transfer taxes are in the no tolerance for change category.

EXAMINATION FINDINGS #10

Failure to Disclose APR in Advertisement

The MCC Examination found the creditor’s advertisement did not comply with TILA advertising requirements. The advertisement provided an interest rate of a finance charge without stating the annual percentage rate. TILA is clear on the requirement for a creditor that advertises an interest rate. The creditor must provide the APR in similar or larger font than the interest rate advertised.

For example, if the interest rate is in font size 16, the APR must be in font size 16 or larger, and not font size 9 hidden in the bottom of the advertisement or not provided at all.⁵⁷

TILA Disclosure Requirements for Advertisements

TILA promotes informed use of consumer credit. To meet this requirement, TILA has requirements for creditors that solicit home loan borrowers. The regulations were designed to stop the ‘bait and switch’ advertising that was plaguing the industry before these TILA regulations.

Annual Percentage Rate

The annual percentage rate or APR is the cost of financing expressed as an annual rate. This rate reflects all the lenders’ credit and finance charges to show the effective rate for the loan. With these factors, the higher the APR the higher the costs for the consumer. A borrower is encouraged to compare loan offers with the APR being used to determine which loan has the overall lower costs for them without the need to understand all the fees disclosed on the Loan Estimate.

Unlike the transactional disclosure of an annual percentage rate, the advertised annual percentage rate need not include a descriptive explanation of the term and may be expressed using the abbreviation APR. The advertisement must state that the rate is subject to increase after consummation if that is the case, but the advertisement need not describe the rate increase, its limits, or how it would affect the payment schedule.

Actual Available Terms

If an advertisement for credit states specific credit terms, it shall state only those terms that actually are or will be arranged or offered by the creditor.

⁵⁶ <https://www.consumerfinance.gov/rules-policy/regulations/1026/38/#g-1-i-A>

⁵⁷ TILA 12 CFR § 1026.24(c)

For example, the creditor may not advertise they offer a low cost, low payment zero down home loan; when the real scenario is for a first and second mortgage loan that requires double closing costs. The closing costs for closing a first and second mortgage are higher than a loan with only a first mortgage that required 3% down payment. In addition, the borrower's monthly payment may be higher, not lower due to the second mortgage payment required at a higher interest rate than the first mortgage. The claim was not factual, but misleading.

Clear and Conspicuous Standard

TILA requires all TRID disclosures to be made clearly and conspicuously. The loan estimate and closing disclosure require the creditor to be clear on the terms of the loan by providing sections that must be completed to inform the consumer of the type of loan they are obtaining and the repayment terms of such loan. TILA requires the same with advertising of the loan programs available to consumers.

Advertisement of Finance Charge

If an advertisement states a rate of finance charge (interest rate that will be on the Promissory Note), it must also state the rate as an "annual percentage rate," using that term or APR. If the annual percentage rate may be increased after consummation, the advertisement must state that fact.

Whether the advertiser provides the interest rate is not a requirement for TILA compliance. If the creditor advertises the interest rate, it must then disclose the APR is the requirement.⁵⁸

Simple or Periodic Rates

The creditor's advertisement for credit secured by a dwelling may not state a periodic rate, other than a simple annual rate, which is applied to an unpaid balance.

For example, a simple annual interest rate may be shown in the same font type and size as the annual percentage rate for the advertised credit. A simple annual rate or periodic rate that is applied to an unpaid balance is the rate at which interest is accrued. Those terms do not include a rate lower than the rate at which interest is accruing, such as an effective rate, payment rate, or qualifying rate.

Buydowns

When a third party (such as a seller) or a creditor wishes to promote the availability of reduced interest rates, the advertised annual percentage rate must be determined in accordance with CFPB interpretations regarding the basis of transactional disclosures for buydowns. The seller or creditor may advertise the reduced simple interest rate, provided the advertisement shows the limited term to which the reduced rate applies and states the simple interest rate applicable to the balance of the term. The advertisement may also show the effect of the buydown agreement on the payment schedule for the buydown period, but this will trigger additional disclosures under TILA.⁵⁹

Discounted Variable-Rate Transactions

The advertised APR for discounted variable-rate transactions must be determined in accordance with TILA regarding the basis of transactional disclosures for such financing.

- A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced simple annual rate, provided the advertisement shows with equal prominence and in close proximity the limited term to which the reduced rate applies and the annual percentage rate that will apply after the term of the initial rate reduction expires.

⁵⁸ <https://www.consumerfinance.gov/rules-policy/regulations/1026/24/#b>

⁵⁹ CFPB commentary to § 1026.17(c)

- Limits or caps on periodic rate or payment adjustments need not be stated. For a buydown example, the fact that the rate is presumed to be 10% in the second year and 11% for the remaining 28 years need not be included in the advertisement.
- The advertisement may also show the effect of the discount on the payment schedule for the discount period, but this will trigger additional disclosures under TILA.⁶⁰

MORTGAGE ADVERTISING REGULATIONS - TILA & MAP

The Truth in Lending Act (TILA) and the Mortgage Acts and Practices (MAP) Rules are the primary federal regulations for mortgage company advertising requirements. These regulations prohibit misleading advertising for financial products.

TILA Advertising Trigger Terms

TILA focuses on certain prohibited acts or practices in advertisements for loans secured by a dwelling. Some loan terms used in the advertisement may require additional TILA disclosures. These terms are called Trigger Terms. TILA trigger terms require lenders to clearly disclose the credit terms and rates in a specific way when advertising directly to consumers. These provisions apply even if the triggering term is not stated explicitly but may be readily determined by the advertisement.

For example, an advertisement may state “80% financing available,” which is in fact indicating that a 20% downpayment is required.⁶¹ The down payment is a trigger term.

In addition, creditors can only advertise terms that are actually available for them to offer.

For example, loan terms that are only available for a limited time or will be available in the future are not acceptable to advertise as currently available.

Trigger Terms Defined

If any of the following terms are in an advertisement, or implied, the advertisement will need additional financing terms disclosed:

- The amount or percentage of any downpayment
- The number of payments or period of repayment
- The amount of any payment
- The amount of any finance charge

Additional Disclosures Required with Trigger Term

An advertisement stating any of the triggered terms must state the following terms, as applicable:

- The amount or percentage of the downpayment
- The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment
- The “annual percentage rate,” using that term, and if the rate may be increased after consummation, that fact

Catalogs, Multiple-page, and Electronic Advertisements

If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in

⁶⁰ <https://www.consumerfinance.gov/rules-policy/regulations/1026/24/#24-c-Interp-4-ii>

⁶¹ TILA 12 CFR §1026.24(d)(1)

sufficient detail to permit determination of the disclosures required, it shall be considered a single advertisement if:

- The table or schedule is clear and conspicuous; and
- Any statement of the credit terms appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

These type of advertisements comply if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

Television or Radio Advertisements

An advertisement made on television or radio stating any of the terms requiring additional disclosures may comply with either by:

- Stating clearly and conspicuously each of the additional disclosures required; or
- Stating clearly and conspicuously the information required and listing a toll-free telephone number along with a reference that such a number may be used by consumers to obtain additional cost information.

Examples of Prohibited Advertising

Advertising “Fixed” Rates and Payments

Using the word “fixed” when referring to rates, payments, or the credit transaction in an advertisement for a variable-rate transactions or other transactions where the payment will increase, requires the following terms:

- In the case of an advertisement solely for one or more variable-rate transactions, the phrase “Adjustable-Rate Mortgage,” “Variable-Rate Mortgage,” or “ARM” appears in the advertisement before the first use of the word “fixed” and it is at least as conspicuous as any use of the word “fixed” in the advertisement; and
- Each use of the word “fixed” to refer to a rate or payment is accompanied by an equally prominent and in close proximity a statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary, or the payment may increase after that period.

In the case of an advertisement solely for non-variable-rate transactions where the payment will increase (for example, a stepped-rate mortgage transaction with an initial lower payment), each use of the word “fixed” to refer to the payment must be accompanied by an equally prominent and in close proximity a statement of the time period for which the payment is fixed, and the fact that the payment will increase after that period.

In the case of an advertisement for both variable-rate transactions and non-variable-rate transactions, the phrase “Adjustable-Rate Mortgage,” “Variable-Rate Mortgage,” or “ARM” appears in the advertisement with equal prominence as any “fixed,” “Fixed-Rate Mortgage,” or similar terms used in the advertisement.

Government Endorsement Misrepresentations

Making any statement in an advertisement that the product offered is a “government loan program”, “government-supported loan”, or is otherwise endorsed or sponsored by any Federal, state, or local government entity, unless the advertisement is for an FHA loan, VA loan, or similar loan program that is, in fact, endorsed or sponsored by a Federal, state, or local government entity.

For example, mortgage bankers and brokers offer FHA insured loans, not FHA government loans. The government is not funding the loan for the borrower, merely insuring the loan when its guidelines are met, and the lender seeks FHA mortgage insurance.

Misleading Use of Current Lender's Name

The advertisement is misleading if it uses the name of the consumer's current lender in an advertisement that is not sent by or on behalf of the consumer's current lender, unless the advertisement:

- Discloses with equal prominence the name of the person or creditor making the advertisement; and
- Includes a clear and conspicuous statement that the person making the advertisement is not associated with, or acting on behalf of, the consumer's current lender.

Claims of Debt Elimination

Making any misleading claim in an advertisement that the mortgage product offered will eliminate debt or result in a waiver or forgiveness of a consumer's existing loan terms with, or obligations to, another creditor is prohibited. A mortgage loan merely replaces debt or lowers monthly payments, but it does not eliminate debt.

Use of the Term "Counselor"

Using the term "counselor" in an advertisement to refer to a for-profit mortgage broker or mortgage creditor, its employees, or persons working for the broker or creditor that participate in offering, originating, or selling mortgages is considered misleading and illegal.

Foreign Language Advertisements

An advertisement that provides information about some trigger terms or required disclosures in a foreign language but provide other required advertising disclosures in English would be considered misleading. Advertising must be clear and conspicuous to the consumer.

MAP RULES - REGULATION N

Mortgage Acts and Practices (MAP) Rules prohibit misrepresentations in commercial communications about mortgage products. This includes advertising rates that are lower than what the market will provide, failing to disclose the annual percentage rate, or omitting mandatory fee disclosures. The MAP Rules also applies to communications via email, text messages, and social media.

Some other MAP prohibited practices include:

- Misrepresenting the minimum down payment needed to qualify for a loan
- Suggesting that anyone can qualify for a mortgage, regardless of their financial situation
- Failing to disclose prepayment penalties
- Bait-and-switch tactics, such as luring consumers with introductory rates and then pressuring them into a less favorable loan

ADDITIONAL FEDERAL ADVERTISING LAWS-UDAP & UDAAP

Unfair or Deceptive Acts or Practices (UDAP)

The Unfair or Deceptive Acts or Practices rules refer to business practices that are considered misleading or harmful to consumers, often involving false advertising, misrepresentation of products or services, or other tactics that could cause substantial injury to customers that they cannot

reasonably avoid. It is primarily regulated by the Federal Trade Commission (FTC), but CFPB may enforce UDAP for lenders and mortgage professionals.

Unfair, Deceptive, or Abusive Acts and Practices (UDAAP)

Unfair, Deceptive, or Abusive Acts or Practices (UDAAPs) rules define what are illegal practices that can harm consumers, undermine the financial marketplace, and erode consumer confidence. The Dodd-Frank Act made these actions specifically illegal in the mortgage industry. The CFPB creates the rules for UDAAPs, and the CFPB and the Federal Trade Commission share enforcement and responsibilities for financial markets.

UDAAP prohibits actions that mislead, exploit, or harm consumers, often through unclear terms, deceptive marketing, or unfair treatment.

For banks, the Office of the Comptroller of the Currency (OCC) recently issued an updated version of the “Unfair or Deceptive Acts or Practices and Unfair, Deceptive, or Abusive Acts or Practices” booklet of the Comptroller’s Handbook, also known as the UDAAP booklet. The UDAAP booklet was last updated in June 2020.⁶²

CFPB ADVERTISING VIOLATION FINES

This law requires a creditor to disclose certain information in writing regarding the terms of a credit transaction. The two main types of TILA violations that can provide relief to borrowers when a creditor violates TILA are monies for damages and rescission.

Under TILA's statutory penalty provisions, a creditor can be liable to the consumer in an amount equal to twice the amount of the finance charge imposed with the amounts adjusted annually.⁶³ Annually, the CFPB in January issues a rule to adjust maximum penalty amounts under various statutes that it administers. Included among the adjustments are the amounts for the three tiers of civil money penalties that the CFPB may impose for violations of consumer financial protection laws under the Dodd Frank Act.

The Dodd Frank Act provided for the following tiers of civil money penalties:

- For any violation of a law, rule, or final order or condition imposed in writing by the CFPB, a civil money penalty of up to \$5,000 for each day during which such violation or failure to pay continues. For 2025, it has increased to \$7,217.
- For any person that recklessly engages in a violation of a federal consumer financial law, a civil penalty of up to \$25,000 for each day during which such violation continues. For 2025, it has increased to \$36,083.
- For any person that knowingly violates a federal consumer financial law, a civil penalty of up to \$1,000,000 for each day during which such violation continues. For 2025, it has increased to \$1,443,275.⁶⁴

CFPB TILA Violation Fines

TILA requires lenders to provide consumers with clear and accurate information about the terms and costs of credit.

In 2024, the CFPB fined a mortgage company \$2.25 million for misrepresenting payment terms on VA cash-out refinance mortgage loans.

⁶² <https://www.occ.treas.gov/news-issuances/bulletins/2024/bulletin-2024-33.html>

⁶³ 15 U.S.C. Section 1640(2)(a)

⁶⁴ <https://www.consumerfinancemonitor.com/2025/01/08/cfpb-adjusts-various-penalty-amounts-based-on-inflation-2/>

In 2023, the CFPB fined a mortgage company \$1 million and permanently banned it from mortgage lending for repeatedly sending advertisements to military families that implied the company was affiliated with the US government. This is misleading and deceptive advertising.

In 2020, the CFPB fined a California-based mortgage company \$150,000 for sending misleading or deceptive mailers about VA-guaranteed mortgage loans to over 700,000 consumers which included U.S. service members and veterans.

Module 2 - Ethics

Ethics Lesson Objective

The student will review the challenges our mortgage industry faces to comply with consumer protection laws while it implements artificial intelligence technologies. The lesson will review AI rules being updated, and the course will review the current challenges for AI compliance with the Gramm-Leach-Bliley Act, Equal Credit Opportunity Act, Truth-in-Lending Act, the Fair Housing Act, and other federal regulations.

ETHICAL COMPLIANCE IN AN AI MARKETPLACE

The subject of ethics is taught in most industries that work with the public. The topic of ethics is a mandatory topic for the annual mortgage licensing education since the enacted legislation the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) required the topic.

For licensed mortgage originators, ethical behavior and habits become an everyday part of their business of residential loan origination. As we see the industry expanding with online mortgage companies, the personal touch in mortgage lending is becoming outdated. Most borrowers today are computer savvy and prefer to complete the loan application online on their own time and pace.

The large online lenders focus on speed with minimal staff who communicate with their clients primarily by email and text. The mortgage loan originator becomes a document processor unlike the mortgage loan originator of the past that would build a rapport and convert the client into a referral partner for long-term client retention. Customer loyalty has faded with the consumer now trained to do online searches for everything a person wants and can get, rather than asking a friend for a referral to a specialist.

The American Bankers Association (ABA) has stated, “with recent advancements in AI, we will soon see 95+% of all loan decisions being made without human intervention and completed by AI.”⁶⁵ With this prediction, mortgage loan originators that can generate a flow of business will be in demand by the few mortgage lenders that will continue to appreciate the human touch in mortgage lending.

Mortgage ethics calls for small and large mortgage lenders to protect their clients against fraud, misrepresentation or unethical procedure or practices. The mortgage lender must adopt policies to ensure that privacy standards are met and avoid errors and misrepresentations of any loan terms or pertinent facts.

What procedures for compliance have you implemented to ensure the person on the phone or online is the person on the ID provided? With Artificial Intelligence (AI), mortgage loan originators are in a precarious position to ensure their clients are not fraudsters. The person may be using AI to impersonate another person. They could even be in a different country.

AI LEARNING ABILITIES

While AI has long managed routine tasks such as data analysis and loan processing with bar codes added to the mortgage forms in the 1990's, the more complex tasks that require human judgement and empathy remain challenging for Artificial Intelligence. When automated underwriting started in the 1980's, it was thought that underwriters would lose their jobs to Fannie Mae Desktop Underwriter (DU) and Freddie Mac Loan Prospector (LP).

⁶⁵ <https://www.aba.com/news-research/analysis-guides/empathetic-lending-in-an-era-of-artificial-intelligence-and-automation#:~:text=However%2C%20with%20recent%20advancements%20in,as%20underwriting%20and%20fraud%20detection.>

Decades later, the use of AI helps to make credit decisions based on facts and not human bias, but AI has not replaced the knowledge of how to package a loan that an experienced underwriter will bring to the loan request. It is the underwriter's task to review the information used to make the automated credit decision properly documented in the loan file. The underwriter ensures all loan program and federal law requirements are met with clear and concise file documentation.

The AI or machine learning model can analyze a loan application, pull credit reports, verify income documentation, and even generate a suggested risk rating. However, at this time, approving or denying the loan or demanding conditions on the approval continue to require a human underwriter, loan originator, or loan processor.

If a particular function in the mortgage loan process could be done better or faster by adding one hundred extra trained staff, it is likely that AI can be used efficiently for that function.⁶⁶ This would be automation using AI.

It is important to distinguish between automation and AI, which is often confusing. Automation can significantly reduce the human effort needed to complete certain routine tasks, such as employment verification, property appraisals, and certain types of marketing. However, automation without AI is limited to the preprogrammed rules implemented by the computer developer of the automated process and relies on their knowledge for its effectiveness.

In its simplest form, AI combines computer science and refined datasets to enable problem solving. It rapidly provides for machine learning, deep learning, and natural language processing. These disciplines are composed of AI algorithms that seek to create expert systems to make predictions or classifications based on input data.

Deep learning uses artificial neural networks that loosely simulate the human brain to identify patterns in data or to predict outcomes. This will be useful technology for lenders to identify fraudulent behavior in their loan applicants.

Machine learning focuses on the development of computer algorithms that can learn and perform tasks without specific additional programming. Machine learning is increasingly being employed in algorithms throughout the mortgage industry. It is a branch of AI and computer science that focuses on the use of data and algorithms to imitate the way humans learn, gradually improving its accuracy.⁶⁷

AI COMPLIANCE

Lending guidelines and law compliance change frequently and often leave the lender to determine if and how they must change their procedures or AI to comply. With AI, the mortgage lender is dependent on computer programmers and AI third-party providers to quickly make the compliance changes needed in the analysis of the information supplied by the borrower.

The biggest improvement in the industry with using AI is to detect fraud. As would be expected, artificial intelligence has had a positive impact on the mortgage loan processes, especially in underwriting and fraud detection.

The Mortgage Brokers Association understands its member companies often rely on AI tools they do not own nor control in order to extend sustainable mortgage credit to low- and moderate-income families through the affordable housing programs. This includes AI tools developed or required by

⁶⁶ <https://www.forbes.com/councils/forbestechcouncil/2024/10/31/can-small-and-midsize-banks-survive-ai/#:~:text=AI%20allows%20banks%20to%20provide,than%206%25%20in%20three%20years.>

⁶⁷ <https://aws.amazon.com/blogs/industries/black-knight-continued-innovation-with-document-extraction-using-aws-machine-learning-capabilities/>

Fannie Mae, Freddie Mac, the Federal Housing Administration, the Department of Agriculture's Rural Housing Service, and the Veterans Administration's Loan Guarantee Program. Given the reliance on federal tools, it is vital that state policy makers continue to allow their federal counterparts to manage these AI systems and not create barriers for mortgage brokers to originate mortgage loans.⁶⁸

According to Mortgage Broker's Association, government agencies and developers have published risk management frameworks to help identify and manage the risks of AI.

