FEDERAL MORTGAGE-RELATED LAWS

Learning Objectives

This chapter was created based on the Federal Mortgage-Related Laws section of the NMLS National Test Content Outline. The topics found in this chapter could likely appear on the NMLS national test in multiple choice question format. In this chapter, students will:

- Explore the requirements of the Real Estate Settlement Procedures Act, (RESPA) including a look at the current Good Faith Estimate (GFE)
- Understand the history and purpose of the Equal Credit Opportunity Act (ECOA) and its regulations
- Review the current requirements of the Truth-in-Lending Act (TILA) and a brief overview of upcoming changes under the law
- Examine the requirements of the federal S.A.F.E. Act and how it affects mortgage professionals
- Review mortgage industry obligations of additional federal laws including:
  - Home Mortgage Disclosure Act
  - Fair Credit Reporting Act
  - The Telemarketing Consumer Fraud and Abuse Prevention Act, including Do-Not-Call requirements
  - Fair and Accurate Credit Transactions Act
  - FTC Red Flag Rules
  - The USA PATRIOT Act

Introduction

Since the early 1970s, the mortgage lending profession has been regulated by an increasing number of federal laws addressing consumer protection. With the creation of the new Consumer Financial Protection Bureau (CFPB), which is focused first and foremost on protecting consumers in the financial marketplace, concerns regarding compliance with federal lending laws is greater than ever. There are many laws and rules regulating the business of mortgage professionals, and complying with them is critical to operating a successful business and avoiding the monetary fines and business losses that come with enforcement actions.

Until July 2011, mortgage professionals were subject to regulations issued by the Federal Reserve, the Department of Housing and Urban Development (HUD), and the Federal Trade Commission (FTC). With the exception of some regulatory authority retained by the FTC, the CFPB is now in charge of implementing and enforcing most of the provisions of federal lending laws that relate to protecting consumers while they are shopping for, securing, and paying off mortgages. The new agency is proving its commitment to carrying out its statutory directives to
monitor the compliance of all loan originators with the law, including those affiliated with both depository and non-depository institutions.

**Real Estate Settlement Procedures Act (RESPA/Regulation X – 12 U.S.C. §2601 et seq.)**

**RESPA Overview**

Congress enacted RESPA in 1974 for two purposes:

- To allow consumers to obtain information on the costs of closing so that they can shop for settlement services. RESPA uses mandatory disclosure requirements to ensure that consumers obtain information on closing costs.
- To protect consumers from excessive settlement costs and unearned fees. RESPA establishes prohibited practices to protect consumers from unearned fees.

**Regulatory Agency**

Effective July 21, 2011, the CFPB has replaced the Department of Housing and Urban Development (HUD) as the federal regulatory agency that is responsible for enforcement of RESPA and for issuing implementing regulations. The regulations that HUD has promulgated under RESPA are known as **Regulation X** (12 CFR § 1024.1 et seq.), and the CFPB will be making some revisions to these regulations in the near future. The regulations were previously found in 24 C.F.R. Section 3500.

**Loans Covered By RESPA**

RESPA applies to “federally related mortgage loans,” which are defined as loans secured by a first or subordinate lien on residential property which are:

- Made with funds insured by the federal government (e.g. FHA loans), or
- Made with collateral insured by the federal government (e.g. flood insurance), or
- Made with funds from a lender regulated by the federal government (e.g. FDIC or NCUA), or
- Intended for sale to Fannie Mae or Freddie Mac, or
- Made by a creditor regulated under the Truth-in-Lending Act, or
- Transactions involving a federally related mortgage loan, which includes most loans secured by a lien (first or subordinate position) on residential properties. This includes home purchase loans, refinances, lender-approved assumptions, property improvement loans, equity lines of credit, and reverse mortgages.

With such a broad definition of “federally related mortgage loans,” the requirements of RESPA apply to virtually every home loan secured by a mortgage.
**Exempt Loans**

RESPA does not apply to:

- Loans for 25 acres or more
- Loans for business, commercial, or agricultural purposes
- Temporary financing, such as bridge loans
- Loans secured by vacant land. A loan is secured by vacant or unimproved property when no proceeds of the loan will be used to construct a one-to-four-family residential structure. If the proceeds will be used to locate a manufactured home or construct a structure within two years from the settlement date, the loan is covered.
- Loan assumptions which are permissible without lender approval
- The sale of a loan into the secondary market
- Loan conversions, when a new note is not required and the provisions are consistent with those of the original mortgage

**Definition of Terms Related to RESPA**

Most of HUD’s enforcement actions result from violations of Section 8 of RESPA. There are a number of terms in RESPA that relate to the Section 8 prohibition against giving or receiving a fee, kickback, or “anything of value” pursuant to an “agreement or understanding” for the referral of settlement business. These terms are:

**Settlement Services:** Borrowers depend on a number of settlement service providers to prepare for closing. Third party services are provided by appraisers, inspectors, credit reporting agencies, title insurers, and loan processors. Settlement services include any service provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing or settlement.

**Things of Value:** Includes, but is not limited to, any payment, advance, loan, or service including money, discounts, commissions, salaries, stock, opportunities to participate in a money-making program, special banking terms, tickets to theatre or sporting events, services at special rates, and trips at another’s expense.

**Agreement or Understanding:** A written or verbal agreement or even an agreement established through a practice, pattern, or course of conduct, to offer things of value in exchange for the referral of settlement business.
**Fee-Splitting and Kickbacks:** The sharing of fees among settlement service providers. No person shall give or accept any split, or percentage of any charge other than for services actually performed.

**Markups:** A unilateral increase in the cost of a settlement service and retention of the additional fee by the party making the markup. Some federal courts have held that markups do not violate the RESPA rule against fee-splitting if they are not split or otherwise shared with the provider of the settlement service. Others have held that even unilateral markups are illegal. In a February 2012 Supreme Court Case, the Court confirmed that fee-splitting is prohibited only if the fee is actually split.

**Affiliated Business Arrangement:** Many service providers have a business relationship and an ownership interest in other settlement service providers. For example, a mortgage company may have an ownership interest in a title company. Profit-sharing by these affiliated companies is permissible under RESPA. However, as discussed in the outline of RESPA disclosures, it is the ownership interest and the potential to realize some profit as a result of that interest which a party making a referral must communicate to a borrower through an “affiliated business arrangement disclosure.”

**Sham Affiliated Business Arrangement:** A partnership or joint venture created between settlement service providers for the illegal purpose of splitting fees under the guise of a bona fide affiliated business arrangement. HUD’s “Policy Statement on Sham Controlled Business Arrangements” outlines the factors that are considered in determining whether an affiliated business arrangement is legitimate, and this issue may be one that the CFPB will address in upcoming rulemaking proceedings. In a July 2011 notice in the Federal Register, it was noted that policy statements such as HUD’s policy statements “…will be applied by the CFPB pending further CFPB action.” ¹ Therefore, mortgage professionals should continue to rely on exiting HUD policy statements to evaluate compliance with RESPA limitations on affiliated business arrangements.

**Borrower Credit:** Historically referred to as “yield spread premium” (YSP), the borrower credit is a fee paid to the borrower by the lender when a loan is originated at a higher interest rate than the lowest rate for which the borrower qualifies. The borrower credit is used to subsidize closing costs such as the origination or broker fee so that the loan results in a low- or no-fee transaction.

**Closing Cost Disclosures Required By RESPA**

There are several mandatory disclosures that are intended to provide consumers with the information that they need to shop for settlement services. These include the Good Faith Estimate, the Settlement Cost Information Booklet, the Mortgage Servicing Disclosure Statement, the Affiliated Business Arrangement Disclosure, and the HUD-1 Settlement Statement.

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Good Faith Estimate
Mortgage brokers and lenders must provide the Good Faith Estimate (GFE) at the time of application or mail it within three business days after receipt of a loan application. Under RESPA, business days do not include federal holidays, Saturdays or Sundays (unless Saturday or Sunday is a regular business day). It is important to note that when a broker takes a loan application, regardless of whether a lender has been selected, the broker is responsible for providing the GFE.

In the case of a purchase transaction, the GFE does not have to be provided until a subject property is identified. In this situation, the loan application is considered a pre-qualification until there is a specific subject property.

The GFE includes an estimate of the charges that are due at the time of closing. The fees listed on the GFE include charges to the borrower for loan origination, property appraisal, credit reporting, title insurance and recording the mortgage. The GFE also includes indirect fees, such as borrower credits, which are not paid directly by the borrower, but are received by mortgage brokers for the benefit of borrowers from lenders.

Fees found on the GFE can be consolidated into four key areas: lender and broker charges, title charges, government charges, and prepaid items and deposits.

Lender and Broker Charges: Lender and broker charges include fees for loan origination, appraisals, credit reports, inspections, mortgage broker services, underwriting and processing.

Title Charges: Title charges include the costs of the title search, title insurance, and notary fees. Title insurance insurers extend coverage after researching land records to determine if a piece of real estate is free of encumbrances such as mortgages, liens, easements, or other claims.

Government Charges: Municipal and government charges vary between states and municipalities. Generally, they include the cost of recording the mortgage transaction in the public land records. If property is changing hands, the charges may also include a tax for the transfer of real estate from one person to another.

Prepaid Items and Deposits: Prepaid items are paid by the borrower at the time of closing, even though the payments are not due until a point in the future. Pre-rated real estate taxes, homeowner’s and flood insurance, private mortgage insurance, and interim interest are among the most common prepaid items.

The key to understanding prepaid items is the idea that interest on a mortgage is always paid in arrears—after it has had a chance to accrue on the balance. This is why the first payment date on a mortgage is typically at least one month after the closing date.

The GFE
On November 17, 2008, HUD published revisions to Regulation X that were intended to make the GFE a document that consumers can rely on as an accurate estimate of settlement costs. Use of the revised GFE became mandatory on January 1, 2010. However, the CFPB has issued a
proposed rule in the Federal Register that includes a new “single integrated initial disclosure,” combining the information currently included in the GFE and the TIL Disclosure. Until this new disclosure is finalized, use of the disclosure form that was finalized in 2008 is required.

Prior to the 2008 revisions, Regulation X simply required a “reasonable estimate” of closing costs on the GFE. Under the 2008 regulations, all charges listed on the GFE, other than the interest rate and fees tied to the interest rate, must be available for at least ten business days from the time that the GFE is provided. At the time of settlement, the following charges cannot exceed the charges listed on the GFE:

- The origination charge
- Charges for locking an interest rate, while the rate is locked
- The adjusted origination charge, while the interest rate is locked
- State/local property transfer taxes

At the time of settlement, the total of the following charges cannot exceed the estimated costs listed on the GFE by more than 10%:

- Lender-required settlement services when the lender chooses the settlement service provider
- Lender-required services, title services, and title insurance, when the borrower uses a provider identified by the loan originator
- Government recording charges

Other types of charges can exceed those listed on the GFE. If a loan originator charges a borrower an amount that wrongfully exceeds the amount listed on the GFE, he/she has 30 days after closing to cure the excess charge by reimbursing the excess amount to the borrower. Loan originators can offer a revised GFE, but they must document the reasons for any changes in the charges listed, and they must retain the information on the revisions for at least three years after settlement. Charges that can change on a GFE, requiring revisions, include required services that a borrower can shop for, title services and lender’s title insurance, owner’s title insurance, initial deposit for the borrower’s escrow account, daily interest charges, and homeowner’s insurance. These changes can be made at settlement.

**Changed Circumstances:** If “changed circumstances” lead to an increase in the cost of settlement services or a change in the eligibility of the borrower for the loan terms stated in the GFE, the loan originator may provide a revised GFE to the borrower. Regulations X defines “changed circumstances” to include:

- *Acts of God, war, disaster, or other emergency*
- *Information particular to the borrower or transaction that was relied on in providing the GFE and that changes or is found to be inaccurate after the GFE has been provided. This may include information about the credit quality of the borrower, the amount of the loan, the estimated value of the property, or any other information that was used in providing the GFE*
- New information particular to the borrower or transaction that was not relied on in providing the GFE
- Other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance, or environmental problems

(12 C.F.R. §1024.2 (b))

If a revised GFE is provided, it must be issued within three business days of the loan originator becoming aware of information that constitutes changed circumstances.

**Definition of Completed Loan Application**

With the GFE due no later than three business days after receipt of a completed loan application, it is important to understand how “loan application” is defined. A loan application has been made when the loan originator has received six pieces of information. The six pieces of information are:

- The borrower’s name
- The borrower’s monthly income
- The borrower’s Social Security number
- The property address
- The estimated value of the property
- The amount of the mortgage loan sought by the borrower

(12 C.F.R. §1024.2 (b))

**Settlement Cost Booklet or Information Booklet**

The Settlement Cost Information Booklet is due three business days after completion of a loan application for a purchase transaction. Loan originators can use their own booklet, or use the HUD booklet, which the CFPB has adopted. The HUD booklet:

- Explains the settlement process
- Tells borrowers that they have the right to negotiate the terms of a loan
- Reviews the protections that RESPA creates for borrowers
- Warns borrowers that their use of false information on a loan application can lead to loss of their home, a poor credit rating, and even criminal prosecution for fraud

There is some flexibility in providing the Settlement Cost Booklet. If there are multiple borrowers, such as a husband and wife, only one disclosure is necessary, and it may be provided to any one of the borrowers. The booklet may also be reproduced in any form, stamped with a mortgage professional’s contact information and translated into any language. However, it cannot be combined into a larger document with other disclosures.
HUD’s version of the booklet is available online. The Dodd-Frank Act requires the CFPB to revise the booklet at least once every five years and to draft multiple versions “…in various languages and cultural styles, so that the booklet is understandable and accessible to homebuyers of different ethnic and cultural backgrounds” (H.R. 4173 §1450(a)).

There is a difference between booklets offered in home purchase transactions and those offered in transactions for a Home Equity Line of Credit (HELOC). The Settlement Cost Information Booklet is for home purchase transactions. Consumers who are shopping for an open-ended loan, such as a Home Equity Line of Credit, must receive an information brochure entitled, “When Your Home Is On The Line: What You Should Know About Home Equity Lines of Credit.”

**Mortgage Servicing Disclosure Statement**

This disclosure requirement applies only to first-lien mortgages. The Mortgage Servicing Disclosure Statement is due three business days after completion of the loan application. The disclosure states whether the loan servicing can be sold, assigned, or transferred during the life of the loan. More specifically, the disclosure must include:

- The applicant’s acknowledgment of receipt of the disclosure (If there is more than one applicant, signatures of all applicants are required)
- A statement indicating that the lender or table-funding mortgage broker does not service loans and intends to sell the servicing or, for those lenders who service loans after funding them, a statement indicating whether there is a possibility that the lender may sell, assign, or transfer the servicing at any time during the loan term
- A statement that the lender or table-funding mortgage broker has not serviced mortgage loans in the past three years and will not service the loan or, for those lenders who service loans after funding them, an indication of the percentage of loans (rounded to the nearest 25%) originated within the past three years for which servicing was sold, assigned, or transferred
- A statement of the borrower’s rights with regard to complaint resolution

Servicing rights are bought and sold regularly. A borrower may see the servicing sold several times over the life of a loan. Servicing transfer statements, which are discussed below, ensure that borrowers know that a new loan servicer has their loan.