For example, the National Institute of Standards and Technology published their Artificial Intelligence Risk Management Framework (NIST AI Framework), which is a resource for organizations designing, developing, deploying, or using AI systems to help them manage AI risks and promote trustworthy and responsible use of AI systems. Currently, this framework compliance is voluntary, but it is believed that lenders and developers that follow this accepted risk management framework should gain some protection for adhering to acceptable standards.⁶⁹

Some fair lending legislations may be hard to effectively manage compliance within AI systems. Mortgage lenders are subject to several fair and responsible lending laws and regulations.

- The Fair Housing Act prohibits discrimination in all aspects of residential real estate-related transactions based on race, color, religion, sex (including sexual orientation and gender identity), national origin, disability, and familial status.
- The Truth-in-Lending Act and Regulation Z govern the way credit terms are disclosed to consumers and include several provisions that address valuation independence in transactions when a consumer's home is securing the loan.
- The Fair Credit Reporting Act, similar to the Equal Credit Opportunity Act, requires creditors to provide an adverse action notice if their decision is based on information contained in a consumer credit report. FCRA allows consumers to dispute the completeness or accuracy of information in their credit report and requires that a credit reporting agency investigate this claim.
- Section 5 of the Federal Trade Commission Act prohibits unfair or deceptive acts or practices. All states also prohibit such acts or practices in their local legislation.
- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) prohibits engaging in unfair, deceptive, or abusive acts or practices.

Lenders are responsible to ensure all employees and AI systems used are in compliance with all fair lending regulations and document their efforts for compliance and any failures. With the expense of a robust AI system, many lenders rely on large companies that offer AI services. Time will tell if these AI systems violate fair lending laws, even if indirectly, who will be held liable to the consumer. The lender relying on the larger company or the larger company that sold they were in compliance.

AI POTENTIAL FOR DISCRIMINATION

A concern for industry regulators found initial training and learning models of AI can introduce elements of bias that could lead to discrimination against certain demographic groups or lending areas. Automation is only as useful as the programming information put into it. If the AI is not current, a wrong decision on a loan file may be made. A borrower that should have qualified may be wrongly declined. If this programming error negatively impacts a protected class of borrowers under fair lending laws, it may lead to a pattern and practice of discrimination which carries costly penalties.

⁶⁸ <https://www.mba.org/advocacy-and-policy/residential-policy-issues/State-Artificial-Intelligence-Law-and-the-Real-Estate-Finance-Industry>

⁶⁹ https://www.mba.org/docs/default-source/policy/27251-mba-policy-state-ai-report.pdf?sfvrsn=e4ba9b49_1

This potential biased input has led to new regulations governing the use of AI in decision making, the US AI Bill of Rights. The AI Bill of Rights is intended to support the development of policies and practices that protect civil rights and promote democratic values in the deployment and governance of automated systems. To achieve this, a Blueprint was provided that sets out five principles to mitigate potential risks, such as algorithmic discrimination.⁷⁰

Multiple regulators have asserted that financial institutions must retain responsibility to comply with applicable laws and regulations for technologies it uses. CFPB issued guidance about certain legal requirements that lenders must adhere to when using AI and other complex models. The guidelines describe how lenders must use specific and accurate reasons when taking adverse actions against consumers. This means that creditors cannot simply use CFPB sample adverse action forms and checklists if they do not reflect the actual reason for the denial of credit or a change of credit conditions. This requirement is especially important with the growth of advanced algorithms and personal consumer data in credit underwriting. Explaining the reasons for adverse actions help improve consumers' chances for future credit and protect consumers from illegal discrimination.

"Technology marketed as artificial intelligence is expanding the data used for lending decisions and also growing the list of potential reasons for why credit is denied," said CFPB Director Rohit Chopra. "Creditors must be able to specifically explain their reasons for denial. There is no special exemption for artificial intelligence."⁷¹

STATE AI LEGISLATION

Additional AI state legislation will affect Lenders in that specific state, requiring them to stay aware of AI related changes in federal regulations and state level legislation. States are looking closely at state-level AI regulation initiatives in jurisdictions.⁷²

According to the Mortgage Brokers Association, the following is the activity in State Artificial Intelligence Legislation as of the end of 2024:

- November 22, 2024: **California's** Consumer Privacy Protection Agency (CPPA) published proposed regulations regarding cybersecurity and automated decision-making technology (ADMT). Comments are due January 14th, 2025.⁷³
- November 2024: **MBA releases** AI in the Mortgage Industry Report to explore the current use of artificial intelligence in the mortgage industry and outline principles for lawmakers.
- October 28, 2024: **Texas** releases draft legislative text for the Texas Responsible Artificial Intelligence Governance Act (TRAIGA) to be introduced in the 2025 legislative session.⁷⁴
- October 2024: *The Critical Role of State Regulators in Shaping AI Policy for the Mortgage Industry*, from the American Association of Residential Mortgage Regulator's quarterly newsletter, by MBA's Liz Facemire, MBA Director of State Government Affairs,
- August 31, 2024: Due to remaining opposition and the end of session, **California** AB 2930 was withheld from a final vote and did not pass. California is likely to pick this issue up next year.
- August 28, 2024: **Montana** pre-files title only legislation, LC 68, Establishing Consumer Protections related to artificial intelligence, awaiting full legislative text.⁷⁵

⁷⁰ <https://www.whitehouse.gov/ostp/ai-bill-of-rights/>

⁷¹ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-guidance-on-credit-denials-by-lenders-using-artificial-intelligence/>

⁷² <https://www.mba.org/advocacy-and-policy/residential-policy-issues/State-Artificial-Intelligence-Law-and-the-Real-Estate-Finance-Industry>

⁷³ https://cppa.ca.gov/regulations/ccpa_updates.html

⁷⁴ https://www.mba.org/docs/default-source/policy/state-relations/draft_texas-ai_10.28.24.pdf?sfvrsn=9f83267e_1

⁷⁵ <https://bills.legmt.gov/#/lc/bill/2/LC0068>

- August 15, 2024: **California** Senate Appropriations Committee passes AB 2930 after amending the bill. These amendments limited the scope of the bill to only employment related decisions (hiring/firing, pay, promotion, etc.) no longer include mortgage transaction decision technology.⁷⁶
- May 17, 2024: **Colorado** Governor Jared Polis signs first in the nation legislation to regulate artificial intelligence - *Consumer Protections for Artificial Intelligence*. You may read Governor Polis' signing statement expressing his reservations but also urging changes to the language before the February 1, 2026, effective date.
- May 16, 2024: MBA and the **Colorado** Mortgage Lenders Association send a veto request to Governor Polis noting that SB 24-205 fails to consider the totality of the real estate finance system.
- May 6 & 7, 2024: The General Counsel of the Federal Housing Finance Agency writes to the governors and legislative leaders of **Connecticut and Colorado** to express FHFA's regulatory authority over Fannie Mae and Freddie Mac and also explained the GSEs' underwriting tools used by mortgage lenders.
- April 24, 2024: MBA background memorandum to the **Connecticut** Mortgage Bankers Association on industry use of artificial intelligence.
- April 9, 2024: MBA and **California** MBA sent coalition letters with CA Bankers, CA Community Banking Network, and CA Credit Union League expressing opposition to AB 2930.
- March 22, 2024: **Rhode Island** introduces SB 2888, which would require risk assessments on certain high-risk artificial intelligence systems.
- March 18, 2024: **Washington** enacts AI Task Force bill, SB 5838, by request of the Attorney General. SB 5838 allows the task force to return with recommendations on legislation to regulate artificial intelligence.
- March 7, 2024: **New York** introduces S8755 to create a New York Artificial Intelligence Commission, the Commission would provide ethical standards for businesses operating in New York.⁷⁷
- February 27, 2024: MBA's comments to a working session of the **Washington** House of Representative's Consumer Protection and Business Committee regarding the industry's use of automated valuation models and property data collectors.
- February 15, 2024: **California** introduces AB 2930, related to the use of automated decision tools - including an opt-out provision.
- February 9, 2024: **Illinois** introduces HB 5322, which would create the *Illinois Commercial Algorithmic Impact Assessments Act*⁷⁸
- February 8, 2024: **Illinois** introduces HB 5116, the *Automated Decision Tools Act*⁷⁹
- February 7, 2024: **Connecticut** proposes SB 2, *An Act Concerning Artificial Intelligence*
- February 7, 2024: **Rhode Island** introduces H 7521, creating requirements for developers and deployers of artificial intelligence with a private right of action.⁸⁰
- February 5, 2024: **Oklahoma** introduces HB 3835, the *Ethical Artificial Intelligence Act*
- January 31, 2024: **California** introduces AB 2013, related to artificial intelligence and training data transparency.

⁷⁶ https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=202320240AB2930

⁷⁷ <https://legislation.nysenate.gov/pdf/bills/2023/S8755>

⁷⁸ <https://www.ilga.gov/legislation/BillStatus.asp?DocNum=5322&GAID=17&DocTypeID=HB&SessionID=112&GA=103>

⁷⁹ <https://www.ilga.gov/legislation/BillStatus.asp?DocNum=5116&GAID=17&DocTypeID=HB&SessionID=112&GA=103>

⁸⁰ <https://webserver.rilegislature.gov/BillText/BillText24/HouseText24/H7521.pdf>

- January 19, 2024: **Hawaii** introduces SB 2524, which would prohibit algorithmic decision-making from utilizing algorithmic eligibility determinations in a discriminatory manner.⁸¹
- January 12, 2024: **New York** introduces S8209, a companion to the A8129, New York Artificial Intelligence Bill of Rights, introduced in October 2023.
- January 9, 2024: **Georgia** introduces HB 890, to protect against discrimination by artificial intelligence and automated decision tools.
- January 9, 2024: **Virginia** pre-files HB 747, Artificial Intelligence Developer Act
- January 9, 2024: **Vermont** introduces H 710 and H 711, creating oversight and liability standards for developers and deployers of high-risk artificial intelligence systems.
- December 28, 2023: MBA and **California** MBA send a coalition letter with California Bankers Association & California Credit Union League conveying concerns overdraft regulations under the California Privacy Protection Act relating to regulation of automated decision-making technology.
- December 14, 2023: **Washington** pre-files for introduction HB 1951, Promoting ethical artificial intelligence by protecting against algorithmic discrimination.
- October 9, 2023: MBA provides memorandum to the **Washington** Mortgage Bankers Association on the industry use of artificial intelligence and consideration of a draft proposed bill in the state.⁸²

It is more important than ever for mortgage professionals to engage with their local and national mortgage associations that are actively monitoring and lobbying for the best interest of mortgage loan professionals as a whole. These associations will also keep their members abreast of coming changes and prompt them to send letters to Washington representatives when needed to provide a collective voice to matters of importance to the mortgage industry.

ONLINE ETHICS

Online competition has never been stronger. Finding a client can be hard, and expecting client loyalty is outdated. Borrowers today go online to search for a lender and thinking of asking a friend or family member for a referral is an afterthought when the loan goes bad, and they cannot get a person on the phone to complain to.

With AI becoming common place, and mortgage loan originator (MLO) will likely not build a rapport with their online client. The MLO will need to do their best for the client and document the loan file to support the person they are working with is not a fraudster.

AI technology enables expedited loan processes and decision-making processes based on loan file data. Document processing and risk assessment automation may further enhance the mortgage lender's ability to maintain compliance and integrity.

These online MLOs will need to determine how they will mitigate fraud with the volume of loans they will be closing. With large volumes of loans, fraud often follows. If the lender's focus is on speed, it could cause a lapse in quality control and verification of loan file information. The lender's quality control department would then be challenged to increase their percentage of random file selections to identify any source of potential fraud.

AI DOCUMENT TECHNOLOGY

As a computer program, AI needs to be able to read the data provided by consumers. AI cannot read the document in the same manner as an MLO or underwriter. Over the years, industry has developed

⁸¹ https://www.capitol.hawaii.gov/sessions/session2024/bills/SB2524_.HTM

⁸² <https://www.mba.org/advocacy-and-policy/residential-policy-issues/State-Artificial-Intelligence-Law-and-the-Real-Estate-Finance-Industry>

methods to convert information for AI comprehension. Borrower loan applications use Uniform Loan Application Dataset (ULAD) information to interpret and make decisions on loan requests rapidly.

A popular lender AI application is automating the document verification process. Mortgage forms have bar codes for quick scanning. Optical Character Recognition (OCR) is a technology that converts images of text into machine-readable text. OCR software can be used to convert a physical document or image into an electronic version. This technology enhances and improves the loan process for handling important tasks. For example, AI will flag and question large deposits, unusual deductions on paystubs and find potential identity theft issues.

MISMO® developed a common language for exchanging information for the mortgage finance industry. The Mortgage Industry Standards Maintenance Organization (MISMO) coding is used for standardization of file information for AI recognition to speed processes and reduce costs. MISMO was developed by a not-for-profit wholly owned organization of the Mortgage Bankers Association. MISMO is the standards development body for the mortgage industry.⁸³

AI driven systems, equipped with Optical Character Recognition technology, can swiftly analyze MISMO data, and verify vast volumes of documents, including pay stubs, bank statements, and identification records.⁸⁴

LOAN APPLICATION AI

Artificial intelligence enhances workflows, and has rapidly changed how mortgages are processed, approved, and managed. The AI adjustment will come with some challenges, but also with rewards in greater efficiency, economy of scale, increased automated customer engagement, and achievable strategic success that can be measured.

As with the MLO's change in client interaction, so will small and mid-sized banks change. Once they boosted the value of local connections and superior friendly service. Now they will need to fight hard to stay relevant as customers prioritize seamless easy online experiences. Convenience of their time being a top priority for today's borrowers.⁸⁵

Programmers are creating intuitive AI interfaces that can be designed to enhance the relationship between homeowners and financial institutions by providing proactive, tailored support that adapts to each borrower's unique needs and circumstances. With the cost of originating a mortgage loan continuing to increase for lenders, the economic gains by using AI integrations are not being ignored.

MORTGAGE BROKERS AI

With the mortgage industry's pursuit of compliance and accuracy in the loans they purchase and funds, the push towards AI smart mortgage brokers is moving quickly. Wholesale lenders are using advanced AI algorithms and machine learning techniques that are designed to understand unique financial situations and preferences. This AI technology allows mortgage broker loan files to meet the online consumer demand in direct competition with other online lenders. Using AI benefits extends beyond mere time savings as new AI programs promise to deliver a previously unattainable level of accuracy in mortgage brokered home loan files.

⁸³ <https://www.mismo.org/>

⁸⁴ https://singlefamily.fanniemae.com/job-aid/loan-delivery/topic/mismo_data_xml.htm#:~:text=What%20This%20Report%20Represents:%20The,for%20selected%20pools%20or%20commitments.

⁸⁵ <https://www.forbes.com/councils/forbestechcouncil/2024/10/31/can-small-and-midsize-banks-survive-ai/#:~:text=AI%20allows%20banks%20to%20provide,than%206%25%20in%20three%20years.>

MORTGAGE LENDING AI

The unbeatable advantage of smaller banks used to be their local presence in their lending communities. There was a smaller community of influence and local client loyalty. The local loan officer went to the neighborhood church, coached your child's Little League team, or lived down the block from your family home. This puts them in a position to recognize financial needs and proactively guide their community toward useful products. But as consumer behavior moved online, customers shifted from relying on their local bank branches to relying on their smart phone's and google searches.

For smaller lenders, the cost and complexity to entering the AI mortgage marketplace can be out of reach. Local banks and lenders are working with larger banks and wholesale lenders that have embraced the use of AI technology. These funding sources provide access to AI and other software for smaller users to take advantage of and compete in the online market.⁸⁶

HOME APPRAISAL AI

For mortgage lenders and investors, the accuracy of the security's valuation is critical. Mortgage lenders use this valuation to determine how much they will lend on a property. Over the years, efforts have been made to use computer models to estimate a property's value. As these evaluation models grow in complexity to incorporate more variables, they can resemble what many people often refer to as artificial intelligence.

Recently, the CFPB approved a new rule to address the current and future applications of complex algorithms and artificial intelligence used to estimate the value of a home. Federal regulators, including the OCC, US Treasury, FDIC, NCUA, CFPB, and FHFA have finalized a rule increasing quality control standards for the deployment of automated valuation models (AVMs) used by mortgage originators and the secondary market.⁸⁷

While these computer models can provide critical insight for buyers, sellers, and lenders, they must not be inaccurate or discriminatory. It can be simple to think that computer models can take bias out of the equation, however, that will depend on how they are designed and tested.

CFPB explained the new rule requires companies that use these algorithmic appraisal tools need to put safeguards in place to ensure a high level of confidence in the home value estimates, protect against the manipulation of data, avoid conflicts of interest, and comply with applicable nondiscrimination laws.

The new appraisal rule is part of CFPB efforts to ensure that the appraisal systems are fair, nondiscriminatory, and free of conflicts of interest. The CFPB has been working to ensure that consumers can challenge an inaccurate appraisal, to fix the serious problems at The Appraisal Foundation, and to provide states with more tools to combat discriminatory appraisals. CFPB is also examining the growing power that appraisal management companies can wield over individual appraisal professionals.

The new appraisal rule is also another example of the CFPB's work to use existing laws on the books to police potential pitfalls when it comes to AI. CFPB terminated special legal immunities and favors to

⁸⁶ <https://www.cnbc.com/2024/04/13/its-not-just-wall-street-local-bank-branches-have-big-ai-ambitions.html#:~:text=Jackie%20Verkuy%2C%20chief%20administrative%20officer,their%20assigned%20point%20of%20contact.>

⁸⁷ https://www.mba.org/docs/default-source/policy/27251-mba-policy-state-ai-report.pdf?sfvrsn=e4ba9b49_1

AI companies and issued guidance and reports to make clear that there is no “fancy technology” exemption in our nation’s consumer financial protection and fair lending laws.⁸⁸

The rule on algorithmic appraisal tools was developed with the Federal Housing Finance Agency, the Federal Deposit Insurance Corporation, the Federal Reserve Board of Governors, the National Credit Union Administration, and the Office of the Comptroller of the Currency. The rule will take effect approximately one year after all agencies provide their final approval.

DISCRIMINATION LAWS AND AI ETHICAL COMPLIANCE

AI can be as simple as humans inputting data into a system, and algorithms analyzing the data. In a broader discussion of technology bias, Federal Reserve’s Vice Chair for Supervision Michael S. Barr stated at a 2023 conference:

“While these technologies have enormous potential, they also carry risks of violating fair lending laws and perpetuating the very disparities that they have the potential to address. Use of machine learning or other artificial intelligence may perpetuate or even amplify bias or inaccuracies inherent in the data used to train the system or make incorrect predictions if that data set is incomplete or nonrepresentative.”⁸⁹

He outlined other risks, and all relate to machine learning relying on the human data input. He stated, as AI technologies become more common, AI ethics risks increase as a result of lack of alignment with societal human values, bias, limited transparency, and data privacy concerns.

According to CFPB, AI governance platforms allow lenders to address these and other factors that could stall AI adoption, such as:

- **Regulatory pressure:** Increasing global regulations on AI use and mandate robust data privacy governance procedures.
- **Public awareness:** Companies must respond to rapidly increasing public concern about AI.
- **The negative side of AI advancements:** More advanced and autonomous AI systems can easily create convincing yet potentially harmful content.

Major tech companies are leading the way on AI ethics by adopting more responsible AI guidelines and methods. There is real money behind these efforts, including from major U.S. foundations, which recently formed a \$200 million funding coalition to promote responsible AI. Companies are also appointing executive-level positions to oversee their AI systems.⁹⁰

FAIR HOUSING ACT

Lenders that use AI for underwriting and processing the loan documents will need to ensure their systems comply with The Fair Housing Act (FHA). FHA makes it illegal to discriminate against someone because of race, color, religion, sex (including gender, gender identity, sexual orientation, and sexual harassment), familial status, national origin, or disability at any stage of the mortgage process, including:

- Approvals and denials
- Terms, for example: interest rates, points, fees, and other costs
- Advertising

⁸⁸ <https://www.consumerfinance.gov/about-us/blog/cfpb-approves-rule-to-ensure-accuracy-and-accountability-in-the-use-of-ai-and-algorithms-in-home-appraisals/>

⁸⁹ <https://www.federalreserve.gov/newsevents/speech/barr20230718a.htm>

⁹⁰ <https://www.fordfoundation.org/news-and-stories/news-and-press/news/philanthropies-launch-new-initiative-to-ensure-ai-advances-the-public-interest/>

- Mortgage broker services
- Property appraisals
- Servicing
- Home loan modification assistance
- Homeowners insurance

The FHAct prohibits discrimination in loans that are secured by residential real estate or that are for the purchasing, constructing, improving, repairing, or maintaining a dwelling. This includes mortgages, refinancing, home equity loans and home improvement loans.