Appendix MS-1 to Part 1024 includes a model form for the Mortgage Servicing Disclosure Statement. Regulation X states that the applicant’s acknowledgement portion of the disclosure must be in the format presented in the model form, with additional signature lines added for co-applicants.

**Affiliated Business Arrangement Disclosure**

If a settlement service provider refers a loan applicant to an affiliated business for settlement services, he or she must disclose the affiliated business arrangement at the time of making the referral. For example, if a loan originator refers a client to a title insurance company in which

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the loan originator has an ownership interest, disclosure of the ownership interest is required at the same time as the referral. When referrals are made by telephone, borrowers must receive written disclosures within three business days after the call. The disclosure must:

- Describe the business arrangement, including the percentage of ownership of the interest of the referring party and service provider
- Estimate the costs that will be charged by the provider to whom the loan applicant is referred
- Advise the borrower that he/she is not required to use the service provider to whom he/she was referred (Note, however, that lenders can require the use of a particular attorney, appraiser, and credit reporting agency)

The Appendix to Regulation X includes a recommended format for use in disclosing an affiliated business arrangement.

**HUD-1 Settlement Statement (HUD-1)**

The HUD-1 Settlement Statement is the form used for the itemization of actual costs in a transaction that involves a borrower and a seller. The HUD-1A Settlement Statement discloses the costs of settlement in lending transactions, such as refinancing or closings on second mortgages, which do not involve a seller. Both are subject to the same rules for proper disclosure. As previously mentioned, the HUD-1 and HUD-1A Settlement Statements are currently the subject of extensive revisions as the CFPB creates and tests prototypes of a “single integrated closing disclosure” that combines the information contained in the HUD-1 disclosures with the Truth-in-Lending disclosures made at the time of closing.

While the GFE provides an estimate of the closing costs, the HUD-1 must show the actual, final dollar amounts for the costs associated with settlement. Both forms have corresponding numbered fields so that a borrower can compare the costs between the two documents.

The HUD-1 or the HUD-1A Settlement Statement is due at the time of closing, but the borrower may request a copy one business day prior to settlement. If the borrower or his/her agent is not at the closing, the settlement statement must be mailed as soon as practicable after closing.

Often, borrowers do not see the HUD-1 Settlement Statement until they arrive at the closing and discover that they must pay more than anticipated for settlement services. Confused by discrepancies between closing costs listed on the GFE and the HUD-1 Settlement Statement, and too frustrated to do anything other than assume the unanticipated costs, few consumers are willing to back away from the closing table to shop for better fees. Proposed reforms to the disclosures by the CFPB are intended to address these concerns.

**Consumer Protections Provided By RESPA After Closing**

RESPA continues to protect consumers after the closings on their mortgage loans take place. Section 10 protects consumers by ensuring that borrowers know the amount of funds deposited in escrow accounts and by preventing lenders from overcharging borrowers for escrow deposits.
The disclosures required by Section 10 are the Initial Escrow Statement and the Annual Escrow Statement. The Initial Escrow Statement is typically given at settlement, however, the lender has 45 days from settlement to deliver it. Section 10 also prevents loan servicers from overcharging for escrow payments by:

- Requiring escrow account analysis annually
- Limiting the cushion a borrower must maintain to cover escrow disbursements to $\frac{1}{6}$ of the estimated total annual disbursements
- Generally, requiring the refund of any surpluses over $50 within 30 days after the completion of the escrow account analysis that reveals a surplus

Section 6 of Regulation X includes provisions to ensure that borrowers have adequate notice when their loan servicing is transferred to another institution and establishes a protocol for managing consumer complaints about the servicing of their loans. The disclosure required by this section is the Servicing Transfer Statement.

The Servicing Transfer Statement must be sent by the lender or servicer who is transferring the loan at least 15 days prior to the transfer. The new loan servicer must also provide notice within 15 days after the transfer has occurred and may not assess late fees for a period of 60 days after the transfer.

**Record Retention Requirements for RESPA Disclosures**

RESPA imposes a five-year record retention requirement on lenders for the following disclosures:

- Mortgage Servicing Disclosure Statement
- HUD-1 or HUD-1A Settlement Statement
- Affiliated Business Arrangement Disclosures

Regulation X states that when selling a loan or transferring the servicing, lenders must include the HUD-1 or HUD-1A Settlement Statement in the loan file. The new owner or servicer must retain the Settlement Statement for a period of five years or until the loan is sold, paid off or its servicing is transferred again.

**Lending Practices Prohibited By RESPA**

Borrowers depend on a number of settlement service providers to prepare for closing. Mortgage brokers, real estate brokers, attorneys, appraisers, inspectors, credit reporting agencies, notaries, and title insurers are examples of professionals who offer settlement services. As industry partners, it is natural for these settlement service providers to exchange referrals. In fact, consumers rely on those who are in the lending industry to help them find the professionals they need to close a loan.
Section 8(a) of RESPA prohibits anyone from giving or accepting referral fees, kickbacks or a "things of value" unless a commensurate amount of work is performed to earn the fee. Section 8(b) prohibits the splitting of fees.

Violations of Section 8(a) and Section 8(b) can result in the payment of significant fines and even imprisonment. Therefore, it is important to understand how HUD applies the law to particular facts.

When investigating the practices of settlement service providers, HUD looks for:

- **Exchange of “things of value” for business referrals**: The term includes, but is not limited to, any payment, advance, loan, or service including money, discounts, commissions, salaries, stock, opportunities to participate in a money-making program, special banking terms, tickets to theatre or sporting events, services at special rates, and trips at another’s expense.

- **Fee-splitting**: Sharing of fees among settlement service providers even though one or both parties fail to perform enough work to earn the fee.

- **Unreasonable charges**: Excessive charges (such as double-billing) even when services are performed to earn a fee. RESPA also prohibits charging any fees (other than a credit reporting fee) until the loan applicant has received the GFE.

- **Illegal “agreement or understanding”**: Two parties share a written or verbal agreement or even an agreement established through a practice, pattern, or course of conduct, to offer things of value in exchange for referrals.

HUD has tried to facilitate an understanding of its interpretation and enforcement of the law by offering descriptions of factual situations that demonstrate RESPA compliance failures. These descriptions may be found in Appendix B of Regulation X.

**Sham Affiliated Business Arrangements**

In 1996, HUD reported receipt of numerous complaints about the creation of sham affiliated business arrangements. HUD’s response was the publication of its “Policy Statement on Sham Controlled Business Arrangements.” In its Policy Statement, HUD explained its method of determining whether the party receiving referrals is a “bona fide provider of settlement services” or if the arrangement is a sham. The CFPB has indicated that it intends to continue to enforce HUD’s policy statements, so despite the transfer of implementation and enforcement authority from HUD to the CFPB, this policy statement remains relevant.

The ten factors HUD considered, and that the CFPB will now consider, when assessing an affiliated business arrangement for legitimacy, include:

1. Sufficient capital to operate
2. Its own employees
3. Control of its own business affairs
4. A separate office
5. Assumption of the risks and rewards of a comparable enterprise
6. Performance of the services it purports to offer, instead of contracting out the work
7. Agreements to contract out work to an independent third party
8. Proof that it pays an amount that reflects the reasonable value of services performed by a third party
9. Evidence that it competes in the market for business
10. Business interaction with members of the lending industry other than its affiliate

In order to determine whether affiliated businesses are properly limiting their financial gains to the “return of an ownership interest,” the CFPB will consider the following factors deemed relevant by HUD, including whether:

- Each owner in the new entity has made an investment of his/her own capital
- Each owner’s interest in the business is based on the amount he/she/it invested
- The owners receive financial awards from the new entity based on the amount they invested or based on the number of business referrals
- Ownership interest is adjusted, based on the number of business referrals

**Markups and Borrower Credit**

Sham affiliated business arrangements have been a focus of RESPA enforcement actions. However, there are two additional practices that have resulted in years of legal challenge and unresolved controversy. These practices are:

- Earning compensation from markups
- Earning compensation from borrower credit

Both practices have been subject to the challenge that they violate Section 8 prohibitions of RESPA and result in unearned compensation.