Examples of Lending Discrimination

Examples of lending discrimination include but are not limited to:

- Denying a mortgage or charging a higher interest rate because the property is located in a majority-minority neighborhood
- Providing a different customer service experience to mortgage applicants depending on their race, color, religion, sex (including gender identity and sexual orientation), familial status, national origin, or disability
- Refusing to consider a mortgage applicant's disability-related income, such as SSI or SSDI
- Steering a borrower to a loan with less favorable terms because of his or her race, color, religion, sex (including gender, gender identity, sexual orientation, and sexual harassment), familial status, national origin, or disability
- Targeting a minority community for fraudulent home loan modification assistance
- Refusing to provide mortgages to a person on parental leave⁹¹

Example of Unethical AI

A major US based tech company settled a dispute with the US Department of Housing and Urban Development (HUD) for unlawful discriminatory housing practices, stemming from algorithms that targeted ads based on perceived protected characteristics.⁹²

"Facebook is discriminating against people based upon who they are and where they live," said HUD Secretary Ben Carson. "Using a computer to limit a person's housing choices can be just as discriminatory as slamming a door in someone's face."

Companies that collect images for facial recognition will continue to face AI ethics concerns. AI may not look differently on ethnic characteristics. Ensuring AI systems align with organizational and societal values is becoming a mandatory consideration as technology evolves.

CIVIL HOUSING RIGHTS

According to HUD.gov, it is illegal to discriminate against the sale or rental of housing, including against individuals seeking a mortgage or housing assistance, or in other housing-related activities. The Fair Housing Act prohibits discrimination because of race, color, national origin, religion, sex (including gender identity and sexual orientation), familial status, and disability.

A variety of other federal civil rights laws, including Title VI of the Civil Rights Act, Section 504 of the Rehabilitation Act, and the Americans with Disabilities Act, prohibit discrimination in housing and

⁹¹ https://www.hud.gov/program_offices/fair_housing_equal_opp/fair_lending

⁹² <https://archives.hud.gov/news/2019/pr19-035.cfm#:~:text=March%2028%2C%202019-,HUD%20CHARGES%20FACEBOOK%20WITH%20HOUSING%20DISCRIMINATION%20OVER%20COMPANY'S%20TARGETED%20ADVERTISING,a%20door%20in%20someone's%20face.%22>

community development programs and activities, particularly those that are assisted with HUD funding.

These civil rights laws include obligations such as taking reasonable steps to ensure meaningful access to their programs. Various federal fair housing and civil rights laws require HUD and its program participants to affirmatively further the purposes of the Fair Housing Act.

HUD's Office of Fair Housing and Equal Opportunity (FHEO) works to eliminate housing discrimination and promote civil rights and economic opportunity through housing. FHEO enforces fair housing laws. One of its roles is to investigate complaints of housing discrimination.⁹³

TRUTH-IN-LENDING ACT CONSUMER PROTECTIONS

The Truth-in-Lending Act with Regulation Z was to protect consumers in credit transactions by requiring clear disclosure of the lending terms. TILA also provides consumers with several rights in the home loan transaction. It gives the borrower a means for the right to cancel the transaction when there was a lien placed on their primary residence. This allows an owner-occupied refinance consumer 'the right of rescission' (the right to cancel) a transaction that has no benefit or is not what they wanted for a loan.

TILA limitations and prohibited certain practices on home equity loans and high-cost mortgages that were subject to section 1026.32 (Section 32). These restrictions placed lenders on notice that predatory high-cost lending was prohibited on a borrower's primary residence.

TILA was amended with Section 35 amendments to limit the mortgage loan further with higher-priced mortgage lending rules (HPML). Further protecting borrowers from predatory lending practices.

TILA added appraisal rules that govern the appraisal process. It specifically required lenders to ensure appraisers were independent and not influenced by the lender when determining a property's value, particularly for higher-priced mortgage loans (HPMLs) which have stricter appraisal requirements due to their higher risk profile. TILA prevents lenders from pressuring appraisers to inflate property values to facilitate loan approval.

TILA was amended to regulate mortgage loan originator compensation to prohibit mortgage loan originators from being paid based on the terms of the loan. This was an attempt to enhance ethical lending practices and stop mortgage loan originators from steering consumers into loan transactions with higher commissions.

TILA has and will continue to have amendments to protect the consumer from unethical lending practices. AI technology issues have not caused an amend to date but may likely be coming in the future.

AI COMPLIANCE WITH PRIVACY LAWS

Basically, AI ethics refers to the principles that govern AI's behavior in terms of human values. AI ethics helps ensure that AI is developed and used in ways that are beneficial to the consumer. It encompasses a broad range of considerations, including fairness, transparency, accountability, privacy, security, and the potential societal impacts.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act (GLBA) with Regulation P set requirements for mortgage lenders management of consumer information and defined what was considered non-public personal

⁹³ https://www.hud.gov/program_offices/fair_housing_equal_op/fair_housing_rights_and_obligations

information (NPI). GBLA requires financial institutions to ensure the security and confidentiality of consumer information, provide consumers with notice about their practices, and give consumers the option to not have personal information shared with non-affiliated third parties.⁹⁴

When considering AI ethics alongside GLBA, the focus is on how AI systems used by lenders will adhere to strict data privacy regulations. Data security includes ensuring the protection of sensitive customer financial information when utilizing AI algorithms for analysis or decision-making. Privacy is a concern for regulators as AI becomes more popular with industries that keep large amounts of borrower NPI.

Privacy and Information Security

The security of consumer private information is the biggest issue for mortgage lenders and AI implementation. A hesitation in AI adoption for lenders is data security and privacy. They have concerns about data integration with their current infrastructures, the high costs and a lack of proven compliance records are all issues on lenders' minds. Risks are high if the creditor does not provide sufficient safeguards to protect NPI data and restricts sharing of data that has not 'opted out' of information sharing.

GLBA Safeguard Rule

The GLBA Safeguards Rule requires covered financial institutions to develop, implement, and maintain an information security program with administrative, technical, and physical safeguards designed to protect customer information. The Rule defines customer information to mean *"any record containing nonpublic personal information about a customer of a financial institution, whether in paper, electronic, or other form, which is managed or maintained by or on behalf of you or your affiliates."*

The definition of "nonpublic personal information" in Section 314.2(l) further explains what is and is not included. The Rule covers information about your own customers and information about customers of other financial institutions that have provided that data to you.

The lenders information security program must be written, and it must be appropriate to the size and complexity of their business, the nature and scope of their activities, and the sensitivity of the information at issue.

The objectives of the privacy program are:

- To ensure the security and confidentiality of customer information.
- To protect against anticipated threats or hazards to the security or integrity of that information.
- To protect against unauthorized access to that information that could result in substantial harm or inconvenience to any customer.

GLBA AI Key Points

Key points to consider when complying with GLBA:

- **Data Privacy:** GLBA mandates that financial institutions safeguard customer data, which becomes crucial when using AI systems that may access and process large amounts of personal financial information. The use of third-party providers is common in the mortgage industry, and bring in added unknown risk the lender is accepting.
- **Transparency and Explainability:** AI ethics principles emphasize the need for transparency in how AI systems reach decisions, which is particularly important when dealing with customer

⁹⁴ <https://www.ftc.gov/tips-advice/business-center/privacy-and-security/gramm-leach-bliley-act>

data. Algorithms must be fair in making the credit decision and the decision may not have a disparate impact on a protected class of borrowers.

- **Bias Mitigation:** AI algorithms must be designed to avoid bias in decision-making. AI decisions that have a disparate impact may be an issue. Biased based outcomes using customer data could violate fair lending practices under the GLBA.
- **Accountability:** Accountability means that not only can the AI system explain its decisions, the stakeholders who develop and use the system can also explain its decisions, their own decisions, and understand that they are accountable for those decisions. Lenders using AI should have clear accountability mechanisms in place to address any issues arising from AI-driven decisions related to customer data. The file must contain documentation on how AI made the credit decision and complied with GLBA.

AI Ethics and GLBA

To comply with GLBA, lenders must set up systems that can monitor compliance and establish risk assessments. The lender needs to determine if their systems meet GLBA requirements. The lender is advised not to wait until a regulator's examination identifies a problem.

- **Developing AI systems:** When designing AI models for financial applications, developers must prioritize data privacy, ensuring compliance with GLBA regulations regarding data collection, storage, and usage. This aspect is generally managed by the mortgage lenders' IT Department.
- **Data Governance:** Strict data governance practices are essential to manage customer information used by AI systems, ensuring appropriate access controls and data minimization. A large part of governance is training. Employees must be trained in how to comply with company data protections, AI systems, and federal compliance. This aspect is generally managed by the mortgage lenders' Compliance Department.
- **Risk Assessment:** Financial institutions must regularly assess the risks associated with using AI, including potential privacy violations and unfair treatment of customers. The mortgage lenders' Quality Control Department generally manages this aspect.

All lender departments work together to make a comprehensive GLBA compliant system to protect their data and limit the risk for a breach.

Customer Identification Programs

As an amendment to the Bank Secrecy Act (BSA), Section 326 of the USA Patriot Act requires lenders to check the identification (ID) of borrowers. This section mandates that financial institutions must obtain, verify, and record identifying information from anyone opening an account, which includes verifying their identity through documentation like a driver's license. These programs are referred to as Customer Identification Programs (CIPs).⁹⁵

- **CIP Purpose:** To combat terrorism, financing, and money laundering by ensuring lenders know who they are doing business with.
- **Requirements:** Financial institutions must implement reasonable procedures to verify a customer's identity when opening an account. At a minimum, CIP must include how it is:
 1. Verifying the identity of any person seeking to open an account, to an extent reasonable and practicable.
 2. Maintaining records of the information used to verify the person's identity, including name, address, and other identifying information.

⁹⁵ <https://www.federalregister.gov/documents/2016/08/25/2016-20219/customer-identification-programs-anti-money-laundering-programs-and-beneficial-ownership#:~:text=Section%20326%20of%20the%20USA,institution%20by%20any%20government%20agency.>

3. Determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency.
- **Information collected:** This typically includes name, address, date of birth, and other identifying information, along with a copy of a government-issued ID.

When using AI, determining how this process will work and comply with CIP requirements will assist lenders in decreasing funding of potential fraudulent loans.

CFPB AI CONCERNS

CFPB provided the following three key points to highlight its findings regarding the role of regulators in managing the adoption of emerging technologies and fostering innovation in the financial services sector.

1. Although institutions sometimes behave as if there are exceptions to the federal consumer financial protection laws for new technologies, that is not the case. Regulators have a legal mandate to ensure that existing rules are enforced with respect to all technologies, including those marketed as new or novel. This is what Congress has instructed regulators to do, and what is required to prevent consumer harm.
2. Ensuring that all market participants comply with the rules fosters innovation. When regulators uniformly enforce rules, firms are discouraged from investing in legal evasion to make law-breaking their competitive advantage and instead are incentivized to invest in developing innovative products and services that benefit consumers.
3. Innovation is also fostered by clear regulatory requirements that do not unfairly advantage incumbent businesses or afford special treatment to individual firms. Establishing clear, straightforward rules encourages firms to invest in better products and services, rather than finding legal gray areas, taking advantage of incumbent-favoring loopholes, or seeking out special treatment.⁹⁶

Per the CFPB, when firms choose to violate consumer protection laws, not only can there be significant harm to people and families, but firms may put resources into evading the law, rather than competing on price or quality.

The CFPB's position is clear: firms must comply with consumer financial protection laws when adopting emerging technology. If firms cannot manage using a new technology in a lawful way, then they should not use the technology.

The CFPB has engaged in extensive outreach and discussions with law enforcement, regulators, market participants, investors, entrepreneurs, individual consumers, and other stakeholders about their experience with emerging technologies in the market for consumer financial products or services. These conversations have shed light on the risks to consumers that may arise when firms rush to adopt such technologies but do not take steps to comply with the law.

For instance, the CFPB published research on the use of automated customer service technology in consumer finance, including technologies built on large language models. CFPB highlighted that these tools may provide incorrect information, fail to provide meaningful dispute resolution, and raise privacy and security risks.

As more companies adopt these types of technology, the CFPB monitors compliance with, among other things, ECOA which prohibits discrimination on a prohibited basis in lending transactions, and the Dodd-Frank Act, which prohibits unfair, deceptive, or abusive acts or practices. These laws apply

⁹⁶ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-comment-on-request-for-information-on-uses-opportunities-and-risks-of-artificial-intelligence-in-the-financial-services-sector/>

not only to the origination of credit but also to servicing and debt collection practices, including critical customer service functions like what options companies provide to struggling consumers.

The Courts have held in other contexts that a firm's decision to use algorithmic, machine-learning, or other types of automated decision-making tools can itself be a policy that produces bias prohibited under civil rights laws. This logic also applies with respect to compliance with ECOA.

AI Fraud Screening

The CFPB has also seen that financial institutions are increasingly using new technologies to engage in "fraud screening," often through third-party vendors that assign consumers individualized risk scores. These companies often tout their use of machine-learning and other forms of AI. It is critical that companies offering these services recognize that the consumer financial laws including the Dodd-Frank Act and ECOA apply to fraud screening conducted as part of a transaction for a consumer financial product or service.

Moreover, because fraud screening is used to assess creditworthiness by determining who gets offered or approved for a financial product, firms that compile and provide such information are typically subject to the requirements of the Fair Credit Reporting Act (FCRA). Taking steps to limit fraud is not an excuse to violate other federal laws that govern the mortgage industry.

Robust AI Testing

Robust fair lending testing of models should include regular testing for disparate treatment and disparate impact, including searches for and implementation of less discriminatory alternatives using manual or automated techniques. CFPB teams will continue to explore the use of automated debiased methodologies to produce potential alternative models to institutions' underwriting models.⁹⁷

The same principles apply when firms use advanced technology for lending and underwriting decisions. The ECOA applies regardless of the complexity or novelty of the technology deployed by institutions, including when it comes to combatting unlawful discrimination or explaining how certain credit decisions are made.

For example, the CFPB will continue to closely monitor and review the fair lending testing regimes of financial institutions, including reliance on complex models.

CFPB Fosters Innovation

The CFPB believes that innovation need not be at odds with compliance with federal consumer protection laws. Indeed, innovation is fostered when regulators ensure that all market participants adhere to the same set of rules and compete on a level playing field.

The CFPB is now focused on fostering innovation and competition that truly benefits consumers. Specifically, the CFPB is making clear that there is no exception to the federal consumer financial protection laws for new technology.

For example, the CFPB has provided guidance on the use of black-box credit models, making it clear that lenders must provide accurate and specific reasons when they deny credit or take other adverse actions against a consumer, regardless of the complexity of their decision models or the use of AI.

For example, the CFPB approved a rule on algorithmic home appraisals that would make these automated tools fairer and ensure they comply with nondiscrimination laws.

⁹⁷ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-comment-on-request-for-information-on-uses-opportunities-and-risks-of-artificial-intelligence-in-the-financial-services-sector/>

CFPB is taking steps to evaluate whether and how companies are testing the algorithms they use to make lending decisions to ensure compliance with the law, including the prohibition against discrimination on the basis of protected characteristics.

For example, when there is evidence of disparities, CFPB examiners engage in further evaluation, including assessing whether the companies searched for less discriminatory alternatives to the models used.

The CFPB is closely tracking how tech firms are expanding into banking-like services in virtual worlds, and ensuring protections and oversight come along with those services. They are also shining a spotlight on how bad actors may use generative AI tools to impersonate others when perpetrating fraud more effectively.

The CFPB has proposed to subject large technology companies that offer services like digital wallets and payment apps to the CFPB's supervisory process to align oversight of their offering of consumer financial products or services with that of banks and other financial institutions. Ensuring that whistleblowers at Big Tech and other companies are protected from retaliation and discrimination, including by being forced to sign broad nondisclosure agreements.

FTC UPDATES SAFEGUARD RULES

The FTC's Safeguards Rule requires non-banking financial institutions, such as mortgage brokers, to develop, implement, and maintain a comprehensive security program to keep their customers' information safe. The updated FTC Safeguards rule states that *"in instances where an employee, officer, or other agent of the financial institution accesses customer information without authorization, a financial institution will be deemed to have knowledge of a notification event if the event is known to another employee, officer, or other agent of the financial institution."* The FTC Safeguards Rule requires financial institutions to report security events to the Federal Trade Commission.⁹⁸

In practical terms, this means that if a first party regulated entity has collected non-public information (NPI) about consumers who have then opted-out of data sharing practices, and an agent at a third-party views that NPI, it would trigger a notification event.

For example, if a database query returns records to a third-party about all consumers, it may be a notification event if a subset of those records has a visible 'opt out' flag shown on screen. The lender would have contributed a borrower's information that opt-out of information sharing. This would be a violation of this safeguard rule. Lender is required to notify FTC of the event.

FTC Information Security Program

FTC recommends the following when designing your information security program, the Safeguards Rule requires your company to:

1. **Implement and periodically review access controls.** Determine who has access to customer information and reconsider on a regular basis whether they still have a legitimate business need for it.
2. **Know what you have and where you have it.** A fundamental step to effective security is understanding your company's information ecosystem. Conduct a periodic inventory of data, noting where it is collected, stored, or transmitted. Keep an accurate list of all systems, devices, platforms, and personnel. Design your safeguards to respond with resilience.

⁹⁸ <https://www.ftc.gov/news-events/news/press-releases/2023/10/ftc-amends-safeguards-rule-require-non-banking-financial-institutions-report-data-security-breaches>

3. **Encrypt customer information on your system and when it is in transit.** If it is not feasible to use encryption, secure it by using effective alternative controls approved by the Qualified Individual who supervises your information security program.
4. **Assess your apps.** If your company develops its own apps to store, access, or transmit customer information, or if you use third-party apps for those purposes, implement procedures for evaluating their security.
5. **Implement multi-factor authentication for anyone accessing customer information on your system.** For multi-factor authentication, the Rule requires at least two of these authentication factors: a knowledge factor (for example, a password); a possession factor (for example, a token), and an inherence factor (for example, biometric characteristics). The only exception would be if your Qualified Individual has approved in writing the use of another equivalent form of secure access controls.
6. **Dispose of customer information securely.** Securely dispose of customer information no later than two years after your most recent use of it to serve the customer. The only exception is if you have a legitimate business need or legal requirement to hold on to it or if targeted disposal is not feasible because of the way the information is maintained.
7. **Anticipate and evaluate changes to your information system or network.** Changes to an information system or network can undermine existing security measures. For example, if your company adds a new server, has that created a new security risk? Because your systems and networks change to accommodate new business processes, your safeguards cannot be static. The Safeguards Rule requires financial institutions to build change management into their information security program.
8. **Maintain a lot of authorized users' activity and keep an eye out for unauthorized access.** Implement procedures and controls to monitor when authorized users are accessing customer information on your system and to detect unauthorized access.
9. **Regularly monitor and test the effectiveness of your safeguards.** Assess your procedures for detecting actual and attempted attacks. For information systems, testing can be accomplished through continuous monitoring of your system. If you do not implement that, you must conduct annual penetration testing, as well as vulnerability assessments, including system-wide scans every six months designed to test for officially known security vulnerabilities. In addition, tests whenever there are material changes to your operations or business arrangements and whenever there are circumstances you know or have reason to know may have a material impact on your information security program.