**Earning Compensation from Markups**

Markups are an issue that has led to extensive litigation and to disagreement among courts in different jurisdictions. A “markup” is a unilateral increase by a settlement service provider of a charge for a service that was completed by another provider. The markup of the charge is made for the purpose of collecting and retaining an additional fee. For example, in one case disputing the legality of a markup, a mortgage banker marked up the fees charged by a courier and retained the difference between the actual cost of the courier’s service and the markup.

Some federal courts have held that markups do not violate the RESPA rule against fee-splitting because they do not involve the actual splitting or sharing of a fee between settlement service providers.
providers. Other courts have deferred to HUD’s interpretation of markups as a violation of Section 8 of RESPA. As noted in the section of this course that defined the term “markup,” in a February 2012 Supreme Court Case, the Court confirmed that fee-splitting is prohibited only if the fee is actually split.

**The Controversy Over Borrower Credit**

The topic of borrower credit is an important consideration when generating the Good Faith Estimate and effectively communicating costs and fees associated with a loan to a borrower. The borrower credit has historically been known by the industry term “yield spread premium,” or YSP. The fee is calculated by determining the difference between the best rate for which a borrower qualifies and the interest rate the borrower accepts. The fee was controversial because some mortgage brokers placed borrowers in loans with rates higher than which they qualified in order to pocket larger commissions from the lenders that funded the loans. As a result of rules adopted by the Federal Reserve in 2010, this practice is illegal, and YSPs may only be used to help borrowers cover settlement costs. Now, borrowers can finance closing costs and reduce the out-of-pocket cash needed at closing.

Page two of the GFE includes a block of information called “Your Adjusted Settlement Charges” and includes three options for disclosing the interest rate and coverage of settlement costs. When a borrower credit fee is involved in a transaction, mortgage brokers must disclose to the borrower that he/she will “…receive a credit of $_____ for this interest rate of _____%” and that this credit “…reduces your settlement charges.” This disclosure is intended to ensure that borrowers receive a benefit from accepting a loan at a higher rate of interest than a lower rate for which they may qualify.

**Penalties for Violations of RESPA and Regulation X**

Violations of Section 8, which prohibits kickbacks, referrals, and fee-splitting, are subject to RESPA’s most severe penalties including fines of up to $10,000 and one year in prison.

Section 6 of RESPA addresses loan servicing and allows consumers to file individual or class actions against loan servicers for RESPA violations. In individual actions, loan servicers may be liable for damages. If a pattern or practice of noncompliance with the servicing requirements of
RESPA exists, the loan servicer can be liable for additional penalties of up to $1,000. In class actions, damages may not exceed $1,000 for each member of the class, and total damages may not exceed $500,000 or 1% of the net worth of the servicer.

Failure to submit an initial or annual escrow statement in compliance with Section 10 of Regulation X can result in a civil penalty of $75, with a limitation of $130,000 on the penalty imposed on one servicer for violations occurring within a consecutive 12-month period. However, if a loan servicer intentionally disregards the requirements of Section 10, penalties are $110 for each violation, with no limit on the total amount of the penalty.

**RESPA Reform**

The primary goals of RESPA are to provide consumers with adequate information to shop effectively for settlement services and to protect consumers from excessive settlement costs. In spite of these goals, settlement costs have increased steadily since the 1974 enactment of the law. With Americans paying more than $55 billion to complete real estate closings each year, many critics argue that RESPA has failed to control these costs.

For close to a decade, regulators, mortgage professionals, consumer interest groups and legislators have dedicated countless hours to reforming RESPA to ensure that it provides consumers with the protections that it was intended to give to them in mortgage lending transactions.

The last result of these efforts was HUD’s publication of a rule in November 2008 that included a new GFE and a revised HUD-1 Settlement Statement. It is likely that mortgage professionals will have to adjust once again to new disclosures. Prototypes for a “single integrated disclosure” that combines the information on the GFE and the TIL Disclosure are available on the CFPB website and are currently the subject of formal rulemaking proceedings.

The forms that the mortgage industry is currently using went into effect on January 1, 2010. Following is a summary of the information found on these forms:

- The GFE is a three-page document that features an instructional page aimed at helping borrowers understand their loan offer. Information that should be apparent to borrowers includes:
  - What is the term of the loan?
  - Is the interest rate fixed?
  - Is there a pre-payment penalty?
  - Is there a balloon payment?
  - What are the closing costs?

- A page on the HUD-1 Settlement Statement which corresponds with the GFE
Yield spread premiums must be clearly disclosed as a credit to the borrower. The GFE and HUD-1 includes an area for disclosure if a premium is earned by the broker in conjunction with the loan transaction.

Verification of information on the loan application cannot proceed until the applicant has given the loan originator the go-ahead. This is intended to ensure the consumer has had time to shop, following receipt of the GFE.

Lenders and settlement service providers have 30 days from the date of closing to correct any errors or violations of RESPA’s disclosure and tolerance requirements. This includes repayment of any overcharges to consumers.

**Equal Credit Opportunity Act (ECOA/ Regulation B - 12 C.F.R. §1002.1 et seq.)**

**ECOA Overview**

In 1974, Congress enacted the Equal Credit Opportunity Act (ECOA) to eliminate discriminatory treatment of credit applicants. The primary reason for the enactment of ECOA was anecdotal evidence that women were not treated on an equal basis with men when applying for credit, including their applications for mortgages.

ECOA and its regulations are intended to promote the availability of credit to all creditworthy applicants regardless of race, color, religion, national origin, sex, marital status, or age. The law also prohibits credit decisions being based on the fact that the applicant has income from a public assistance program, or that the applicant has exercised his or her rights under the Consumer Credit Protection Act (e.g. participation in a consumer credit counseling program).

**Regulatory Agency**

Before the creation of the CFPB, the Board of Governors of the Federal Reserve was the agency that issued regulations for the implementation of ECOA. These regulations are known as Regulation B (12 C.F.R. § 1002.1 et seq). Until July 2011, the enforcement of ECOA was shared by the federal banking agencies, but the CFPB is now the agency that has authority to enforce the law and regulations. As directed by the Dodd-Frank Act, the CFPB has established an Office of Fair Lending and Equal Opportunity that is directly responsible for enforcing ECOA and the Fair Housing Act. The FTC retains some of the authority that it historically held for enforcing the compliance of non-depository lenders, mortgage brokers, and mortgage loan originators with ECOA.

**Loans Covered by ECOA**

ECOA applies to transactions for the extension of credit by any person who regularly extends, renews or continues credit. The law also applies to a person who “…regularly refers applicants to creditors, or selects or offers to select creditors to whom requests for credit can be made.”

Mortgage brokers serve primarily as a liaison between borrowers and lenders by referring applicants to select lenders or by offering borrowers a variety of loan products from a number of
lending institutions. Therefore, the definition of creditor applies to mortgage brokers, and is not limited to lenders or mortgage bankers who actually extend credit.

Unlike RESPA and TILA, ECOA applies to extensions of credit for business, commercial, and agricultural use.