The FTC has more information about the Safeguards Rule and general guidance on data security here are three things your business can do to promote identity theft awareness to customers, employees, and members of your community.⁹⁹

Be Fair to People Who Have Experienced ID Theft

Assisting people who are trying to recover from identity theft is not simply good customer relations. It is the law. If a consumer spots charges on their account they did not make and it appears that an unauthorized transaction occurred at your company, the FCRA requires lenders to provide them with relevant records. The law allows borrowers to get proof of their identity (like a driver's license), but it is illegal to re-victimize them by making them jump through hoops to get the documentation they need.

⁹⁹ <https://www.ftc.gov/business-guidance/privacy-security/gramm-leach-bliley-act>

According to an FTC law enforcement action, a national retail chain did not honor FCRA provision and paid a \$220,000 civil penalty.¹⁰⁰

Spread ID Awareness with Social Networks

Identity theft does not just harm consumers. It is bad for business, too. In addition to the billions of dollars lost every year to fraudsters, identity theft takes a tremendous toll on the well-being and peace of mind of affected customers, employees, friends, and family. That is why FTC wants to enlist MLOs in the effort to raise awareness about how to prevent identity theft and streamline the recovery process. The FTC has sharable Identity Theft Awareness Week resources including videos and other visuals an MLO can post on social media.¹⁰¹

In addition, during Identity Theft Awareness Week, the FTC and partners will be hosting podcasts and webinars for general audiences, as well as events focused on servicemembers, older adults, young adults, and business owners.¹⁰²

Data Breach

When there is a data breach, financial institutions have to respond to the breach to comply. FTC's Safeguard Rules requires covered companies, including mortgage companies, to report certain data breaches and other security events to the FTC.

The FTC requires the breach to be reported as soon as possible and **no later than thirty days** after the discovery of a security breach involving the information of **at least five hundred consumers**. Such an event requires notification if unencrypted customer information has been acquired without the authorization of the individual to which the information pertains. The notice for FTC must include certain information about the event, such as the number of consumers affected or potentially affected.¹⁰³

Here is how the Rule defines an incident that triggers notification:

- An acquisition of unencrypted customer information without the authorization of the individual to which the information pertains. Customer information is considered unencrypted for this purpose if an unauthorized person accesses the encryption key.
- Unauthorized acquisition will be presumed to include unauthorized access to unencrypted customer information unless they have reliable evidence showing that there has not been, or could not have been, unauthorized acquisition of such information.¹⁰⁴

Cyber Security

Financial institutions use AI systems in connection with their operations, and specifically to support their cybersecurity and anti-fraud operations. Many financial institutions have incorporated AI related risks into their existing risk management frameworks, especially those related to information technology, models, compliance, and third-party risk management.

Cybersecurity refers to the practice of protecting computer systems, networks, applications, and data from malicious cyberattacks by implementing technologies, policies, and procedures to prevent

¹⁰⁰ Section 609(e) of the Fair Credit Reporting Act

¹⁰¹ <https://consumer.ftc.gov/features/identity-theft-awareness-week>

¹⁰² <https://www.ftc.gov/business-guidance/blog/2024/01/three-ways-your-business-can-mark-identity-theft-awareness-week>

¹⁰³ <https://www.ftc.gov/news-events/news/press-releases/2023/10/ftc-amends-safeguards-rule-require-non-banking-financial-institutions-report-data-security-breaches>

¹⁰⁴ <https://www.ftc.gov/business-guidance/blog/2024/05/safeguards-rule-notification-requirement-now-effect>

unauthorized access, data breaches, and other digital threats. The act of safeguarding information in the digital environment is important to consumer privacy laws.¹⁰⁵

According to the US Treasury, some of the financial institutions reported that existing risk management frameworks may not be adequate to cover emerging AI technologies, such as Generative AI, which emulate input data to generate synthetic content.

In the case of cybersecurity and anti-fraud AI usage, participants have found that effectively managing risks requires collaboration across the financial services sector. Applying appropriate risk management principles to AI development is critical from a cybersecurity perspective, as data poisoning, data leakage, and data integrity attacks can take place at any stage of the AI development and supply chain. AI systems are more vulnerable to these concerns than traditional software systems because of the dependency of an AI system on the data used to train and test it.¹⁰⁶

Financial institutions that have adopted AI technology, including Generative AI, found it has the potential to significantly improve the quality and cost efficiencies of their cybersecurity and anti-fraud management functions. Technology advancements are dependent on data, and lenders agree that more collaboration on fraud detection is needed for optimum cyber protection. It needs to become common for financial institutions to share information that has NPI information removed, and only sharing the NPI information when the information is encrypted.

When a cyberthreat is detected, there are well established standards, frameworks, and apparatuses for sharing cyberthreat information, including the Financial Services Information Sharing and Analysis Center (FS-ISAC).

AI technology and the complexity of AI technology development increases financial institutions' reliance on third-party providers of data and technology. As a result, it is often an overlooked third-party risk in data integrity. Emerging AI solutions may challenge traditional expectations regarding financial institutions' ownership of data, models, and insights.

Cost of Data Breaches

- In 2024, the average cost of data breach for financial institutions was around \$6 million
- Detection and escalation were the most expensive part of data breaches, costing around \$1.63 million on average

In addition, lenders have to determine if they may be a party to a class action lawsuit because of a breach, adding additional actions and expense to NPI security. Consumers have the right to be compensated for these security failures and may pursue compensation for the breach.¹⁰⁷

In addition to FTC notification requirements, starting in 2024 financial institutions are subject to new data breach notification laws and increased obligations from the US Securities and Exchange Commission (SEC). These laws require institutions to notify affected individuals as soon as possible, and to provide notice to everyone whose information may have been accessed.¹⁰⁸

FREDDIE MAC COMMITTED TO FIGHTING FRAUD

Freddie Mac's Single Family Fraud Risk (SFFR) team is at the forefront of prevention, detection, investigation, reporting and resolution of mortgage-related fraud and other suspicious activities.

¹⁰⁵ <https://www.cisa.gov/news-events/news/what-cybersecurity>

¹⁰⁶ <https://home.treasury.gov/system/files/136/Managing-Artificial-Intelligence-Specific-Cybersecurity-Risks-In-The-Financial-Services-Sector.pdf>

¹⁰⁷ <https://www.statista.com/markets/424/topic/1065/cyber-crime-security/>

¹⁰⁸ <https://www.ftc.gov/business-guidance/blog/2024/05/safeguards-rule-notification-requirement-now-effect>

Freddie Mac issued 3201.2 on November 4, 2024, providing revised guidance on Handling of Fraud and other Suspicious Activity reporting requirements.

Freddie Mac Guidance Review

Freddie Mac requires its Seller/Servicer to have in place a written program with written procedures for detecting, identifying, and reporting fraud, suspected fraud, and other Suspicious Activity in connection with a Mortgage sold to, or serviced for, Freddie Mac. The time of discovery does not matter. Lenders are required to report suspicious activity any time including, but not limited to, during origination, quality control reviews, Servicing activities or loss mitigation efforts.

The Seller/Servicer must report to Freddie Mac when the Seller/Servicer has a reasonable belief that one of the following is occurring or has occurred during the origination, sale, or Servicing of a Mortgage (including any loss mitigation activity):

- Misrepresentation, misstatement, or omission related to the Borrower including, but not limited to, identification, employment, income, assets, sources of funds, indebtedness, and property occupancy.
- Misrepresentation, misstatement, or omission related to the Mortgaged Premises including, but not limited to, property valuation, property value and property use.
- Misrepresentation, misstatement or omission of any other information related to a Mortgage or the underlying real estate transaction including, but not limited to, undisclosed Seller or other third-party incentives, loan performance, Mortgage purpose, kickbacks, undisclosed relationship between parties to the transaction when Freddie Mac requires that the transaction be an “arm’s length” transaction.
- A person or entity on the Freddie Mac Exclusionary List is involved or engaged in the origination, sale, or Servicing of the Mortgage or in the underlying real estate transaction in violation.
- A person or entity on the FHFA Suspended Counterparty Program list is involved or engaged in the origination, sale, or Servicing of the Mortgage or in the related real estate transactions in violation.
- Termination or denial of mortgage insurance based on fraud.

Before notifying Freddie Mac about any fraud, suspected fraud or other Suspicious Activity, a Seller/Servicer must conduct appropriate due diligence to determine whether a reasonable basis exists to conclude that fraud or Suspicious Activity may have occurred, regardless of whether a breach occurred.

In addition to the Bank Secrecy Act that requires Anti-Money Laundering procedures and a Suspicious Activity Report, Freddie Mac still requires Seller/Servicers report all suspected or known mortgage fraud. The SAR does not replace the notice with Freddie Mac. The Seller/Servicer must maintain records of fraud types and trends, fraud cases and positive Exclusionary Lists in accordance with its retention policies, which must be shared with Freddie Mac upon request.

Tip Referral Tool

Freddie Mac has provided a tool to use for reporting all mortgage fraud, suspected mortgage fraud and other Suspicious Activity using the Tip Referral Tool. Referrals made through the Tip Referral Tool must include at a minimum:

- Freddie Mac loan number
- Property address
- Mortgage fraud/Suspicious Activity type and category
- Parties involved

- Supporting documentation
- A narrative detailed description of the activity, including why it has been deemed suspicious or fraudulent. Seller/Service providers should not include protected personal information, such as Social Security numbers, in the narrative description.
- Any other required information as identified in the Tip Referral Tool¹⁰⁹

¹⁰⁹ https://guide.freddie-mac.com/app/guide/content/a_id/1000159

Module 3 Non-Traditional

Non-Traditional Lesson Objective

This lesson reviews the types of home loan programs that allow down payment assistance, the type of down payment assistance available, and some sources for down payment assistance. This lesson provides the student information about the use of down payment assistance and other helpful loan programs to provide to their borrowers. It reviews many of the nationally available down payment assistance programs guidelines that their borrowers may use as their source of funds to close. For a stronger understanding, the lesson specifically reviews the highlights of one state's down payment assistance programs, Arizona.

DOWN PAYMENT ASSISTANCE PROGRAM REVIEW

A traditional home loan is considered to be a 30-year fixed mortgage according to the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). All other types of loans are termed non-traditional. Almost all home loan programs to purchase a property will require the borrower to pay a down payment. The challenge for most consumers is having sufficient funds to close their loan transaction regardless of whether it is a 30-year fixed or adjustable-rate mortgage.

A residential home purchase mortgage may require the borrower to provide a down payment and closing costs, but the loan program may also allow for flexible sources of funds to close. Our current housing market is challenging for most low-to middle-class consumers. Many have insufficient savings to cover the amount of money needed to purchase a home. Everyday life emergencies often take what extra money they can save, leaving little to no savings for a home purchase.

To help consumers with this important home investment, a mortgage loan originator (MLO) may provide options for the borrower who is short funds to close. An MLO should be versed in what DPA programs are available for their consumers, and what loan programs allow assistance to be the borrower's source of funds. Even borrowers that saved enough money may benefit from a DPA program and retain their savings for home improvements.

According to the Department of Housing and Urban Development (HUD), there are currently over 2,200 homebuyer assistance programs available in the United States. The most common type of down payment assistance comes as either a gift, grant, or loan.¹¹⁰

Homeownership DPA programs are for owner-occupant buyers only. The qualifications for the DPA programs vary greatly. The borrower may or may not need to be a first-time homebuyer, may or may not need to make a minimum investment out of pocket, and may or may not be required to complete homebuyer education. Common eligibility or limiting factors include the home's sales price, homebuyer or household income, location of property, minimum credit scores, and homeownership history.

GROWING NEED FOR DOWN PAYMENT ASSISTANCE

Recent CNBC news statistics found down payment challenges for consumers underscore the importance of educating borrowers about these additional funding sources:

- More than 40% of non-homeowners do not have enough money to put towards the down payment on a house.
- Among millennials the figures are even lower, with 67% having put no money aside.

¹¹⁰ <https://downpaymentresource.com/homebuyer-resource/know-your-programs-an-overview-of-the-three-most-common-homebuyer-assistance-programs-2/>

In 2024, the average rate for a 30-year fixed mortgage jumped to the highest rate since 2000, putting additional pressure on consumers to put more money down to lower their house payment. The more a borrower puts down on their home purchase, the lower the loan amount borrowed, the better the interest rate, and the lower the monthly payment. History has shown borrowers with more skin in the game are less likely to default on their mortgages.

Many down payment assistance (DPA) programs will have a higher than market interest rate, and higher fees for the administration of the DPA program. Grants often will have government supplemented interest rates which may provide the borrower with a lower than market interest rate. For borrowers that have tight debt ratios, understanding the impact on the rate with the different DPA loan programs, gifts, and grants will allow the MLO to provide the borrower with different lending options for them to decide what is the best loan program to meet their needs.

The MLO will need to discuss the options with the borrower and determine their needs. What is the most important aspect to the borrower; a lower monthly payment (due to putting more money down), or lower amount of funds out of pocket (due to use of DPA higher interest rate program)?¹¹¹

DPA SOURCE OF FUNDS

All money coming into the mortgage transaction must be sourced. The Bank Secrecy Act (BSA) contains Anti-Money Laundering legislation that requires the lender to ensure the money coming into the transaction is from a legitimate source, and not from an illegal source such as Human Trafficking.

The source of funds used by the borrower must meet the home loan program requirements. For example, some DPA programs do not allow a gift from a relative.

The source of funds to be provided to the borrower for closing must be documented in the loan file. If the source for closing is DPA funds, the underwriter will require proof of registration to ensure the funds are available and reserved. The underwriter will use the requirements of the DPA program as part of the requirements to approve the home loan request.

If the DPA program requires repayment, this payment would be considered as part of the borrower's housing payment costs and included in the debt ratios.

The DPA funds are added to the borrowers' documented liquid assets for closing to provide the total amount of funds used for qualifying.¹¹²

There are several down payment assistant sources for borrowers that may provide sufficient funds to close or portion of the fund's requirement. For this course we are focused primarily on down payment assistance programs for owner occupied home purchase. These sources will include:

- **Grants:** Funds that do not need to be paid back if the borrower owns and continuously lives in their home for a certain length of time (often 3-5 years). There may be conditions to have the grant forgiven or be recaptured if grant terms are not met.
- **Second Mortgage Loans:** These subordinate loans often have low or zero interest rates, and the payments may be deferred over time. Often funded by an Agency, which may or may not require loan repayment.
- **State & Federal Government Programs:** Many state and local governments offer down payment assistance programs, often with federal funding assistance which include:

¹¹¹ <https://www.cnn.com/2023/09/08/what-size-down-payment-you-need-to-buy-a-home.html>

¹¹² <https://www.fdic.gov/banker-resource-center/bank-secrecy-act-anti-money-laundering-bsaaml#:~:text=BSA%20is%20the%20common%20name,to%20the%20BSA%20recordkeeping%20requirements.>

- **Tax credits:** Some states and local governments issue mortgage credit certificates (MCC), which can reduce the amount of federal income tax the borrower pays, which allows the lender to use more qualifying income for the borrower.
- **Housing Choice Voucher (HCV):** This Section 8 program can help low-income buyers purchase a first home. Some Public Housing Agencies (PHAs) offer an HCV homeownership program that allows participants to use their Section 8 voucher to buy a home. A mortgage loan originator will need to check their local HUD office to see if this is an option in their lending community.¹¹³
- **State Department of Housing:** Most states have a housing division or housing finance agency (HFA) that provides DPA programs for residential home purchases. Some states may also have specialty programs for low-income or targeted areas in the community.
- **Federal Housing Administration (FHA):** HUD designed the FHA home loan program to allow a large variety of funding sources, with lenient underwriting for the challenges first time homebuyers' encounter.
- **Fannie Mae and Freddie Mac:** These quasi-government agencies provide affordable housing loan options similar to FHA. These loan programs are more lenient than standard conforming loans and may allow lower MI coverage.
- **Nonprofit Programs:** These programs may be exclusively for first-time buyers with lower incomes. These can come from community based or larger nonprofit organizations.
- **Other Assistance:** Additional down payment funds that may be acceptable based on the home loan program include:
 - Gifts from family members
 - Employer assistance
 - Seller assistance or contribution
 - Personal or retirement savings withdrawal
 - Matched savings programs or Individual Development Account (IDA)
 - Closing cost lender credits
 - Sweat equity¹¹⁴

FIRST TIME HOMEBUYER

It is important to know that a first-time homebuyer is defined as someone who has not owned a home in the last three years. It is not defined as someone who has never owned a home. If the borrower is currently renting, they can be a first-time homebuyer again. It is estimated that less than half the DPA programs have a first-time homebuyer requirement.

DPA programs may require more documentation, however it is similar to what is already needed on the typical home loan transaction.

HOMEBUYER EDUCATION

Homebuyer education can prepare homebuyers for the home-buying process, as well as the responsibilities of homeownership. It is assumed that borrowers who have attended homebuyer courses may be better prepared and know what to expect during the home buying process.

Homebuyer education requirements vary by program, but typically include:

- Attending an ACCEPTABLE approved education course

¹¹³

https://www.hud.gov/topics/housing_choice_voucher_program_section_8#:~:text=The%20housing%20choice%20voucher%20program,to%20admission%20the%20voucher%20program.

¹¹⁴ <https://www.usa.gov/buying-home-programs>

- Receiving a certificate of completion
- Providing the lender with the certificate of completion
- Undergoing a one-on-one household budget and credit assessment

In order to qualify for a HomeReady, HFA Preferred, or 97% LTV loan, the borrower may be required to complete homeownership education.

The education and who provides the education vary between DPA programs and conforming loan programs. If a consumer completes the wrong education course, they would be required to take the mandatory course. Not all DPA education is the same or transferable. Know the DPA program to be used and forward all the approved educators for that DPA program to the consumer to choose from to avoid this issue.

Homebuyer education courses can be taken in person or online. They have an expiration date that would require the consumer to retake the course if the loan closes after the certificate expires.

Homebuyer education courses can help buyers understand complex concepts and learn how to apply them. They can cover topics such as: credit basics, how to build credit, how to establish and maintain a solid credit history, and how to manage good credit.

Fannie Mae's HomeView® Homebuyer Education

Fannie Mae offers a comprehensive homebuyer course available in English and Spanish and provides the information consumers need to take the next steps toward homeownership.

Fannie Mae's HomeView certificate course aligns with National Industry Standards for pre-purchase homeownership education, so it fulfills education requirements for most conforming mortgage products. After finishing and passing the end of course quiz with a score of 80% or higher, the borrower will receive a certificate of completion to provide to the lender for proof of completion.¹¹⁵

HUD offers information in English and Spanish to help potential homebuyers. HUD resources include local homebuying programs and HUD-approved housing counseling agencies.

DOWN PAYMENT ASSISTANCE TYPES

Down payment assistance (DPA) is an umbrella term for programs offered by federal, state, county or local government agencies, nonprofits, and employers. The assistance may come in the form of gifts, grants or second mortgages.

Gifts

Gifts can come from a variety of sources and can help borrowers reduce upfront costs. Gifts do not need to be repaid. Gifts may come from:

- Any individual who is related to the borrower by blood, marriage, domestic partnership, adoption, or legal guardianship may provide the gift.
- That includes relatives of the borrower or domestic partner, former relatives, godparents, spouses, individuals engaged to marry the borrower, children, or other dependents.¹¹⁶

Grants

Grants are gifts provided for closing by an eligible third-party provider to help cover the cost of some or all of the borrower's down payment and/or closing costs. Grants do not have to be repaid by the

¹¹⁵ <https://www.fanniemae.com/education>

¹¹⁶ Fannie Mae *Selling Guide* section B3-4.3-04

homebuyer, do not incur a liens on the property being purchased, and have no associated note or deed.

Grants are another way to help borrowers pay down payment costs and can be:

- From employers, municipalities, states, counties, or local HFAs, nonprofit organizations (excluding credit unions), federal agencies, regional Federal Home Loan Banks, Native American tribes and their sovereign instrumentalities, or lenders (under specific conditions).

The HUD gives grants to state and local organizations nationwide to help borrowers with the down payment funds to close on a home.

When a gift or grant is from an Agency, it must be pursuant to an established home loan program. The Agency must not be an interested party, and the funds may not be obtained from an interested party either directly or indirectly through a third party.

With respect to the subject property, the Agency must not:

- Be the Seller or have participated in any aspect of the mortgage origination process.
- Be affiliated with, under contract to, or financed (directly or indirectly) by the Seller or any party that participated in the mortgage origination process.

Second Mortgages

Many DPA programs come in the form of a second mortgage, or subordinate lien, with varying payback provisions. Community Seconds mortgages can come from many of the same sources as grants, but a second lien is placed on the property to enforce compliance with the terms of the second. Although Fannie Mae does not purchase Community Seconds, it does purchase first mortgages associated with Community Seconds.

Benefits of Community Seconds include:

- Loans may have more than one Community Seconds mortgage (for example, a third lien) up to the maximum 105% CLTV.
- Can be used with both standard and affordable products, such as HomeReady®.¹¹⁷

Repayable DPA programs provide down payment funds at closing often as a 0%-interest second mortgage loan. Some of these seconds may accrue interest although no payments are required. Some seconds may be fully amortizing loans.

DPA second mortgages terms typically will range from 5-year forgiveness provisions to 30-year loans with varying repayment terms, which may start immediately or kick in after a predetermined period. Each program is designed based on the needs of the community it is being offered to, and the tolerance for risk the source of funds is willing to accept.

Deferred or silent second programs postpone repayment of the down payment assistance until the borrower sells, refinances, rents, or moves out of the home. Buyers who plan to live in the home for several years will benefit most from the home's appreciation in value.

Forgivable second mortgage programs forgive some or all of the DPA amount. When and how much of that DPA is forgiven may vary, but it is common for a percentage of the loan to be forgiven each year for a predefined number of years. Providing the borrower maintains the property as their primary

¹¹⁷ <https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/down-payment-and-closing-cost-assistance>

home. If the second program's conditions are not met, the loan must be repaid, sometimes with interest owed.

For example, the buyer moves out of the home after two years and rents it to family members. If the program required the borrower to owner occupy the property for the first five years of the loan to obtain forgiveness of the DPA second mortgage, this arrangement would not meet the owner-occupied requirements. This property is no longer an owner-occupied house. The program terms will outline how the borrower may manage this type of change in occupancy and compliance with the terms of the DPA program.

HFA & GOVERNMENT DPA PROGRAMS

State, County, City, and some churches or special funds may be available from Housing Finance Agencies (HFAs). The state's local housing department should have a list or be able to direct the borrower or MLO on where to look for the added money for home purchase.

USDA Government Assistance

The USDA has two first mortgage programs, the Rural Direct Loan, and the Rural Guaranteed Loan. Both primarily are used to help low-to moderate-income individuals or households purchase homes in rural areas. Funds can be used to acquire, build (including purchasing and preparing the site and provide water and sewage facilities), repair, renovate or relocate a home.¹¹⁸

USDA home loans are a great option if the borrower is buying a home in a qualified rural area. USDA loans make it possible for borrowers to qualify with a 0% down payment and lower closing costs.

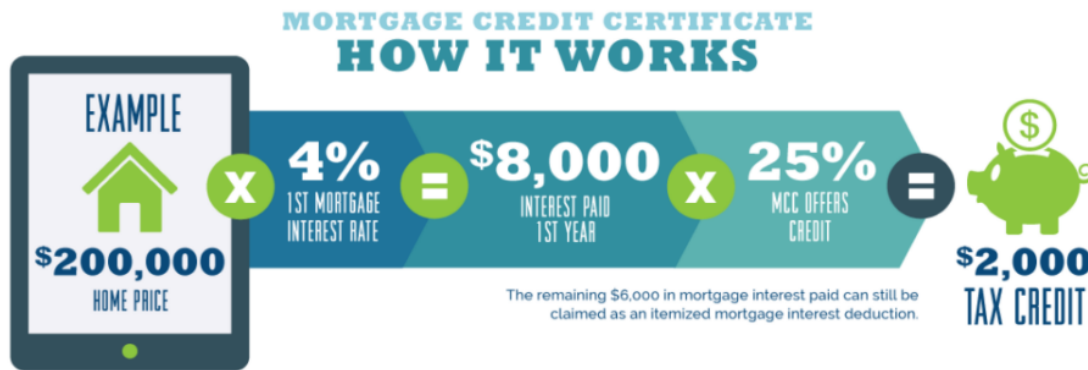
Mortgage Tax Credit Certificates (MCC)

This annual federal income tax credit is designed to help first-time homebuyers offset a portion of their mortgage interest on a new mortgage as a way to help qualify for a loan. Mortgage credit certificates are not a loan program, but rather a federal tax credit. MCCs are certificates issued by state HFAs that increase the federal tax benefits of owning a home. An MCC is not a tax deduction, but it provides a dollar-for-dollar tax credit to recipients to increase housing payment affordability.

The Mortgage Tax Credit Certificate (MCC) program was established by the Deficit Reduction Act and was modified by the Tax Reform Act. Under the law, states may convert a portion of their federal allocation of private activity bonds (PABs) to MCC authority. Mortgage tax credit certificates can help lenders increase their appeal to first-time homebuyers and help more borrowers qualify debt ratios for homes by reducing their mortgage payments or providing additional effective income.

The tax credit percentages vary by state, but the Internal Revenue Service (IRS) caps the maximum tax credit that may be taken for any given year at \$2,000. The MCC tax credit remains in place for the life of the mortgage, so long as the residence remains the borrower's principal residence.

¹¹⁸ <https://downpaymentresource.com/homebuyer-resource/know-your-programs-an-overview-of-the-three-most-common-homebuyer-assistance-programs-2/>



How the MCC tax credit will be applied for qualifying the borrower will depend on the loan program guidelines. After purchasing the home loan, MCCs are issued directly to qualifying homebuyers entitled to take a non-refundable federal tax credit equal to a specified percentage of the interest paid on their mortgage loan each year.

The total MCC tax credit for each year cannot exceed the recipient's total federal income tax liability for that year, after accounting for all other credits and deductions. Credits in excess of the current year's tax liability may be carried forward for use in the next three years. Unlike down payment assistance programs, MCC programs do not restrict the type of mortgage financing the borrower uses to purchase the property.¹¹⁹

MCC Eligibility and Benefits

- Available to first-time homebuyers, defined as homebuyers who have not owned a home in the last three years, and Veterans.
- Income limits apply and vary by county and may be lower than down payment assistance (DPA) program income limits.
- Purchase price limits apply.
- MCC funds are limited.
- An MCC provides flexibility to reduce federal income taxes owed. An MCC certificate holder may choose to adjust their W-4 withholdings downward with their employer. With less money withheld for taxes, the MCC holder receives more take-home pay monthly.
- The MCC can be used by the lender to gross up qualifying income and improve debt-to-income ratios, if allowed by the loan program guidelines.
- MCC may be combined with state down payment assistance program for double benefit to the borrower, if allowed by the guidelines.¹²⁰

Bond Issues

It is the state's choice if they want to offer MCC tax credit, or they may instead offer Bond issues. Bond issues are monies set aside for lending to home buyers and are often offered a lower than market interest rate. Bond issues help low-to middle income families obtain favorable low-interest rate financing.

State and local governments sell tax-exempt Housing Bonds, commonly known as Mortgage Revenue Bonds (MRBs) and Multifamily Housing Bonds and use the proceeds to finance low-cost

¹¹⁹ <https://www.fdic.gov/resources/bankers/affordable-mortgage-lending-center/guide/part-2-docs/mortgage-tax-credit.pdf>

¹²⁰ <https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/Subpart-B3-Underwriting-Borrowers/Chapter-B3-3-Income-Assessment/2367083361/Is-a-mortgage-credit-certificate-allowed-as-income.htm#Mortgage.20Credit.20Certificates>

mortgages for lower-income first-time homebuyers or the production of apartments at rents affordable to lower-income families.¹²¹

County and city housing divisions may also have special programs for low-income families and community development areas.

Government Real Estate Sales and Auctions

Some federal agencies sell real estate on their websites or business partner sites by holding auctions. These programs do not allow down payment assistance, but if the borrower is obtaining the property at a lower than market value, their down payment would be lower than paying for a full market priced listed home.

To identify potentially lower priced houses, check:

- Fannie Mae's HomePath lists many single-family homes for sale across the U.S.¹²²
- Federal Deposit Insurance Corporation sells homes and commercial real estate from failed banks.¹²³
- U.S. Department of Agriculture sells homes, farms, and ranches, by auction or offer.¹²⁴
- US Department of Housing and Urban Development's HUD Homes lists homes for auction throughout the US.¹²⁵

The auctions below sell real estate, federal lands, and other types of government-owned surplus or seized property.

- **GSA Auctions:** Real estate, land, and lighthouses along with other government-owned excess property.
- **US Treasury Auctions:** Homes, land, commercial property, and other items forfeited by owners for violations of Treasury law.
- **US Marshals Service Auctions:** Seized homes, condominiums, commercial real estate, and land in the US and Caribbean, plus other items.
- **Bureau of Land Management:** BLM sells public lands, which are undeveloped land tracts with no improvements. To learn about public lands for sale, find and contact the BLM state office for the area of interest.¹²⁶

FNMA AFFORDABLE OPTIONS

Many larger housing finance agencies (HFAs), particularly at the state level, offer first mortgages to accompany their down payment assistance programs. They are often funded by state housing finance agencies and may subsidize portions of the interest to offer rates below what the normal market can provide, helping lower borrower buying costs and potentially monthly payments. They may also have reduced closing costs and fees and waive mortgage insurance requirements.

HFA Preferred

Fannie Mae HFA Preferred™ conventional loans are available to buyers with low-to moderate incomes and require the lender to work directly with the property's state Housing Finance Agency (HFA) or an approved lender within their network. Fannie Mae HFA Preferred pairs features of HomeReady with

¹²¹ <https://www.ncsha.org/advocacy-issues/housing-bonds/#:~:text=State%20and%20local%20governments%20sell,affordable%20to%20lower%20income%20families.>

¹²² <https://homepath.fanniemae.com/>

¹²³ <https://www.fdic.gov/buying/owned/>

¹²⁴ <https://properties.sc.egov.usda.gov/resales/public/home>

¹²⁵ <https://www.hudhomestore.gov/Home/Index.aspx>

¹²⁶ <https://www.usa.gov/real-estate-sales>

the flexibilities from local HFAs, designed to serve low-to moderate income borrowers. Freddie Mac offers the same type of benefits for their affordable options.¹²⁷

Standard 97% LTV Loan

Fannie Mae expands credit for eligible borrowers and supports sustainable homeownership with this 97% loan-to-value (LTV) financing options that help lenders serve first-time homebuyers.¹²⁸

Loan program key points:

- Desktop Underwriter (DU) underwriting approval required
- Allows financing up to 97% of the home purchase with just a 3% down payment.
- Gift funds can be used toward the down payment and closing costs.
- Reserves requirement from DU may be gifted.
- Allows for a higher debt-to-income ratio than some other loan programs.
- Combined LTV up to 105% provided subordinate lien is an eligible Community Seconds Loan.

Program Requirements:

- At least one borrower must be a first-time homebuyer.
- Minimum FICO score of 620, but some lenders might require a higher score depending on other factors like debt-to-income ratio.
- No minimum income requirements.
- Standard MI coverage, or Minimum MI coverage may be used subject to LLPA for Minimum MI.
- Property may be a single-family home, eligible condo, co-op, PUD, or MH Advantage Manufactured Home, and property used as their primary residence. Standard manufactured housing max LTV/CLTV is 95%.
- Purchase transactions with LTV, CLTV, or HCLTV > 95%, if all occupying borrowers are first-time homebuyers, then at least one borrower must complete homeownership education.

HomeReady

The Fannie Mae HomeReady program is designed to offer a conforming alternative to FHA financing. It is available for creditworthy first-time homebuyers. The program may allow for additional benefits such as title insurance credit, appraisal reimbursement and one-year home warranty reimbursement.

Loan program key points:

- Borrower is not required to be a first-time homebuyer.
- Lower rates and costs, along with a 3% down payment option.
- No minimum contribution to closing costs unless 2–4-unit property or sweat equity is being used for down, then 3% borrower contribution is required from their own funds.
- Accessible option for buyers with a minimum required FICO score of 620.
- Flexible underwriting guidelines, including the use of non-traditional credit sources and income from non-occupant borrowers.¹²⁹
- Allows supplemental boarder and rental income sources.
- 25% MI coverage for LTV ratios of 90.01–97%; standard MI coverage for LTV ratios of 90% or less. Minimum MI coverage used may be subject to LLPA for Minimum MI.

¹²⁷ <https://yourhome.fanniemae.com/buy/youve-got-options-when-it-comes-home-financing>

¹²⁸ <https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/97-loan-value-options>

¹²⁹ <https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/97-loan-value-options>

- Gifts, grants from lenders or other eligible entities, and Community Seconds®, and Cash-on-hand allowable for 1-unit properties only. Any eligible loan may have more than one Community Seconds (for example, third lien) up to the maximum 105% CLTV.

Program Requirements:

- Must meet income limits based on household size and location. 80% of AMI in all census tracts. HomeReady income limits are integrated into DU.
- Property must be used as borrower's primary residence.
- Eligible properties include single-family homes, condominiums, and townhouses.
- If all occupying borrowers are first-time home buyers, then at least one borrower must complete homebuyer education, regardless of LTV.

HomeReady Very Low-Income Purchase (VLAP)

Beginning with deliveries to Fannie Mae starting March 1, 2025, Fannie Mae is extending for twelve months, the HomeReady \$2,500 credit cap. The credit may be used towards down payment or closing cost assistance for very low-income purchase (VLIP) first-time homebuyers. Closing costs, down payment, or a combination of the two cannot exceed \$2500 credit. For this credit, at least one borrower on the loan must be a first-time homebuyer to be eligible for the VLIP LLPA Credit.¹³⁰

The credit will be effective for whole loans purchased through Feb. 28, 2026, and for loans delivered into MBS with issue dates through Feb. 1, 2026.¹³¹

HomePath Ready Buyer Program

In designated targeted areas, the borrower may receive \$5,000 for down payment or closing cost assistance and receive free homeownership education. The HomePath program additionally offers:

- \$500 credit for closing costs when buying a HomePath property.
- HomePath Ready Buyer program offers a 3% cash contribution to cover mortgage closing expenses.

HomePath properties are homes that Fannie Mae has repossessed due to foreclosure, short sale, or forfeiture. They are usually more affordable than standard market homes, but they are also sold in as-is condition. Fannie Mae has made a commitment to neighborhood stabilization across the country by making previously foreclosed homes available to new buyers at an affordable price.

HomePath Ready Benefits

- First-time homebuyers of HomePath properties who take Fannie Mae's HomeView course and receive a certificate of completion may receive up to 3% in closing cost assistance when purchasing a HomePath property.
- Both the HomePath Ready Buyer program and a HomeReady mortgage can be combined on the same home purchase.
- Buyers planning to live in a HomePath home as their primary residence get an exclusive "first look" at what is available and may even be able to put in an offer without competition from real estate investors.
- Additional closing cost assistance may be available for owner-occupant buyers of HomePath properties if their household income is at or below the area median income (AMI).

¹³⁰ <https://singlefamily.fanniemae.com/media/document/pdf/lender-letter-ll-2024-01-homeready-product-enhancement>

¹³¹ <https://singlefamily.fanniemae.com/media/37856/display>

- HomePath portal allows searches of homes for sale. Customize the home search based on location, price, square footage, property status, number of bedrooms or bathrooms, or any other preferences that matter to the borrower.¹³²

HomePath Property Purchase

To buy a HomePath property, the borrower must:

- Complete the Framework buyer education course
- Meet eligibility requirements, such as:
 - Having a low income (at or below 100% of the AMI)
 - Having a credit score of at least 620
 - Having a maximum debt-to-income ratio (DTI) of 36%
- If available, allows supplemental boarder or rental income
- Must qualify for their mortgage loan

Shared Equity Programs

Shared equity programs are usually run by government or nonprofit organizations and give first-time or low- and moderate-income buyers access to housing at prices much lower than typically available in a market.

Shared Equity Program Advantages

- They are usually only available to buyers below a certain income level.
- When borrowers agree to the terms, it can mean the home is theirs for as long as they like and may even be able to pass it down to their family.
- Pre-approval with the program provider may be needed for things like refinancing or home equity loans. Counseling to help homeowners make these kinds of financial decisions is usually offered in this instance.¹³³
- Fannie Mae HomeView has a comprehensive online course that is offered free of charge and can be used to satisfy the counseling requirements.

FREDDIE MAC AFFORDABLE OPTIONS

The following are Freddie Mac's solutions for homebuyers that need assistance with the down payment for the purchase of their owner-occupied home. These programs allow for relaxed guidelines for credit and sources of funds to close.

HomeOne

The Freddie Mac HomeOne mortgage is a low-down payment option that serves the needs of many first-time homebuyers, along with no cash-out refinance borrowers. A HomeOne loan is available to qualified first-time homebuyers for a low-down payment of just 3%.

This mortgage solution allows a borrower to achieve the milestone of homeownership, regardless of their income levels or geographic location. HomeOne provides the lender with responsible lending options, sustaining homeownership and improving access to credit.

With more flexibility for maximum financing, HomeOne provides expanded opportunity and greater certainty to bring more borrowers to the closing table.¹³⁴ More information may be found in Freddie Mac Guide 4605.2.

¹³² <https://homepath.fanniemae.com/>

¹³³ <https://yourhome.fanniemae.com/buy/youve-got-options-when-it-comes-home-financing>

¹³⁴ <https://sf.freddie-mac.com/working-with-us/origination-underwriting/mortgage-products/home-one>

HomePossible

Home Possible offers more options and credit flexibility to help very low-to-low-income borrowers attain the dream of owning a home. Freddie Mac's Home Possible program is an FHA alternative for conforming loans. The guidelines for these home loan programs are in the Guide Chapter 4501.

Home Possible Key Points:

- Allows a 3% down payment.
- Provides reduced mortgage rates and costs, including fixed-rate and adjustable-rate loan options.
- Flexible sources of funds for the down payment and closing costs, including gift funds, grants, cash on hand, and community second programs.
- Flexible underwriting guidelines, such as allowing for a higher debt-to-income ratio and the use of non-traditional credit sources.
- Allow for the inclusion of income from non-occupant borrowers, which can help multi-generational households qualify for a larger loan amount.

Loan program requirements:

- Must meet income limits based on household size and location.
- Property must be used as borrower's primary residence.
- Eligible properties include single-family homes, condominiums, and manufactured homes.
- Minimum FICO score of 660.

HOME READY AND HOME POSSIBLE DIFFERENCES

HomeReady is backed by Fannie Mae, while Home Possible is backed by Freddie Mac.

- **Credit score:** HomePossible requires a minimum credit score of 660, while HomeReady requires a minimum score of 620.
- **Down payment:** HomePossible has a minimum down payment of 5% on manufactured homes, while HomeReady allows a minimum 3% down payment on manufactured homes.

Both programs allow for 3% down payment for all other property types.

Properties with PACE (Property Assessed Clean Energy) are allowed on HomeReady, provided the lien subordinates to the first mortgage.

- **Homeownership education:** HomePossible does not require a homeownership education course but completing one may result in benefits like lower mortgage insurance costs.
- **Income limits:** Both programs have an income cap based on the AMI where the home is being purchased.
- **Multifamily & Unique Properties:** HomeReady requires a minimum borrower contribution of 3% for multifamily properties, while Freddie Mac requires a minimum of 5% for two-to-four-unit houses.

If the property is unique such as a working farm, look at HomeReady that is more lenient on property uses including multi-use properties and 3D printed homes.

- Both programs allow for flexible sources of down payment and closing costs, including gifts, grants, and rental income.
- Both also allow for non-occupying co-borrowers.

CHENOA FUND PROGRAM

The Chenoa Fund Program is a national initiative designed to help individuals with financial constraints afford homeownership by providing down payment assistance. The Chenoa Fund supports buyers by offering secondary financing options that include forgivable loans, repayable loans, and some with zero interest rates.