**Exemptions**

There are very few exceptions to ECOA’s prohibitions against unlawful inquiries concerning the personal characteristics of credit applicants. Two notable exceptions include:

- Inquiries regarding race, ethnicity, sex, marital status, and age are permitted for purposes of federal programs that monitor compliance with fair lending laws, such as the Home Mortgage Disclosure Act (HMDA)
- Creditors may obtain information about an applicant’s protected characteristics in order to determine the applicant’s eligibility for special-purpose credit such as a credit assistance program offered by a non-profit organization or for a federal or state program to assist the economically disadvantaged

Loan originators may inquire if the borrower wishes to voluntarily provide information on personal characteristics for purposes of completing HMDA forms or for determining the borrower’s eligibility for credit assistance, and, if not, the loan originator must use his/her best judgment to guess.

**Definition of Terms Related to ECOA**

Adverse Action: (i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor makes a counteroffer (to grant credit in a different amount or on other terms) and the applicant uses or expressly accepts the credit offered; (ii) A termination of an account or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor’s accounts; or (iii) A refusal to increase the amount of credit available to an applicant who has made an application for an increase.

Discriminate: To treat an applicant less favorably than other applicants.

Discouragement: An oral or written statement, communicated to applicants in advertising or by any other means that discourages an applicant from applying for credit on a prohibited basis.

Prohibited Basis: Prohibited basis means race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract); the fact that all or part of the applicant’s income derives from any public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any state law upon which an exemption has been granted by the Board.
**Self-Testing:** Any program or study conducted by a creditor that is designed to evaluate the creditor’s compliance with ECOA and Regulation B.

**Tester:** An individual who poses as a loan applicant to test a creditor’s fair lending policies and practices.

**Corrective Action:** Action that a creditor must take if a self-test shows that “it is more likely than not” that a violation of ECOA has occurred. The action must include identification of the policies and practices that led to the violation, and an assessment of the scope of the violation. If corrective action is adequate to remedy possible violations, the information and data obtained during the self-test is privileged. Taking corrective action is not an admission that a violation occurred.

**Disclosures and Notifications Required by ECOA**

**Notice of Action Taken:** Within 30 days of receipt of a loan or credit application, lenders must notify consumers in writing of action taken. If the creditor takes adverse action on the application, the notice must provide a statement of the reasons for the unfavorable decision, and must include a statement that ECOA prohibits discrimination against credit applicants. A description of the credit is also provided on the notice and, if the adverse action was based on data from a consumer credit report, information on the credit reporting agency must also be included.

**Notice of Incomplete Application:** Within 30 days of receipt of an application that lacks information that the applicant can provide, the creditor must provide a Notice of Action or a Notice of Incompleteness. A Notice of Incompleteness must state the information needed, set a reasonable time for submission of the information, and advise the applicant that failure to provide the information will result in no further consideration of the application.

**Notice of Right to Receive Appraisal Report:** If a loan applicant applies for credit is to be secured by a lien on a dwelling, the creditor must notify the loan applicant in writing of the right to receive a copy of the appraisal report, unless the appraisal report is routinely provided. The notice must advise the applicant to make a written request for the appraisal report. It must give the creditor’s mailing address and specify time limitations for making the request. Creditors are not required to respond to requests received more than 90 days after providing a Notice of Action Taken. Notices of the Right to Receive Appraisal Reports are due at the same time as the Notice of Action Taken. (Please note: a notice is not required if the appraisal is routinely provided to the borrowers.)

**Disclosures Regarding Monitoring Programs:** While ECOA establishes prohibited bases that may not be considered when granting credit, the law does make an exception for demographic information gathered for government monitoring programs. The Home Mortgage Disclosure Act is one law which requires compliance with government monitoring. Providing information about a prohibited category such as race or sex is voluntary on the part of a loan applicant.
When obtaining information on race, ethnicity, sex, marital status, and age for monitoring purposes, creditors must advise applicants that the information is requested by the federal government for monitoring purposes and that the creditor must provide information on ethnicity, race, and sex, and will provide the information to the government based on visual observation if the applicant refuses to provide it.

**Lending Practices Prohibited by ECOA**

In order to prevent discrimination in the extension of credit, ECOA prohibits certain inquiries and statements.

**Unlawful Inquiries:** Lenders may not ask questions regarding:

- Marital status (permissible inquiries for government monitoring may only use the categories: “married,” “unmarried,” or “separated”)
- Sex of the applicant
- Bearing and rearing of children
- Race, color, religion, or national origin
- Age
- Intentions regarding the bearing and rearing of children

**Unlawful Statements:** Lenders may not make oral or written statements that would discourage prospective credit applicants from applying for a loan.

**Additional Prohibitions:** Lenders may not:

- Refuse to consider public assistance as income
- Assume a woman of childbearing age will stop work to raise children
- Refuse to consider income from a pension, annuity, or retirement benefit
- Refuse to consider regular alimony or child support (although borrowers are not required to disclose alimony and child support unless it is used as qualifying income)

The CFPB began formally accepting complaints from consumers about mortgage transactions in December 2011. The online complaint form includes an optional question: “Do you believe the issue involves discrimination?” With a special department in place to address fair lending matters, the CFPB is equipped to address claims involving allegations of discrimination.

**Penalties for Violations of ECOA**

Violations can result in civil penalties of $5,000 per day for violations of ECOA or Regulation B. Where a pattern of misconduct exists, penalties of $25,000 are permitted. Violations of ECOA can also lead to punitive damages for non-governmental entities.

Punitive damages are limited to $10,000 in individual actions and to the lesser of $500,000 or 1% of the creditor’s net worth in class actions. Costs and attorney’s fees may also be awarded.
Consumers are required to bring civil actions within two years of the occurrence of an alleged violation.

**Discussion Scenario: Equal Credit Opportunity Act and Redlining**

The United States Department of Justice (DOJ) entered into a consent decree with Big Bux Mortgage Lender after charging Big Bux with multiple violations of the Equal Credit Opportunity Act (ECOA).

Big Bux Mortgage Lender is a mortgage lender headquartered in a large metropolitan area of a mid-west state. Big Bux is primarily a residential real estate and small business lender, and has been one of the area’s largest volume lenders in each category for many years.

DOJ claimed that Big Bux avoided doing business in a large number of minority census tracts in their service area. The complaint alleged that the lender’s policies and practices denied minority residents an equal opportunity to obtain financing because of their race and ethnicity. As a result, hundreds of potential African American and Hispanic borrowers were denied loans.

The case also alleged:

- In operating and extending its business, Big Bux acted to meet the credit needs of predominantly white residential areas while avoiding the majority minority neighborhoods.
- Big Bux had a pattern of acquiring branch offices outside of African American and Hispanic communities. In one particular year, Big Bux opened 20 branch offices throughout the metropolitan area, but none in a majority minority census tract.
- None of the branches in the minority census tracts offered the full range of lending services available at Big Bux’s full-service branches located in white suburban communities.
- Big Bux unlawfully considered race and national origin in its business practices by marketing and advertising only to a general audience, despite the existence of minority format radio and newspaper.
- During a four-year period, only 4.8% of the residential loan applications Big Bux generated were secured by property located in majority minority census tracts – in an area in which 38% of the census tracts are majority minority tracts.

Big Bux Mortgage Lender denied the DOJ’s allegations and claimed it never deliberately discriminated against any individuals, groups, or areas based on race or national origin. However, it freely entered into a consent decree with the United States. The decree included a number of provisions including a nondiscrimination injunction prohibiting Big Bux and its agents from engaging in discriminatory acts. The decree forced Big Bux to take reasonable steps to ensure that all credit offers are made available and marketed in the minority census tracts throughout the metropolitan area.
The decree also required Big Bux to open additional full-service branch offices located in the designated areas that provide the same range of services typically offered at its full-service branches in suburban areas. Finally, Big Bux was required to train employees regarding ECOA statutes and the Fair Housing Act.