The program is tailored to meet various borrower needs. This program is particularly effective because it can be combined with FHA loans, offering a comprehensive solution for those lacking upfront capital to purchase a home.

Chenoa Fund Qualifications

To qualify for the Chenoa Fund, applicants must meet specific criteria to ensure they truly need down payment assistance. Prospective homebuyers should have a minimum credit score of 600 and a debt-to-income (DTI) ratio not exceeding 50% to demonstrate financial readiness. The programs offer down payment assistance of 3.5% to 5% of the purchase price or appraised value, whichever is lower, as a second mortgage that can be forgivable or repayable.¹³⁵

Before receiving assistance, borrowers are required to complete a homeownership counseling session, which can be done online or in-person, to fully understand the responsibilities of homeownership.

Income limits are set at no more than 115% of the median income for the region where the home will be purchased. The property bought must be the buyer's primary residence.

The borrower must secure a primary FHA mortgage through a participating lender and contribute a minimum of \$500 toward the purchase. The Chenoa Fund does not work with conventional loans.

Although primarily aimed at first-time homebuyers, the Chenoa Fund also offers products for repeat buyers. Chenoa Fund guidelines can vary slightly based on location.

For example:

- **Special Panama City Grant** - Up to \$50,000 to cover closing costs, down payments, and mortgage payments.
- The loan is forgiven after a specified period, typically 10-20 years, provided they maintain the home as their primary residence.
- Accommodates a diverse range of home types to ensure broad accessibility.

HERITAGE ONE MORTGAGE

The HeritageOne mortgage offering is an innovative financing solution designed to meet the borrowing needs of members of federally recognized Native American tribes living in tribal areas. With this offering, borrowers have access to conventional financing for various types of land ownership interests (for example, tribal trust land, allotted trust land, unrestricted or restricted fee simple land, etc.) and for homes located within eligible Native American tribes' tribal areas.

HeritageOne Requirements:

- At least one borrower must be an enrolled member of a federally recognized Native American tribe who will occupy the property as their primary residence.

¹³⁵ <https://chenoafund.org/>

- Regarding tribal eligibility, a federally recognized Native American tribe that has either entered into a memorandum of understanding with Freddie Mac or is listed in HUD's most recent Section 184 Participating Tribes List is considered eligible.
- The mortgaged premises must be located in the tribal area of an eligible Native American tribe.
- For purchase transactions where all occupying borrowers are first-time homebuyers, at least one occupying borrower must complete a homeownership education program before the mortgage's note date.¹³⁶

SECOND MORTGAGES – HOUSING FINANCE AGENCIES

Freddie Mac Affordable Seconds are designed to help meet the needs of borrowers who require flexible secondary financing options to increase their homeownership opportunities. If the Lender does not fund the Affordable Second, an Affordable Second must be provided by an Agency, credit union or community development financial institution under an established ongoing documented secondary financing or financial assistance program.

Originating with Affordable Seconds help strengthen mortgage originators community investment by leveraging public funds to originate more loans, increase originations for low- and moderate-income borrowers, reduce processing costs for secondary financing programs, and support collaboration with public agencies and nonprofit organizations.

The Fannie Mae Community Seconds program allows lenders to accept loans from sources like the community, nonprofits, and employers as a source of down payment and closing costs as well as from other down payment assistance sources. The funds may also be used for interest rate buydowns or property renovations.

SWEAT EQUITY

FHA loan programs, Fannie Mae HomeReady, and Freddie Mac FHA Advantage loan programs allow sweat equity for a source of down payment funds. Sweat equity is credit for labor performed on the mortgaged premises and/or materials furnished for the mortgaged premises by the borrower. Such credit must be fully explained and documented. The repairs and improvements must be reflected in the appraisal report as outstanding at the time of the appraisal. All repairs and improvements that are listed in the sales contract must be included in the appraisal report. Any labor performed must be completed in a skillful manner as certified by the appraiser. The value of the labor performed must be estimated by the appraiser or a cost estimating service and documented in the appraisal report or separately in the mortgage loan file.

Sweat equity is a way to apply the value of the borrower's volunteer work toward a borrower's down payment for a HomeReady loan. For borrowers putting sweat equity into their homes for HomeReady loans, Fannie Mae no longer requires a 3% personal funds contribution nor caps the sweat equity contribution towards a down payment.¹³⁷

The value for materials furnished must either be estimated by the appraiser or a cost estimating service or be calculated using receipts from the purchase of the materials. The value of the sweat equity that may be used as an eligible source of funds equals the value of the labor performed plus the value of the materials furnished.

¹³⁶ https://sf.freddie.mac.com/working-with-us/origination-underwriting/mortgage-products/heritageonesm-mortgage?gad_source=1&gclid=Cj0KCQjA4L67BhDUARIsADWrl7EA79cmfbFPmxOIPpPZe24QxaZMW6-FOEI-QAuVfRkMVvkii_N-cEaAmGuEALw_wcB&gclid=aw.ds

¹³⁷ Fannie Mae Selling Guide B4-4.3-13 and Selling Guide B5-6-02.

CLOSING COST ASSISTANCE IN US TERRITORIES

Closing cost appraisal assistance helps lenders support borrowers in the US territories of Guam, Puerto Rico, and the US Virgin Islands. This program is designed to reduce the financial burden of appraisal costs for eligible purchases and refinance loans, making homeownership more attainable for homebuyers.¹³⁸

MATCHED SAVINGS PROGRAM

As an asset-building strategy, matched savings programs provide financial incentives for people to save for specific goals. Studies show that participants in matched savings programs experience positive outcomes related to savings accumulation and goal attainment.

In theory, families with savings of \$250-\$750 are less likely to be evicted, miss a payment, or receive public benefits. It is documented, income volatility is on the rise, and 40% of adults said if faced with an unexpected \$400 expense, they lack the savings or disposable income to cover such an expense without selling something, borrowing money, or missing another payment.¹³⁹

Despite positive findings and a strong need for small dollar savings, federal Assets for Independence (AFI) funding for matched savings programs ended in 2016. In response to the lack of federal funding and based on previous success, NeighborWorks America began experimenting with and supporting matched savings pilot programs within its network of local NeighborWorks organizations providing homeownership, rental, and financial capability services across the country in 2016. NeighborWorks America wanted to learn what impact incentives would have on customers' financial behaviors and outcomes and what it takes to run a successful matched savings program.

Many of the NeighborWorks organizations that offered matched savings reported that the savings incentive was an excellent hook to attract new customers. Once in the program, participants saved more, achieved goals quicker, and engaged in more coaching than other customers. According to NeighborWorks organizations who were interviewed in 2019, such as the NHS of Baltimore and Community HousingWorks, the program strengthened relationships with customers, especially through the combination of matched savings and financial coaching.

It was found that adding matched savings to an established program leverages success. Before launching a matched savings program, it is helpful to take stock of existing programs and services and consider where such a program would add to the work already being done. NeighborWorks organizations with successful matched savings programs leveraged a variety of established services.

For example, Neighborhood Housing Services (NHS) of Baltimore tied its matched savings program to its Homebuyer Club, a peer-support homebuyer education model. Community HousingWorks offered the Emergency Matched Savings Program to participants of its Financial Health Club, a six-month financial education and coaching program.

INDIVIDUAL DEVELOPMENT ACCOUNTS (IDAs)

IDAs are matched savings accounts that help low-income and low-wealth individuals save for specific goals. IDAs are similar to 401(k) plans but are offered through partnerships between banks and non-profit or government agencies.

¹³⁸ <https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/down-payment-and-closing-cost-assistance>

¹³⁹ https://www.neighborworks.org/_neighborworks_/Documents/HomeandFinance_Docs/FinancialSecurity_Docs/ProjectBrief_LessonsLearned-MatchedSavingsPrograms.pdf

EMPLOYER ASSISTED HOMEOWNERSHIP BENEFITS

Freddie Mac allows employer assisted benefits on their Home Possible, HFA Advantage and Heritage One programs. The Employer Assisted Homeownership (EAH) is provided to an employee from the employer pursuant to an ongoing and documented employer benefit program provided:

- The employer is not an interested party to the transaction.
- The funds were not obtained from an interested party either directly or indirectly through a third party.

EAH may be used to provide financial assistance for down payment, closing cost grants, or even a portion of the mortgage payment to its eligible employees buying a home. These funds are not sourced from outside parties or investments, but rather from the company's operating budget or documentation required by the underwriter.¹⁴⁰

MANUFACTURED HOME AFFORDABLE MORTGAGE OPTIONS

Manufactured homes can be a less expensive option compared to site-built homes. There are a variety of modern, attractive models built to high standards with many modern amenities. Manufactured homes can come with attached garages, upgraded kitchens and bathrooms, energy-efficient appliances, and architectural features that blend seamlessly into a variety of neighborhoods.

The main difference is manufactured homes are built indoors in efficient facilities, then delivered to the property site and attached to a slab or secured to the land to meet HUD standards. As this is a different type of property, manufactured homes have specialty loan programs designed to meet the needs of these type of buyers.

Freddie Mac MH Advantage

For borrowers looking to purchase a manufactured home (MH) that is built to meet construction, architectural design, and energy-efficiency standards that are more consistent with site-built single-family homes, MH Advantage could be the right mortgage loan option.

Key Features of program:

- This loan allows for 30-year fixed-rate financing
- The down payment can be as low as 3%-5%
- The flexibility to fund the down payment through multiple sources, including gifts and grants
- Potential for lower interest rates compared with other manufactured home financing
- Opportunity for cancelable mortgage insurance once they reach 20% equity in their home.
- Credit scores as low as 620
- Provides conventional financing for both single-width and multi-width manufactured homes.

MH Advantage Sticker

The MH Advantage sticker, like the one shown, identifies homes that meet the standards for an MH Advantage mortgage. The presence of this sticker means that the borrower, and any future buyer of the home, will be eligible for MH Advantage financing.

MH Advantage stickers are usually applied near the HUD Data Plate (a government-required sticker) in a discreet location, such as in the utility closet or in a cabinet under the kitchen sink.

¹⁴⁰ <https://guide.freddiemac.com/app/guide/section/5501.4#:~:text=General%20requirements,to%204%2Dunit%20Primary%20Residence>

If the sticker is removed or damaged, it may impact the ability of the property to qualify for MH Advantage financing. If the MH Advantage sticker is removed or damaged, the borrower would need to contact the manufacturer of the home to see if a replacement sticker is available.



MORTGAGE OPTIONS FOR RENOVATIONS & UPDATES

Fannie Mae HomeStyle Renovation

This renovation loan program is for homebuyers that need additional sources of funds for the repairs on the property they are purchasing. It allows the borrower to do some updates or major repairs immediately after purchase, as the purchase money loan helps to finance the repairs or improvements.

A HomeStyle Renovation mortgage is an alternative for borrowers that do not want to use or may not qualify for the FHA 203k program. With HomeStyle Renovation, homebuyers can renovate a home to fit their needs and personal style with just one loan that covers the mortgage and improvements. HomeStyle Renovation lets buyers finance improvements expenses up to 75% of the property's as-completed value or the appraised value of the home once the upgrades are completed.

The program's key benefits include:

- Down payments as low as 3% for first-time homebuyers or those combining HomeStyle Renovation with a HomeReady mortgage.
- Cancelable mortgage insurance, competitive interest rates, which may provide a lower payment then if the borrower obtained a home equity line of credit or personal loan for the renovations.
- The flexibility to use HomeStyle Renovation for any projects such as updates to an older home, extensive design improvements, and even to construct or renovate additional living spaces like in-law suites and basement apartments.

- Allow borrowers to start their improvement projects sooner without having to spend out of pocket by using upfront draws from the loan. This is how contractors get paid for things like permits and architect's fees.
- One monthly payment with renovation funds bundled into your mortgage under one loan.
- Immediate equity in the home created by any renovations.

Fannie Mae HomeStyle Energy

With a HomeStyle Energy mortgage, there are options for the borrower to keep their utility bills low and their home environment healthy. HomeStyle Energy mortgages let homebuyers use up to 15% of the “as completed” value of the property for new energy improvements. Improvements above \$3,500 may require a Home Energy Reporting System (HERS), Department of Energy (DOE), or comparable report.

HomeStyle Energy mortgage can be used for:

- Energy efficiency improvements including ENERGY-STAR® certified products, smart thermostats, HVAC systems, basic weatherization and insulation, energy-saving windows and doors, and water heaters.
- Water efficiency improvements include water-saving toilets and low-flow shower heads and faucets.
- Renewable energy improvements including solar panels, wind power, and geothermal power.
- Home resilience/natural disaster readiness projects including storm surge barriers, foundation retrofitting for earthquakes, brush, and tree removal in fire zones, retaining walls, and radon remediation system installation.
- Pay off an existing energy improvement debt from Property Assessed Clean Energy (PACE) loans, credit cards, and home equity credit lines.¹⁴¹

Freddie Mac CHOICEReno Express

CHOICERenovation mortgage, is a new streamlined renovation mortgage that enables MLO to offer an additional financing option for borrowers who are looking to finance smaller-scale home renovations. Lenders may be allowed to sell a CHOICEReno eXPress mortgage to Freddie Mac prior to completion of the renovations without recourse. Most other renovation loans require all renovations to be completed with the lender prior to the sale of the whole loan to the secondary market.

Special loan program guidelines are:

- For CHOICEReno eXPress mortgages located in designated Duty to Serve high-needs areas, the total cost of the financed renovations should not exceed 15% of the value for purchase transactions and “no cash-out” refinance mortgages.
- For CHOICEReno eXPress mortgages not in Duty to Serve high-needs areas, the total cost of the financed renovations should not exceed 10% of the value for purchase transactions and “no cash-out” refinance mortgages.

Loan program benefit:

- Borrowers looking to finance relatively small-scale renovations
- Homeowners who need financing to make home improvements or repairs to their existing properties or a home they intend to purchase.
- Homeowners and borrowers who want to use the mortgage proceed to pay for the renovations

¹⁴¹ <https://yourhome.fanniemae.com/buy/youve-got-options-when-it-comes-home-financing>

FINDING DOWN PAYMENT PROVIDERS

The mortgage loan originator is the key contact for most borrowers to find out what assistance is available for their financial situation. The MLO should have access to the tools necessary to identify what assistance their borrower may use to turn a prospect into an active borrower.

MLOs can also look up the state's Housing Finance Agency and view available programs. View the agency's list of participating lenders to see if your company is approved.¹⁴² Freddie Mac offers a DPA One to assist MLOs in finding available DPA programs.

Freddie Mac DPA One®

Freddie Mac developed DPA One to assist MLOs and borrowers. The mission of DPA One is to overcome the down payment hurdle and centralize municipal, local, and state level down payment assistance programs under one platform.

With DPA One, down payment program providers can:

- Update, publish and manage DPA program information on demand.
- Save time and resources with an efficient submission process using a standardized format.
- View other DPA programs offered nationwide.

Although there are numerous down payment assistance programs (DPA) available in the US, first-time homebuyers often have little understanding about where to find a program or how to use it. Freddie Mac developed DPA One, a free online solution that effectively and efficiently helps lenders match home purchase borrowers to DPA programs.¹⁴³

DPA One's unique, user-friendly interface helps lenders and MLOs seamlessly identify and compare up to three DPA programs that best match a borrower's needs. It also offers DPA providers with a centralized location to manage their programs and share information about how funds are received, matched, and used.

In short, the initiative is a one-stop shop for DPA assistance with over 700 DPA programs. Using services like DPA One can make the difference between turning a prospective client into a homebuyer.

Freddie Mac is working to make this free service an online resource for all housing professionals. You may register for DPA One access to monitor new programs as they become available. Over 6,000 MLOs are finding eligible DPA programs for their clients using this system.

DPA One allows MLO to:

- Easily enter client eligibility parameters.
- Receive appropriately matched programs in real-time with ability to view and compare up to three matches.
- Download results to share with clients for easy reference.

¹⁴² <https://downpaymentresource.com/are-you-eligible/>

¹⁴³ <https://dpaone.freddiemac.com/>

DPA One Moves the Needle

DPA One reduces friction in the housing ecosystem by providing centralized access to DPA programs and reducing questions from lenders and submission errors by program providers, increasing the number of qualified borrowers and accelerating originations.¹⁴⁴

DPA One includes state-level HFA programs, and they have added municipal and local programs in all 50 states and DC with even more programs being added continuously.

Fannie Mae Home DPA Search Tool

Fannie Mae has partnered with DownPaymentResource.com to help mortgage professionals find the down payment and closing cost assistance borrowers need.¹⁴⁵ The Fannie Mae DPA search tool works much like Freddie Macs. As a mortgage professional, you may review both and see what best fits your lending community.

EXAMPLES OF ARIZONA STATE SPECIFIC DPA PROGRAMS

To give you an example of state DPA programs, let us review the state of Arizona. Arizona offers many down payment assistance programs that Arizonians can take advantage of and can be offered by their MLO.¹⁴⁶



AZ Home Plus Mortgage Program

The Arizona Home Plus mortgage program has been updated to offer a greater variety of opportunities to Arizona home buyers who need down payment assistance. These expanded options include different down payment amounts, higher maximum loan amounts and income limits, different loan programs and different qualifying criteria.¹⁴⁷

The Arizona Home Plus home loan program is popular because the funds have been consistently available over the past few years. The assistance program is structured as a three-year period, with no interest, no payment, soft second mortgage (no monthly payment), forgiven monthly at a rate of 1/36 over the term of the lien.

The DPA loan lien is completely forgiven after the borrower stays in the home for three years without refinancing. This type of lien is sometimes referred to as a silent second mortgage because the borrower does not pay interest on the loan balance or make monthly payments. The purpose of the silent second is to provide stability and ensure the ongoing success of the Home Plus Assistance Program in Arizona.

Government loan programs with Home Plus down payment assistance can be a great option because they usually have easier qualifying requirements. The three common government loan programs are FHA, USDA, and VA.

¹⁴⁴ <https://sf.freddie.mac.com/articles/insights/the-abcs-of-dpa-how-homebuyers-can-find-and-use-grants-second-loans-and-other-resources-to-boost-down-payments>

¹⁴⁵ <https://yourhome.fanniemae.com/calculators-tools/down-payment-assistance-tool>

¹⁴⁶ <https://www.arizonadownpaymentassistance.com/>

¹⁴⁷ <https://www.arizonadownpaymentassistance.com/down-payment-programs/>

Money from the Home Plus assistance is combined with government-sponsored mortgage programs and can be used for down payment and/or closing costs equal to as much as 5% of the mortgage loan.

Program Highlights:

- There is not a minimum amount that the borrower must provide to close. The down payment assistance can potentially cover all of their down payment and closing costs.
- No first-time home buyer requirement for most programs.
- The assistance money received is a silent second that has no interest, no payment and is forgiven monthly over the first three years of home ownership. The lien is completely forgiven after the borrower stays in the home for three years without refinancing.
- Qualified members of the U.S. military (active and Veterans) are eligible for an additional 1% of down payment assistance.
- The money continues to be consistently available.

Program Requirements:

- Maximum income limits for most programs. Check for maximum income information for conventional HFA loans under 80% AMI.
- Maximum debt-to-income of 45% if FICO score is 640 and 50% if FICO score is 680 or above.
- Additional requirements are needed based on the type of first mortgage the borrower is obtaining.

AZ Home Plus Conventional Loan Programs

Conventional loans with down payment assistance can be a great option because unlike some other loan programs, conventional loans allow home buyers to cancel their private mortgage insurance typically when the equity in the property reaches 20% of the property value.

AZ Home Plus Fannie Mae HFA Preferred Loan Program

This program is derived from the Fannie Mae HomeReady program and is one of the Arizona conventional Home Plus loan programs offered. It is offered anywhere in Arizona.

Program Highlights:

- Down payment assistance options between 3% and 5%.
- Minimum FICO score is 640 and 50% if FICO score is 680 or above
- If purchasing a manufactured home, the minimum FICO score is 660
- Maximum debt-to-income of 50%
- Maximum income limit if over 80% AMI.

Home Plus Freddie Mac HFA Advantage Loan Program

This program is derived from the Freddie Mac Home Possible Advantage program and is the other Arizona conventional Home Plus loan programs offered. It is offered anywhere in Arizona.