**Discussion Questions**

- What are some steps mortgage loan originators can take to ensure they are not engaging in discriminatory practices?
- What should a mortgage loan originator do if he/she feels that a potential loan applicant has no way of qualifying for a loan? Is it ever ok to refuse an application?

**Discussion Feedback**

ECOA prohibits creditors from discriminating in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, because the credit applicant receives income from a public assistance program, or because the credit applicant has exercised rights under the Consumer Credit Protection Act.

The provisions in the consent decree illustrate the DOJ’s commitment to enforcing fair lending practices and protecting borrowers’ rights. Through this and similar lawsuits, the DOJ enforces the idea that all Americans have the right to purchase homes and to borrow that money free of illegal discrimination.

Mortgage professionals can ensure their origination and lending practices are compliant by:

- Putting business policies and procedures in place which ensure discrimination does not occur
- Ensuring their advertising campaigns are inclusive of their service area and appropriately communicate a commitment to non-discriminatory practices
- Accepting applications from potential borrowers without regard to any of the protected categories and only discussing with a borrower the factors that have relevance to creditworthiness (i.e. income, assets, credit history, etc.). Remember that it’s the lender’s determination to extend or deny credit; loan originators cannot refuse to accept a loan application.


**TILA Overview**

Congress enacted the Truth-in-Lending Act [15 U.S.C. 1601 et seq.] (TILA) in 1968 as Title I of the Consumer Credit Protection Act (CCPA). The ultimate goal of the CCPA was to promote the informed use of credit by consumers. TILA was the first law in which the federal government adopted disclosure requirements as a means of protecting consumers from unfair treatment by creditors. The primary goals of TILA are to:

- Protect consumers by disclosing the costs and terms of credit
- Create uniform standards for stating the cost of credit, thereby encouraging consumers to compare the costs of loans offered by different creditors
- Ensure that advertising for credit is truthful and not misleading
- Provide borrowers with the right to rescind certain types of mortgage transaction

TILA has been amended many times since its enactment. In 2008, the Mortgage Disclosure Improvement Act led to a number of revisions to the law, and the most recent amendments occurred under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Title XIV of the Dodd Frank Act, referred to in the law as the “Mortgage Reform and Anti-Predatory Lending Act” creates many new provisions under TILA. The following outline of TILA requirements focuses on the requirements that are currently effective.

**Regulations and Regulatory Agencies**

The regulations issued pursuant to TILA are known as Regulation Z (12 C.F.R. § 1026.1 et seq.). Before the creation of the CFPB, the Board of Governors of the Federal Reserve (the Board) was responsible for writing TILA’s implementing regulations and enforcing them. Now, the CFPB is responsible for implementing and enforcing TILA and Regulation Z. An understanding of the requirements of Regulation Z is critical to achieving compliance with TILA.

In addition to writing the provisions of Regulation Z, the Board also published Official Staff Interpretations of its regulations. Regulation Z is extremely complex, and the Staff Commentary is a useful tool for interpreting these regulations.

Before July 21, 2011, the Board shared its TILA enforcement authority with the federal banking regulatory agencies and the Federal Trade Commission (FTC). After the July 2011 transfer of authority from these agencies to the CFPB, only the FTC retained some enforcement authority. In January 2012, the CFPB and the FTC signed a memorandum of understanding in which they agreed to coordinate their rulemaking and enforcement efforts.

**Loans Covered by TILA**

TILA applies to all credit transactions which meet the following four conditions:
- The credit is offered to consumers
- The offer or extension of credit is made regularly
- The credit includes a finance charge or a written agreement stating that the loan may be repaid in more than four installments
- The credit is primarily for personal, family, or household purposes
Definitions Relating to TILA

There are a number of terms used within the Truth-in-Lending Act that are important to understand the law’s requirements. The following definitions are intended as an introduction. The terms will be addressed in more detail throughout the course.

Finance Charge: The cost of credit expressed as a dollar amount

Annual Percentage Rate (APR): A measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made

Closed-end Credit: Credit that is extended in a lump sum at one time, such as a traditional mortgage loan

Open-end Credit: Credit that may be accessed in a revolving manner such as a credit card. Home Equity Lines of Credit (HELOCs) are a common example in the mortgage industry.

Creditor: An individual or entity, such as a lender, that extends closed-end or open-end credit

Home Equity Plans: Loans structured as open-end credit. Home equity plans shouldn’t be confused with the general industry term “home equity loan” – a home equity loan is generally a second mortgage or piggyback loan based on the equity a borrower has in his or her home.

Truth-in-Lending (TIL) Disclosure Statement: The primary disclosure required by TILA for loans

CHARM Booklet: A disclosure booklet used to educate consumers on the risks associated with adjustable-rate mortgages

Early ARM Disclosure: A type of Truth-in-Lending disclosure for variable/adjustable-rate mortgages – covers specifics for each type of loan program

Trigger Terms: Terms used in advertising that trigger specific information required by TILA

Lenders Regulated by TILA

TILA regulates “creditors,” defining them as natural persons or business and financial organizations that do all of the following:

- Offer credit to consumers
- Make the credit subject to a finance charge or make the credit payable under the terms of a written agreement that requires repayment in more than four installments
- Regularly extend consumer credit to consumers
Regulation Z applies the definition of “regularly extend consumer credit” differently to closed-end and open-end lenders. The definition applies to lenders who originate more than one closed-end loan in a 12-month period. With open-end lenders (such as those who offer home equity lines of credit), the definition applies to those who extend credit more than 25 times in a calendar year.

Throughout this course, the term “lender” is used to denote those creditors who are subject to TILA and Regulation Z while engaged in the business of mortgage lending.

**Loans Regulated by TILA**

TILA regulates transactions that involve the extension of credit to individuals for personal, family or household purposes. Under TILA, mortgages are a form of credit and are subject to regulation when both of the following are true:

- The borrower’s dwelling secures the mortgage debt
- The homeowner uses the proceeds of the loan for personal, family, or household purposes

TILA does not apply to:

- Business, agricultural, or organizational credit
- Credit in excess of $25,000, as long as it is not secured by real property or a dwelling (Note that if the lender later uses the borrower’s principal dwelling to secure the loan, it becomes necessary to comply with TILA)
- Public utility credit
- Credit extended by a broker registered with the Securities Commission Exchange or the Commodity Futures Trading Commission
- Home fuel budget plans
- Student loans

The loans that are subject to TILA are subject to two sets of rules: Those for open-end credit and those for closed-end credit. While differences in Regulation Z’s rules for closed-end and open-end credit may be minor at times, it is important to note the distinction in order to fully comply with the law.

**Closed-End Loans**

In a closed-end transaction, a lender disburses all of the funds at closing and demands repayment within a specified period of time. During the repayment period, borrowers cannot request an increase in the principal amount of the loan. A loan to purchase a home and a mortgage refinancing to secure a lower interest rate are examples of closed-end loans that are subject to the provisions of TILA and Regulation Z.
**Open-End Loans**
The primary characteristic of an open-end loan is that both borrower and lender anticipate repeat transactions. In an open-end transaction, a lender gives the borrower a limit on the amount of funds that he/she can withdraw, and the borrower can request a cash advance in any amount. The borrower may have the option of requesting an increase in the credit amount. Payments depend on the interest due on the amount withdrawn.

**Timing of the Truth-in-Lending Disclosure Statement**
TILA requires loan originators to provide the initial Truth-in-Lending (TIL) Disclosure Statement to loan applicants within **three business days** of application and a final version at closing. This requirement does not change, however no fees may be charged to the loan applicant before the initial disclosures are provided. The law does provide an exception for credit reporting fees. The TIL Disclosure Statement must be delivered or mailed to the loan applicant no less than **seven business days** prior to settlement. (12 C.F.R. § 1026.19(a)(2)) If a mortgage professional is properly providing the early TIL (within three business days after application) and there are no changes to the information on the TIL, settlement can be scheduled as early as seven business days following the initial disclosure. However, an example provided in the Regulation Z Commentary clarifies that the day the disclosure is delivered or placed in the mail is not counted as one of the seven business days. (See Staff Commentary to Section 19 (a)(2)(i))

The TIL Disclosure Statement is presented along with the Good Faith Estimate (required by the Real Estate Settlement Procedures Act) and provides the cost of credit. These costs are expressed as a dollar amount – the finance charge – and a percentage – the annual percentage rate (APR). The TIL Disclosure Statement also includes terms of the loan such as the existence of prepayment penalties, a variable rate, etc.

TILA mandates that the TIL Disclosure Statement must be re-disclosed if the APR on a regular loan varies by more than one-eighth of 1% at any time prior to closing. This requirement stays in effect, but there must be at least a three-business-day waiting period prior to closing if an inaccurate APR must be re-disclosed. The idea is that this provides the borrower with ample time to consider his/her options prior to settlement.

**Disclosing the Cost of Credit**
One of the primary goals of TILA is the establishment of a uniform standard for stating the cost of credit. Use of the same standard enables consumers to compare the costs of loans offered by competing lenders. The two uniform standards created by TILA are **finance charges** and **APR**. The challenge in calculating the finance charge is to accurately distinguish between the charges that should be included in the finance charge and those that are excluded. We will take a look at how to make this determination.
**Determining Finance Charges**

There are two basic rules for determining whether a fee is included in the calculation of the finance charge:

- The finance charge does not include any fees of the type that are payable in a comparable cash transaction.
- The finance charge includes fees paid to third parties if the lender requires the use of a particular third party or retains a portion of the third party charge. This is particularly important in mortgage transactions because third party settlement service providers generate many of the fees.

Two more rules that are important when calculating the finance charge for a mortgage are the special rules for closing agents and mortgage brokers.

**Closing Agent Charges**

Fees charged by the closing agent are included in the finance charges if the lender requires these services, requires a charge for these services, or retains a portion of the charge. If the lender retains a portion of the charges, the finance charge should reflect only the portion of the fee that the lender keeps.

**Mortgage Broker Fees**

A mortgage broker’s fees are always included in the finance charge even if the lender does not require the use of the broker’s services and does not retain a portion of the charge. The following chart found on the CFPB website is helpful in identifying charges that are included and those that are excluded from the finance charge.⁴

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### Finance Charge Chart

**Finance Charge** = Dollar cost of consumer credit. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as a condition of or incident to the extension of credit.

<table>
<thead>
<tr>
<th>Charges Always Included</th>
<th>Charges Included Unless Conditions are Met</th>
<th>Conditions (Any loan)</th>
<th>Charges Not Included (Residential Mortgage transactions and loans secured by real estate)</th>
<th>Charges Never Included</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>Premiums for credit life, A.H.I., or loss of income insurance</td>
<td>Insurance not required, disclosures are made, and consumer authorizes</td>
<td>Fees for title insurance, title examination, property survey, etc.</td>
<td>Charges payable in a consummated cash transaction.</td>
</tr>
<tr>
<td>Transaction fees</td>
<td>Debt cancellation fees</td>
<td>Coverage not required, disclosures are made, and consumer authorizes</td>
<td>Fees for preparing loan documents, mortgages, and other settlement documents</td>
<td>Fees for unanticipated late payments</td>
</tr>
<tr>
<td>Loan origination fees</td>
<td>Premiums for property or liability insurance</td>
<td>Consumer selects insurance company and disclosures are made</td>
<td>Amounts required to be paid into escrow, if not otherwise included in the finance charge</td>
<td>Overdraft fees not agreed to in writing</td>
</tr>
<tr>
<td></td>
<td>Premiums for vendor's single interest (VSI) insurance</td>
<td>Insurer waives right of subrogation, consumer selects insurance company, and disclosures are made</td>
<td>Notary fees</td>
<td>Seller's points</td>
</tr>
<tr>
<td></td>
<td>Security interest charges (filing fees), insurance in lieu of filing fees and certain notary fees</td>
<td>The fee is for loan purposes, prescribed by law, payable to a third public official and is itemized and disclosed</td>
<td>Pre-consummation flood and past inspection fees</td>
<td>Participation or membership fees</td>
</tr>
<tr>
<td></td>
<td>Charges imposed by third parties</td>
<td>Use of the third party is not required to obtain loan and creditor does not retain the charge</td>
<td>Appraisal and credit report fees</td>
<td>Discount offered by the seller to induce payment by cash or other means not involving the use of a credit card</td>
</tr>
<tr>
<td></td>
<td>Charges imposed by third party closing agents</td>
<td>Creditor does not require and does not retain the fee for the particular service</td>
<td></td>
<td>Interest forfeited as a result of interest reduction required by law</td>
</tr>
<tr>
<td></td>
<td>Appraisal and credit report fees</td>
<td>Application fees, if charged to all applicants, are not finance charges. Application fees may include appraisal or credit report fees</td>
<td></td>
<td>Charges absorbed by the creditor as a cost of doing business</td>
</tr>
<tr>
<td></td>
<td>Other examples: Fee for preparing TILA disclosures, real estate construction loan insolvency fees, fees for post-consummation tax or flood service policy, required credit life insurance charges</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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The columns that list conditional charges show that generally, optional charges such as charges for insurance policies and debt cancellation plans are excluded if the consumer authorizes the financing of these products and receives the disclosures that are related to their purchase. If the choice of these products is not voluntary, or if the lender fails to provide the proper disclosures or to obtain the borrower’s agreement to purchase them, the related fees are included in the finance charge.

**Tolerance for Inaccuracies**

For closed-end transactions, disclosure of the finance charge must not understate the charge by more than $100. Differences of less than $100 are considered minor and do not impact the accuracy of the disclosure. Overstatements of the finance charge are not considered a violation of the law. Regulation Z does not establish tolerances for errors in the calculation of the finance charge for open-end loans.

**Re-disclosure of APR**

Mortgage professionals are required to provide consumers with re-disclosure of the annual percentage rate anytime the APR varies by more than one-eighth of 1%. This re-disclosure is required, at least three business days prior to the settlement, whether the variance increases or decreases the APR. In other words, if there is a change in APR by more than 0.125% in a regular loan, plus or minus, prior to settlement, the borrower must be provided with a new disclosure as soon as the variance is known.

**Disclosures Required by TILA**

**Closed-End Loans - the TIL Disclosure Statement**

TILA requires numerous disclosures, but it is the initial disclosure, known as the **Truth-in-Lending (TIL) Disclosure Statement**, that is intended to help consumers compare costs and to shop competitively for credit plans and mortgages. The statement is currently due no later than **three business days** after a consumer submits a loan application, although many lenders provide the statement at the time of application.

The early TIL Disclosure Statement is due at least **seven business days** prior to consummation of a loan transaction.

The borrower may waive this seven-business-day waiting period if he/she has a bona fide emergency and the initial disclosure is still accurate. However, if the consumer waives the waiting period and a change occurs to make the APR inaccurate, the waiver is no longer effective and a new disclosure must be provided. The new disclosure must be provided no less than three business days prior to settlement, although the consumer can provide a new waiver. The three-business-day waiting period would not apply if the consumer provides a waiver after corrected disclosures are made.