Program Highlights:

- Down payment assistance options between 3% and 5%
- Minimum FICO score is 640
- If purchasing a manufactured home, the minimum FICO score is 660
- Maximum debt-to-income of 50%

Home Plus vs FHA Advantage Comparison

Similarities:

- 97% LTV/105% TLTV/CLTV
- MI is cancelled
- Borrower can own one additional property
- Flexible sources of funds
- Allows 2-4 units and manufactured homes
- Non-occupying borrowers allowed

Differences:

Home Possible	vs.	HFA Advantage
Needs to meet income limits (qualifying income must be 80% or less of AMI)		Must be partnered with participating housing finance agency (HFA)
Only qualifying income needs to be considered-not household income		Each HFA sets income limits and requirements
Reduced MI coverage (25% for loans with LTV>95%)		Each HFA establishes homeownership education requirements
		Each HFA may offer their own DPA
		Charter Level MI (18% loans with LTVs >95%)

AZ Home Plus VA & USDA Loan Programs

VA and USDA loans are two popular government loan programs that offer 100% financing. Since there is no down payment requirement, the assistance money from the Home Plus program is used to cover closing costs. As such, a borrower can buy a home with little to no money out of pocket. Home Plus VA and USDA Loan Programs are great Arizona zero down loan programs

Program Highlights:

- Down payment assistance of 2% to 5%
- Minimum FICO score is 640
- If purchasing a manufactured home, the minimum FICO score is 660
- Maximum debt-to-income of 45% if FICO score is 640 and 50% if FICO score is 680
- Maximum income limits per program guidelines
- Borrower must meet the guidelines required to be approved for the VA or USDA loan

AZ Home Plus FHA Loan Program

FHA loans with down payment assistance in Arizona are popular because of their flexibility and other benefits. The Home Plus FHA loan program is offered anywhere in Arizona.

Program Highlights:

- Down payment assistance options of 2% to 5%.
- Minimum FICO score is 640
- If purchasing a manufactured home, the minimum FICO score is 660

- If using an FHA loan with Home Plus, the maximum loan amount depends on the FHA loan limits in the property's county
- Maximum debt-to-income of 45% if FICO score is 640 and 50% if FICO score is 680
- Maximum income limits

Maricopa County Home in Five Advantage

Borrowers buying a house in Maricopa County can get help with their down payment and closing costs by using the Home in Five Advantage program. This program has been extremely popular and used by home buyers in Phoenix and other parts of Maricopa County for years.

Program Highlights:

- Assistance for down payment and/or closing offered up to 6%. An additional 1% is available to qualified Veterans, active-duty Military, active Reservists, active National Guard, First Responders and Teachers.
- The assistance money is actually available. Many down payment assistance programs run out of funds within a short period of time each year.
- The Home in Five assistance money received is a silent second mortgage that has no interest, no payment, and is forgiven monthly over the first three years of home ownership. The lien is completely forgiven after the borrower stays in the home for three years without refinancing.
- The borrower does not need to be a first-time home buyer.

How to Qualify:

- Buy a house anywhere in Maricopa County, including in the City of Phoenix with no limit to purchase price outside of guidelines for the mortgage loan program limits.
- Purchase new or existing single-family homes, 2-to-4-unit homes, condos, townhomes, and manufactured homes.
- Qualify for a FHA, VA, USDA, Fannie Mae HFA Preferred or Freddie Mac Advantage Loan with a maximum debt-to-income ratio of 45% if FICO score is 640 and 680 if borrower is purchasing a manufactured home.
- Income from all borrowers may not exceed income limits
- Complete a required homebuyer education course

Pima County Tucson Homebuyer's Solution

The Pima Tucson Homebuyer's Solution benefits are similar to those offered by the programs listed before and are offered in all of Pima County including the City of Tucson. There is no purchase price limit to this program other than the maximum amounts of the loan program that the borrower uses for their first mortgage.

A Pima Tucson Homebuyer's Solution loan is offered through FHA, VA, USDA, Fannie Mae HFA Preferred and the Freddie Mac Advantage loan program.

Program Highlights:

- Down payment assistance options available between 0% and 4%.
- There is no first-time homebuyer requirement.
- Down payment assistance money received through the Pima Tucson Homebuyer's Solution is a silent second that has no interest, no payment, and is forgiven monthly over the first three years of home ownership. The lien is completely forgiven after the borrower occupies the home for three years without refinancing.
- The assistance money offered to help a borrower buy a home in Tucson or other parts of Pima County has been consistently available and has continuous funding.

- There are 3-year and 30-year forgivable down payment assistance options.

How to Qualify:

- Qualify for a FHA, VA, USDA, or conventional loan with a maximum debt-to-income ratio of 45% (some exceptions apply).
- Minimum FICO score is 640. Some of the different mortgage programs and down payment amount scenarios may require a higher score.
- Household income cannot exceed the income limits
- Complete a homebuyer education course.

AZ First Time Home Buyers ADDI Funds

ADDI will be administered as part of the HOME Investment Partnerships Program (HOME) by state and local participating jurisdictions. For more information on ADDI or the HOME program, contact your state or local participating jurisdiction, and confirm the available funds and time required to close.¹⁴⁸

AZ Home Buyer Grants

Programs offered by the federal government are typically administered through HUD. Programs including home loan grants in Arizona that HUD offers include (but are not limited to) the following:

- **Good Neighbor Next Door** provides substantial discounts on homes in key revitalization areas to teachers, law enforcement officers, firefighters and EMTs.
- **Homeownership Voucher Program** provides assistance in the form of home buying subsidies to first time homebuyer low-income families.
- **Homeownership for public housing residents** provides assistance for public housing residents in becoming homeowners.
- **Neighborhood Stabilization Program** helps revitalize Arizona communities that have been hit hard by foreclosures and abandonment to help boost and stabilize home values. The program aims for the purchase and redevelopment of foreclosed and abandoned homes and residential properties.

No matter what the DPA program a mortgage professional uses for their borrowers, it is their responsibility to ensure the DPA funds are reserved, and the borrower qualifies for the program. Work closely with your local agencies to keep informed of new programs coming available, and updates to existing DPA programs.

¹⁴⁸ <http://portal.hud.gov/hudportal/HUD?src=/states/arizona/homeownership>

Module 4 – FCRA Credit Review

FCRA Credit Review Lesson Objectives

The student will learn the importance of credit report accuracy, and who regulates the mortgage industry use of the credit report. The student will learn what makes up and influences the borrower's credit scores. There is an in-depth review of the coming credit report changes that will take effect in the 4 quarter of 2025.

CREDITWORTHINESS

When a consumer applies for credit for a home mortgage, lenders want to know what the risk is of loaning the consumer money. To evaluate this risk, lenders pull a credit report and credit score to review the applicant's creditworthiness. Credit scores have proven over many decades of use to be a good indicator of consumer creditworthiness.

The predominant credit scores used are FICO® Scores. FICO Scores are used by 90% of top US lenders, helping them make decisions about extending credit and at what terms and rates. FICO Scores are based on a complex, scientific algorithmic assessment of the information in the consumer credit report. FICO Scores have proven that it provides an unbiased and proven way to evaluate a consumer's credit risk and allows for faster credit decisions.¹⁴⁹

Per Experian, creditworthiness is a lender's appraisal of how likely a consumer is to repay their debts. Lenders assess consumer creditworthiness by taking into consideration income and looking at consumer history of borrowing and repaying debt.¹⁵⁰

CREDIT INQUIRIES

When a consumer applies for credit, they provide authorization to the lender with 'permissible purpose' to obtain a consumer's credit report and scores. The consumer must provide the lender with permission to obtain or inquire for a copy of the consumer's credit report from a credit bureau. When the lender pulls the credit report, the borrower's credit report will provide notice that their credit had an inquiry and list from who on the consumer's report. The only inquiries that will reduce a consumer's FICO Scores are the ones that result from applications for new credit that use a full credit report, or hard pull credit report.

It is important to know that there are 2 types of credit inquiries. Soft inquiries such as when a consumer views their own credit report which will not impact their FICO Score. Hard inquiries such as when actively applying for a new mortgage which will impact their score. Hard inquiries negatively impact the consumer's FICO Score, while soft inquiries do not affect their scores.¹⁵¹

For example, hard inquiries:

- A consumer goes car shopping and applies for financing at the car dealership who pulls a credit report on them to identify if they will qualify for the car financing.
- A consumer gets a preapproved credit card offer in the mail and responds to the offer.
- A consumer contacts a credit card company and requests a credit line increase. The company pulls a credit report on the consumer to help determine if they will grant the line increase.

Note: All hard inquiries are looking for creditworthiness to offer credit (money) to the consumer.

¹⁴⁹ <https://www.ficoscore.com/education>

¹⁵⁰ <https://www.experian.com/blogs/ask-experian/what-is-creditworthiness/>

¹⁵¹ <https://www.myfico.com/credit-education/credit-reports/credit-bureaus>

For example, soft inquiries:

- A bank gets an updated FICO Score on all its customers to check the credit quality of its customer base.
- Consumer gets a new job, and their employer pulled their credit report as part of its new employee screening process.
- Consumer goes to annualcreditreport.com and reviews their credit report.

CREDIT SCORE VERSIONS

Credit scoring was introduced to the mortgage industry in the late 1980's for testing and was then called Fair Isaac Scores after the company that created the score algorithms, Fair Isaac and Company. Credit scores were then used regularly in the mortgage industry in the mid-1990s when Fannie Mae and Freddie Mac made FICO scores mandatory for lenders to use on residential mortgage applications.

FICO scores have different names at each of the different credit reporting agencies:

- Equifax (Beacon)
- TransUnion (FICO Risk Score, Classic)
- Experian (Experian/FICO Risk Model)

To keep up with consumer trends and the evolving needs of lenders, FICO periodically updates its scoring models. As a result, there are multiple FICO Score versions and their updates for industry-specific FICO Scores uses.

FICO has created multiple versions as it has updated its scores, each focusing on a different type of credit usage, including:

- FICO Score 8 and 9: The most widely used versions of FICO
- FICO Bankcard: Used for credit cards
- FICO Score 2, 4 and 5: Used for mortgage lending
- FICO Auto Score: Used for auto loans
- FICO Score 10, 10T, Auto Score 10 and Bankcard Score 10: Newest versions of FICO Scores, not yet widely implemented

Each industry value different aspects of a borrower's credit history. Hence to determine if good credit risk for that industry they have different algorithms which generate different scores.

For example, a credit card provider would look less favorably on the consumer being late on a credit card debt whereas a mortgage company would be less concerned about a late on a small credit card debt, provided all installment debts are paid on time. The scores generated for the different FICO models will depend on the version the lender chooses to use.

The three major credit bureaus are Experian, TransUnion, and Equifax. Each of the three credit bureaus compiles its own credit report from the consumer's credit file, which is then used to generate the consumer's credit score. Since some creditors do not report to all three credit bureaus and because of the different versions of FICO used, the consumer may have a variation in credit scores generated.

Newest FICO 10T

In 2020, FICO released the FICO Score 10T to help lenders better predict and manage credit risk. FICO Score 10T uses a powerful new set of predictive characteristics generated from both traditional and trended credit bureau data. FICO Score 10T has the same minimum score criteria and score range as prior versions of the FICO Score.

FICO 10 uses the same reason codes as previous versions and can be easily adopted because it is “backward compatible”. FICO 10T is more predictive, but it requires some new reason codes and so will take more time and money to adopt this score for lenders.

This credit scoring model is different in that it will be using trended credit bureau data to help lenders evaluate new applications in real-time, make data-driven lending decisions, manage credit risk and default rates, and project cash flow more accurately.

From FICO, here are some updates related to FICO 10T:

- FHFA: In October 2022, the Federal Housing Finance Agency (FHFA) validated and approved FICO 10T for use by the GSEs.
- Planet Home Lending: In April 2024, Planet Home Lending began using FICO 10T to compare loans and retain customers.
- Transition: The FHFA has set a transition for lenders to use the new credit models for late 2025. The FHFA and credit bureaus are organizing historical data for the FICO 10T model and will issue a publishing date when it is determined ready.¹⁵²

Other FICO Score Versions

Different versions of credit scores have different factors in the algorithm determining the positive or negative impact for a consumer’s credit score. When a borrower makes an inquiry about a mortgage loan, the impact to their credit is supposed to allow for rate shopping on a loan. The scores are designed to allow the consumer to shop for a loan, without each hard inquiry negatively impacting their credit score.

In theory, the consumer while shopping for credit may receive hard inquiries for a set period of time that will allow the initial inquiry and all others to count as only one inquiry to the credit score. Currently the set periods are 14 days for Version 2 or 45 days for Version 5 and 6. Versions 5 and 6 provide the consumer with longer rate shopping periods than earlier versions.

For example, Experian is currently using Version 2 (14 days hard inquiry look back), while Equifax is using Version 5 and TransUnion is using Version 6 (both with 45 days hard inquiry looks back).

A problem with this ‘look back’ theory is that the input must be tagged a mortgage inquiry to still count as a single inquiry for credit. Not all lenders will tag the inquiry as a mortgage loan inquiry for the single pull impact for rate shopping. If the lender fails to designate the inquiry as a mortgage loan inquiry, the algorithms will think the consumer is inquiring about multiple types of credit rather than one home loan.

DU USE OF CREDIT SCORE

Credit scores are not an integral part of Desktop Underwriting (DU), but Fannie Mae relies on them to:

- Help establish a minimum credit threshold for mortgage lending.
- Provide a foundation for risk-based pricing.
- Support financial statements and disclosures to mortgage investors.

¹⁵²

<https://www.fico.com/en/ficoscore10#:~:text=FICO%C2%AE%20Score%2010%20T%20Outperforms%20All%20Prior%20FICO%20Scores,of%20the%20FICO%C2%AE%20Score.>

CURRENT CREDIT SCORING ISSUES

Consumer credit file accuracy is important as credit is the cost of money. Someone with good credit scores will receive a better interest rate on the money they borrow than a consumer that has low credit scores.

The funding lenders are not the ones that price up the low credit scores. The GSEs require LLPAs for clients with lower credit scores who then pay more for the use of credit. Whereas those with high credit scores are the 'cream of the crop' and get low Bank interest rates.

Loan-Level Price Adjustments (LLPAs) are assessed by Fannie Mae and Freddie Mac based upon certain eligibility or other loan features submitted in GSE's loan delivery system, such as credit score, loan purpose, occupancy, number of units, product type, etc.

In our current credit market environment, many things can impact a consumer's credit and keep them from purchasing a home with a good interest rate even though they technically are creditworthy.

CREDIT REPORT MODERNIZATION

Government agencies and credit bureaus have been working to improve consumer credit reports to better reflect the consumer's true creditworthiness without misleading issues tainting their credit scores. Credit report accuracy has been the focus for decades, and with the updated changes to the Fair Credit Reporting Act (FCRA), consumers are thought to be closer to a more accurate credit profile with the coming changes in 2025.

FICO 10T is one of two new credit scoring models that will improve and replace the Classic FICO score. The other score is termed VantageScore 4.0. They have differences in the amount of credit needed to generate a credit score.

- **FICO 10T:** Requires at least six months of credit history
- **VantageScore 4.0:** Only requires one month of credit history

FHFA's validation and approval of these two new credit score models, FICO 10T and VantageScore 4.0, for use by the GSEs is a big change for the mortgage industry. Once implemented, lenders will be required to deliver both FICO 10T and VantageScore 4.0 credit scores, when available, with each single-family loan sold to the GSEs.

The FICO 10T credit scoring model is expected to be required for conventional mortgages in the fourth quarter of 2025. This model will view collections and other negative information different from currently used scoring models.

During the extensive testing done on these two models, both of the newly approved models exceeded the required thresholds for accuracy, reliability, and integrity. The new models are expected to improve competition, reduce complexity for market participants, and provide a more comprehensive view of a borrower's credit history.

Other 2025 modernization changes include:

- Lenders will be able to pull two credit reports instead of three, reducing costs for borrowers.
- The transition will align with the implementation of bi-merge credit reporting, which requires lenders to pull two credit reports from the national consumer reporting agencies. Three bureaus will no longer be needed for GSE loans.

The FHFA in 2025 is working to:

- Accelerate the publication of VantageScore 4.0 historical data

- Provide similar data to support the transition to the FICO 10T model
- Release historical data on tens of millions of GSE loan acquisitions¹⁵³

In March 2023, FHFA and the GSEs initiated a public engagement process to solicit input on this initiative and gather information on how to ensure a smooth transition to the new credit score requirements. This engagement process was further expanded in September 2023, with additional opportunities for stakeholder input expected throughout 2024 and beyond.¹⁵⁴

Bi-merge Credit Reports

FHFA announced in October 2022, the GSEs would permit lenders to use either tri-merge credit reporting, in which credit reports from each of the three nationwide consumer reporting agencies are used, or bi-merge credit reporting, in which credit reports from two nationwide consumer reporting agencies are used.¹⁵⁵

Under a bi-merge approach, credit reports from two, rather than three, of the nationwide consumer reporting agencies may be used, which is expected to promote more robust market competition. GSEs are allowing the lender to determine which two credit bureaus they will use to generate the borrower's 10T scores.

By allowing the lender a choice of which credit agencies to use it was not the intent to allow MLOs to hedge the market by pulling three scores and then using only the highest two. The intent was for the lender to initially choose two bureaus to use to increase favorable lending decisions and borrower's ability to qualify.

New Rule Implementation

The new models will replace the Classic FICO score, which has been used for decades. The transition will take place in two phases, with the Interim Phase beginning in Q4 2025 and lasting for six to nine months. New models are more comprehensive and include use of non-traditional credit items when available.

Freddie Mac has provided lenders with an Enterprise Credit Score and Credit Reports Initiative Partner Playbook providing additional information about the initiative, including instructions on how to access Historical Data Files. In addition, it has a VantageScore 4.0 Historical Credit Score User Guide and Historical Data FAQs for lenders to use as they prepare for the changes.¹⁵⁶

FHFA and FICO have estimated that using FICO Score 10T can expand mortgage approval rates by 5% relative to versions most commonly in use today, without adding incremental risk.

FICO estimates delinquency rates could be reduced for mortgage originations by 17% at a cutoff of 680 as compared to prior FICO score models.

VantageScores

VantageScores® were introduced in 2006 by Equifax, Experian, and TransUnion, the three major credit bureaus in the United States. The credit scoring system was created to provide a more consistent credit score across all three bureaus and to compete with its competitor FICO.¹⁵⁷

¹⁵³ <https://capitalmarkets.fanniemae.com/mortgage-backed-securities/fhfa-announces-key-updates-implementation-enterprise-credit-score-requirements>

¹⁵⁴ <https://www.fhfa.gov/policy/credit-scores>

¹⁵⁵ <https://www.fhfa.gov/policy/credit-scores>

¹⁵⁶ https://sf.freddiemac.com/docs/pdf/fact-sheet/credit-report-and-credit-score-model_playbook.pdf

¹⁵⁷ <https://www.vantagescore.com/company/about-vantagescore/#:~:text=Launched%20in%202006%2C%20VantageScore%20is,%E2%80%93%20Equifax%2C%20Experian%20and%20TransUnion.>

The three primary credit bureaus in the US are Equifax, Experian, and TransUnion, and they are primarily responsible for generating FICO scores and VantageScores.

The Federal Housing Finance Agency announced an accelerated timeline for VantageScore adoption in the mortgage marketplace. Lenders who want to continue to sell mortgages to Fannie Mae and Freddie Mac will begin using VantageScore 4.0 scoring models by Q4 2025.

The FHFA emphasized that VantageScore adoption will help mortgage applicants more easily enter the marketplace. VantageScore 4.0 is touted by industry leaders as more accurate and more inclusive than the FICO scoring models currently required by Fannie Mae and Freddie Mac.

“Synchronizing bi-merge credit reporting with the implementation of the new credit score model requirements will reduce complexity for market participants, which is a key objective of our transition efforts,” FHFA Director Sandra L. Thompson said in a statement. *“The release of historical data on tens of millions of GSE loan acquisitions affirms the commitment of FHFA and the GSEs to a robust, transparent implementation process.”*

VantageScore research has found:

- An estimated 4.9 million new borrowers could gain access to the mortgage market
- Lenders could originate as many as 2.7 million mortgages, with an annual loan volume as high as \$1 trillion.¹⁵⁸
- New research indicates lenders could originate up to \$1 Trillion in new high-quality mortgage loans
- Adoption of VantageScore 4.0 helps address the racial homeownership gap while improving predictive performance

There are some differences between FICO and VantageScore to highlight:

- **Length of credit history:** To have a FICO score, consumers must have one or more credit accounts that have been open for at least six months and have been reported to the three nationwide credit bureaus within six months.

VantageScore credit scores can be calculated if consumers have one or more credit accounts that have been open for at least one month and one account reported within the past two years.

- **Hard inquiries:** When a consumer is shopping around for the best loan terms, both FICO and VantageScore count multiple hard inquiries for the same purpose as one inquiry for a certain period of time to minimize the inquiries' impact on credit scores. The time period, however, differs.

More recent versions of FICO use a 45-day shopping period, while VantageScore uses 14 days. FICO only includes mortgages, vehicle loans and student loan inquiries. VantageScore will do the same for hard inquiries dealing with other types of credit, including credit cards.

- **Collection accounts:** If past-due accounts are sent to a collection agency, it may impact their credit scores from either company. FICO ignores smaller collection amounts when the original balance is below \$100. VantageScore does not factor in paid collections but includes all unpaid collections regardless of amount.¹⁵⁹ Note there are pending changes to how medical collections are factored into the scores.

¹⁵⁸ <https://www.vantagescore.com/inman-new-rules-for-scoring-mortgage-borrowers-coming-in-q4-2025/>

¹⁵⁹ <https://www.equifax.com/personal/education/credit/score/articles/-/learn/difference-between-fico-scores-vantagescore/>

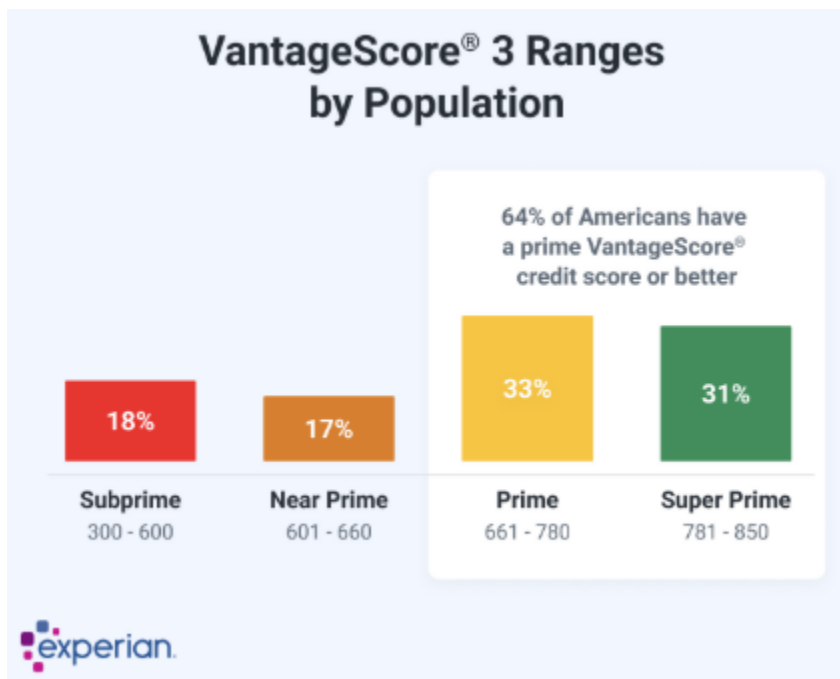
Credit Score Distribution

Both FICO and VantageScore assign higher credit scores to consumers deemed as lower-risk borrowers, and both currently range from 300 to 850. The classic FICO credit score found in 2019 that 59% of consumers had between 700 and 850, 45% had between 740 and 850, and 1.2% of consumers held the highest (perfect) FICO score of 850.¹⁶⁰ The average FICO Score continued to rise to 717 in 2023.¹⁶¹

Estimated consumer breakdown of FICO score ranges:

- Exceptional (800-850): 23%
- Very Good (740-799): 28%
- Good (670-739): 22%
- Fair (580-669): 16.6%
- Poor (300-579): 12.1%

VantageScore does similar with their three ranges of scores among the population.



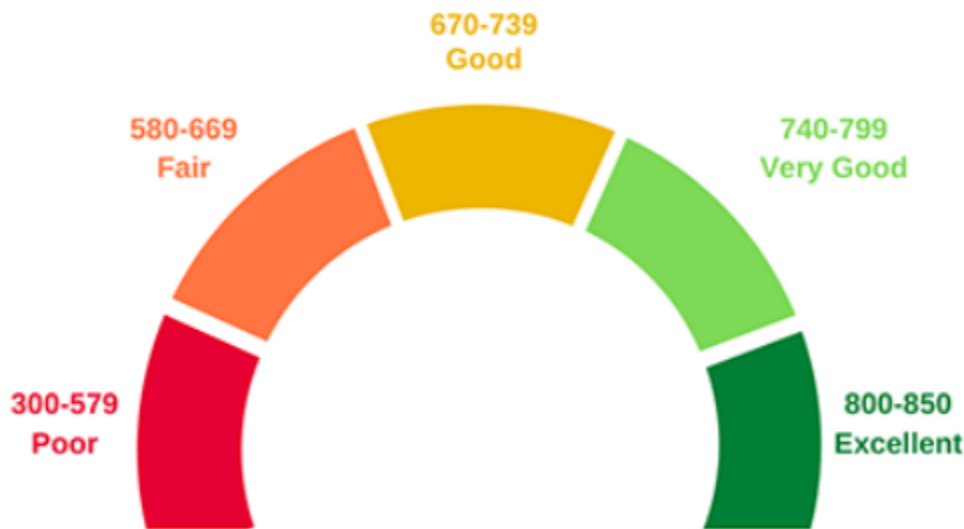
While individual Americans do not directly affect each other's credit scores, the collective credit behavior of Americans as a whole can indirectly impact the overall credit market, potentially influencing the interest rates and credit availability for everyone. This includes factors like the overall economic climate and lending practices which can affect how lenders assess credit risk for all borrowers based on broader trends in creditworthiness across the population.¹⁶²

¹⁶⁰ <https://www.experian.com/blogs/ask-experian/consumer-credit-review/>

¹⁶¹ <https://www.fico.com/blogs/average-u-s-ficor-score-stays-717-even-consumers-are-faced-economic-uncertainty>

¹⁶² <https://www.experian.com/blogs/ask-experian/credit-education/score-basics/what-is-a-good-credit-score/>

Credit Scores Interpreted-Good or Bad



There is more than one credit scoring model available and more than one range of scores. However, most credit score ranges are similar to the following:

- **800 to 850:** Excellent Credit Score
Individuals in this range are considered to be low-risk borrowers. They may have an easier time securing a loan than borrowers with lower credit scores.
- **740 to 799:** Very Good Credit Score
Individuals in this range have demonstrated a history of positive credit behavior and may have an easier time being approved for additional credit.
- **670 to 739:** Good Credit Score
Lender's view those with credit scores of 670 and up as acceptable or lower-risk borrowers.
- **580 to 669:** Fair Credit Score
Individuals in this category are often considered "subprime" borrowers. Lenders may consider them higher-risk, and they may have trouble qualifying for new credit.
- **300 to 579:** Poor Credit Score
Individuals in this range often have difficulty being approved for new credit. Consumers will find themselves in the poor category, which will require them to take steps to improve their credit before they can secure any new credit.

Consumers in the range of scores from 800 to 850 is considered Exceptional. This range is well above the average credit score. Consumers with scores in this range may expect easy approvals when applying for new credit. 23% of all consumers have FICO Scores in the Exceptional range.¹⁶³

CREDIT SCORE CATEGORIES

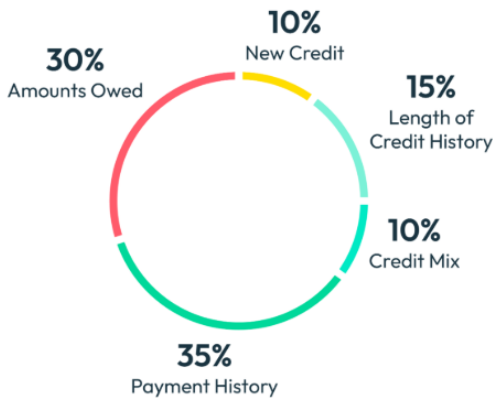
FICO Scores

FICO scores are calculated using five categories of information contained in consumer credit files, with varying weights given to each:¹⁶⁴

These categories are:

¹⁶³ <https://www.experian.com/blogs/ask-experian/credit-education/score-basics/820-credit-score/#:~:text=Your%20score%20falls%20in%20the,Scores%20in%20the%20Exceptional%20range.>

¹⁶⁴ <https://www.equifax.com/personal/education/credit/score/articles/-/learn/difference-between-fico-scores-vantagescore/>



1. **Payment history** (35% of the scores): Whether consumer has paid past credit accounts on time
2. **Amounts owed** (30% of the scores): The amount of credit and loans they are using. Note it says using, this is why paying off a credit card may lower a credit score. It is no longer part of the factor when it is paid off.
3. **Length of credit history** (15% of the scores): How long they have had credit
4. **New credit** (10% of the scores): Frequency of credit inquiries and new account openings
5. **Credit mix** (10% of the scores): The mix of consumer credit, retail accounts, installment loans, finance company accounts and mortgage loans.

VantageScore

VantageScore is calculated with six categories of information contained in consumer credit files. It does not focus on the percentages as much as their level of influence:

1. **Consumer payment history**: (extremely influential-40%)
2. **Depth of credit**: Consumer credit utilization, or the percentage of their credit limits (highly influential-21%)
3. **Credit Utilization**: The length of consumer credit history and their mix of credit accounts (highly influential-20%)
4. **Balances**: The amounts they owe (moderately influential-11%)
5. **Recent Credit**: Consumer recent credit behavior (less influential-5%)
6. **Available Credit**: Consumer available credit (less influential-3%)

When it comes to VantageScore, if a consumer falls within the 661 to 780 range, their credit score is considered to be good.

CREDIT SCORE MODERNIZATION

When the changes are implemented in Q4 of 2025, the current parts that influence the consumer's credit score will change. The new models take a different view of credit related items such as medical collections, credit card debts, and credit inquiries.

Medical Collection Changes

Medical collections can lower a borrower's credit scores by 75 to 80 points for recent collections. With these changes, a medical collection becomes a non-issue provided the consumer handles as needed in the time period now allowed.

- Medical Collections < \$500 are no longer eligible to be reported so there is no impact on scores.
- Medical collections >\$500 are not eligible to be reported for 12 months after being sent to collection.

Remember this change does not mean they do not owe the debt. A waiting period to report the debt allows the consumer time to resolve the collection issue without immediately impacting a consumer's credit scores.

Revolving Credit Changes

Revolving credit has been a crucial part of the consumer's credit score. Managing their revolving debts is one aspect that consumers have total control of. FICO credit scores look at the balances of the revolving credit versus the high credit available. Revolving balances account for 30% of a consumer's FICO scores. Previous recommendations for an optimal credit score were to keep the balance owed at 30% or less of the high credit available. The total amount of revolving credit was viewed against the total amount of balanced owed.

Recommendations have now been updated for consumers to keep their credit card balances 20-25% or less of the credit limit to have an optimum higher credit score. Credit scoring takes into consideration what credit cards are in use with balances. The credit cards with no balances will have less impact as the new models do not look at the total revolving owed versus total available.

Impact of Credit Inquiry Changes

FICO's research showed that opening several credit accounts in a short period of time represents greater credit risk. A consumer that takes on too much debt at one time has no history of being able to manage that amount of debt. This unknown increases a consumer's credit risk and lowers their credit score.

When the information on the credit report indicates that a consumer has been applying for multiple new credit lines in a short period of time (as opposed to rate shopping for a single loan, which is managed differently in scoring), the FICO Scores can be lower as a result. Although FICO Scores only consider inquiries for the last 12 months, inquiries remain in a consumer's credit report for two years.

As of 2025, the new FICO scoring model FICO 10T could potentially lead to a shift in how credit inquiries are considered, with a greater emphasis on recent credit activity and a more nuanced approach to evaluating multiple inquiries within a short period, potentially impacting how "rate shopping" is viewed in the credit scoring process. This change is expected to be most impactful for mortgage lending.

Key points about the changes in credit inquiries with the new FICO 10T scoring model:

- **Focus on recent activity:** The new model might place more weight on recent credit inquiries, meaning a flurry of inquiries within a short timeframe could have a larger impact on the borrower's score compared to previous versions.
- **Rate shopping considerations:** While the system may still allow for some degree of rate shopping (comparing loan options from different lenders), the number of inquiries and the timeframe within which they are made could become more critical in determining the credit score.
- **Bi-merge credit reports:** The FHFA is also pushing for the use of "bi-merge" credit reports, which combine information from only two credit bureaus instead of all three, potentially impacting how credit inquiries are evaluated.

These changes are expected to primarily affect mortgage applications, as the FHFA is driving the transition to new credit scoring models for conventional loans in Q4 2025.¹⁶⁵

PROPOSED FCRA CHANGES

The Consumer Financial Protection Bureau (CFPB) has proposed new rules for credit reporting that could significantly expand the scope of the Fair Credit Reporting Act. These proposed rules include:

- **Expanded definitions:** The CFPB proposes to expand the definitions of "used or expected to be used" and "assembles" or "evaluates" for a consumer reporting agency.
- **Credit header information:** The CFPB proposes to include a consumer's personal identifier, such as their name, date of birth, and Social Security number, in the definition of a consumer report.
- **Re-identification prevention:** The CFPB proposes to continue treating de-identified information as consumer reports.
- **Information verification:** The CFPB proposes to validate information received about a consumer, such as checking if their date of birth matches an external database.

Re-identification is the process of matching anonymized personal data with its owner. This can be a privacy concern because consumers may not be aware of how their information is used.

De-identification is the process of removing or obscuring personally identifiable information from data so that it is not possible to identify an individual. The goal is to minimize the risk of unintended disclosure of the individual's identity. The CFPB wants to continue to treat de-identified information as consumer reports, even if it has been aggregated.

Consumer Reports Definition Changes

One critical element of analyzing whether an entity is a "consumer reporting agency" is whether the data it provides to a third party is a consumer report.¹⁰ The Proposed Rule would interpret this definition in four new ways:

1. The definition of "consumer report" under the Proposed Rule would apply to certain types of data regardless of the purpose for which such data is used in connection with a particular product.
2. The definition of "consumer report" would apply to any product that is used in any way for an FCRA permissible purpose, even if the product were not intended to be used in such a manner and the product's provider reasonably attempted to prevent an improper use.
3. The Rule proposes three potential options for the circumstances under which information of the type that is subject to the FCRA has been de-identified falls within the definition of "consumer report."
4. The Rule adopts an interpretation in which credit report header data is a consumer report, even if provided in isolation from the substance of a consumer report.¹¹

In particular, the Proposed Rule's expansion of the definition of consumer report to include certain types of data regardless of how such data is used could cause many products or services specifically designed to fall outside the FCRA to be subject to its requirements in the future.

The Proposed Rule would also trigger consumer report treatment and its attendant significant legal risks and liabilities for any downstream recipient's use of the report for a permissible purpose. If the provider expects or should expect that a downstream recipient will use the information for an FCRA permissible purpose, they would be liable for its use.¹⁵ As a result, a provider of borrower's credit

¹⁶⁵ <https://www.housingwire.com/articles/fhfa-sets-transition-to-new-credit-models-for-late-2025/>

report would be deemed a consumer reporting agency if any person down the chain of information flow used the information for an FCRA permissible purpose, even if reasonable controls are put in place to prevent that from occurring.

Permissible Purpose Defined

A permissible purpose under the Fair Credit Reporting Act is a set of circumstances when a consumer reporting agency can provide a consumer report. The FCRA protects consumer privacy by limiting when consumer information can be disclosed.

Examples of permissible purposes

- **Credit:** Determining a consumer's creditworthiness for a loan application they requested.
- **Employment:** Evaluating a candidate's suitability for a position, promotion, or re-assignment
- **Insurance:** Underwriting a candidate's application for homeowner's insurance or driving a company vehicle
- **Rental housing:** Screening a tenant applicant to determine if they meet the terms of the lease agreement
- **License or benefit eligibility:** Determining if a consumer is eligible for a license or other benefit
- **Business transactions:** Reviewing a consumer's business transactions¹⁶⁶

Prohibited Credit Report Pulls

- **Lenders:** Lenders must ask for permission to pull a credit report on a potential borrower. Loan files require proof of the lender's receipt of permission. When the borrower signs the application for credit, this provides proof of permission.
- **Family and friends:** The general public, including family and friends, cannot request a copy of your credit report without a consumer's permission.
- **Employers:** Current or prospective employers can only get a copy of a credit report if the consumer agrees to it in writing.

The FCRA prohibits obtaining or using a consumer report without a permissible purpose. An MLO cannot pull a credit report on themselves. The Fair Credit Reporting Act (FCRA) limits who can check your credit and under what circumstances. As a consumer, an MLO can request a free copy of their credit report annually from each of the three nationwide credit reporting agencies at annualcreditreport.com.

Advertising Through Consumer Reporting Agencies Changes

The Proposed Rule also seeks to disrupt marketing services offered by consumer reporting agencies whereby consumer reporting agencies directly deliver advertisements based on consumer report information but avoids the requirements of the FCRA by never providing the consumer report information to their client.

As a technical manner, the Proposed Rule changes by defining what it means to "furnish a consumer report" to a third party to include facilitating a person's use of a consumer report for the person's financial gain.

As a result, the client on behalf of whom an advertisement is being delivered by a consumer reporting agency is a user of a consumer report and must have a permissible purpose. The client benefits from

¹⁶⁶ <https://www.federalregister.gov/documents/2022/07/12/2022-14823/fair-credit-reporting-permissible-purposes-for-furnishing-using-and-obtaining-consumer-reports>

the information in the credit report by targeting their advertising to the consumer based on the information in their credit report.

Currently, it would not include advertising unless it is in connection with making firm offers of credit or insurance. CFPB's policy focus is on preventing the use of consumer reports in marketing and given the expansions of this proposal, it could have far-reaching consequences on the consumer data used in targeting financial services and beyond.

Proposed Rule Changes for Data Broker Practices

The CFPB proposed changes to FCRA aimed at broadening its application to sensitive consumer information, including data managed by brokers. However, the proposed FCRA changes extend beyond data brokers, with significant implications for the definitions of "consumer report" and "consumer reporting agency," as well as permissible purposes for using consumer data.

This proposed rule would amend Regulation V to change the Fair Credit Reporting Act definitions. CFPB states the changes are needed to ensure that FCRA protections are applied to sensitive consumer information that the statute was designed to protect, including information sold by data brokers.

The proposed effective date (as of the writing of this course) has a CFPB consideration period of six months or one year after the final rule is published in the Federal Register. Comments due are due by March 3, 2025¹⁶⁷

Credit Report Trigger Lead Changes

Legislation to control trigger leads is in the works, but nothing has been proposed for industry review as of the writing of this course. Trigger leads are generated by the credit bureaus to customers that pay for the information to know when a consumer is applying for a mortgage loan. When a creditor obtains a 'hard pull' credit report on a borrower, the inquiry can generate a trigger lead. Upon receipt of this information that a borrower is shopping for a mortgage, the credit bureau's client uses the trigger lead information to solicit the consumer in an attempt to take the client away from the lender that did the initial credit pull. Trigger leads are different from prescreen leads in that a competitor is vying directly for your clients.¹⁶⁸

¹⁶⁷ <https://www.consumerfinance.gov/rules-policy/rules-under-development/protecting-americans-from-harmful-data-broker-practices-regulation-v/>

¹⁶⁸ <https://www.mgic.com/training/credit-in-2024----mike-olden>