In order to waive a waiting period, the consumer must provide a written and dated statement. Mortgage professionals may not provide a pre-printed form for the purposes of submitting a waiver. The statement providing the waiver must be signed by each party to the loan who is
entitled to receive Truth-in-Lending disclosures. The requirements for bona fide emergency and waiver of a waiting period are substantially similar to those for waiver of the rescission period or waiver of the waiting period for consummation of a Section 32 (HOEPA) loan.

Regulation Z does not prescribe a particular format for the Truth-in-Lending Disclosure Statement, but it requires that the words finance charge and annual percentage rate are made more conspicuous than any other terms on the disclosure. (12 C.F.R. § 1026.17(a)(2)) In its Staff Commentary, the Federal Reserve suggests several methods of making the terms conspicuous such as segregating them and “outlining them in a box.” 5 This suggestion led to the standard industry use of the Truth-in-Lending Disclosure Statement which includes the four prominent boxes for:

- APR
- Finance Charge
- Amount Financed
- Total of Payments

Following is a copy of a Truth-in-Lending Disclosure Statement.

![Truth-in-Lending Disclosure Statement](image)

Another disclosure that lenders must make at the time they provide loan applicants with a Truth-in-Lending Disclosure Statement is that “You are not required to complete this agreement merely because you have received these disclosures or signed a loan application” (12 CFR § 1026.19(a)(4)). This disclosure must be in “conspicuous type size and format.”

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5 Official Staff Commentary to Regulation Z Section 226.17(a)
The requirement to provide this disclosure and other Truth-in-Lending disclosures seven business days prior to the consummation of the loan can be waived if the borrower needs to meet a “bona fide personal financial emergency” that is described, in writing, by the borrower. Details concerning waiver of waiting periods are discussed in the previous course section relating to the TIL Disclosure.

**Disclosing the Cost of Credit for Open-end Loans**

The primary characteristic of an open-end loan is that both the borrower and lender anticipate repeat transactions. The sections of Regulation Z that apply to open-end loans secured by a consumer’s dwelling are called “Requirements for Home Equity Plans.” A home equity plan is a form of revolving credit that is secured by a mortgage on the borrower’s home. Disclosures for home equity plans are due “...at the time an application is provided to the consumer.” (12 C.F.R. § 1026.5b(b)) However, just like the TIL Disclosure Statement, if the consumer applies via phone or Internet, the disclosures must be placed into the mail within three business days or sent by email if authorized by the consumer.

As previously discussed, statement of the APR and finance charge in closed-end transactions must be more conspicuous than the other disclosures. The disclosure for a home equity plan must also include clear and conspicuous disclosure of this information; however, other disclosures take precedence over information on loan costs. Regulation Z lists four topics that “...shall precede the other required disclosures.” (12 C.F.R. § 1026.5b(a)(2))

All of these topics relate to the risks associated with a home equity plan. These four disclosures include:

- **Retention of disclosure:** The disclosure must include a statement advising the consumer to retain a copy of the disclosure.
- **Availability of disclosed terms:** The disclosure must explain that the lending terms described are subject to change and that a loan applicant is entitled to a refund of any fees paid in connection with the loan application in the event that the terms change.
- **Risk of losing the home:** The disclosure must state the lender will have a security interest in the borrower’s home and that payment defaults could result in the loss of the home.
- **Possibility of unfavorable actions by lender:** The disclosure must advise consumers that in certain conditions, the lender can take adverse actions such as demanding payment of the outstanding balance in a single payment, reducing the credit limit, or prohibiting additional extensions of credit.

After these disclosures are made, the disclosure statement must provide information on:

- Payment terms
- APR
- Fees associated with use of the plan
- Fees imposed by third parties to open a plan
- Negative amortization
- Transaction requirements
- Tax implications

In addition to these disclosure requirements, Regulation Z states that the lender must provide loan applicants with a copy of its brochure on home equity plans or a “suitable substitute.” The brochure written by the Federal Reserve, entitled *When Your Home is On the Line: What You Should Know About Home Equity Lines of Credit*, is a good option.

**Disclosures for Adjustable-Rate Loans**

TILA was originally enacted as a cost disclosure law that would enable consumers to make informed choices about loans and credit. TILA also functions as a risk disclosure law with regard to adjustable-rate loans (ARMs).

**ARM Disclosures for Closed-End Loans**

If the borrower obtains an adjustable-rate mortgage (ARM), creditors must provide additional disclosures at the time an application is completed or before the borrower pays a non-refundable fee, whichever is earlier. This requirement is specific to ARMs, which are secured by the borrower’s principal dwelling and have a term of more than one year.

As with other disclosures mandated by TILA, if the borrower makes the application by phone, the creditor must deliver the disclosures within **three business days** following receipt of the loan application.

The special disclosures include the CHARM booklet and specific loan program disclosures.

**The Consumer Handbook on Adjustable-Rate Mortgages (CHARM)**

This booklet was originally created in 1987 to educate consumers on the risks associated with ARMs. In 2006, the Board revised its booklet to address the risks associated with nontraditional mortgage products such as interest-only ARMs and payment-option ARMs. The booklet is available online on the Federal Reserve’s website.6

**Loan Program Disclosures**

The lender must provide a loan program disclosure for each variable-rate mortgage product in which the applicant has expressed interest. Each disclosure must include:

- A statement that the interest rate, payment or loan term can change
- Identification of the index formula used to make adjustments
- An explanation of how the interest rate and payment will be determined

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- A recommendation that the borrower ask about the current margin value and current interest rate
- A notation that the interest rate will be discounted and a recommendation that the loan applicant ask about the amount of the discount if true
- The frequency of interest rate and payment changes
- The rules relating to index, interest rate and payment amount, such as the use of rate and payment caps
- A statement, when applicable, of the fact that negative amortization can occur
- An explanation of how to calculate payments for the loan amount
- A reminder that the loan contains a demand feature if true
- A statement of the type of information that will be provided in notices of interest rate adjustments and an indication of when these notices will arrive
- An indication that disclosure forms are available for other variable-rate loan programs
- The creditor has the option of providing an example, based on a $10,000 loan, that shows how changes in the interest rate can affect payments and loan balance

Regulation Z includes a model disclosure form for variable-rate mortgages in Appendix H-14 of the regulations. Regulation Z also includes a model disclosure form for adjustable-rate home equity loans. The model form is located in Appendix G-14B of the regulations.

**Additional Disclosures for ARMs**

The law requires additional disclosures for ARMs and including a statement, provided with payment schedule information, which notes that “Payments will vary based on interest rate changes.” In addition to this statement, the disclosures must include the following information:

- Examples of payment adjustments based on interest rate changes specified in the lending agreement
- An example of the maximum payment amount based on the maximum rate of interest allowed under the lending agreement

In addition, a disclosure is required that is provided with the GFE and TIL Disclosures which states “You are not required to complete this agreement merely because you have received these disclosures or signed a loan application.” (12 C.F.R. § 1026.19(a)(4))

The regulations indicate that these statements must be provided conspicuously and prominently – meaning they cannot be in the “fine print.”

**Right of Rescission Under TILA**

Rescission is a legal remedy that voids a contract between two parties, restoring each to the position held prior to the transaction.
TILA includes two provisions that address the right to rescind certain types of mortgage loans:

- **Three-Business-Day Rescission Period:** The three-business-day rescission period creates a cooling-off interval after closing on a loan. This interval is intended to give a borrower the opportunity to reconsider whether he/she wants the loan, and the ability to cancel the loan by simply providing the lender with timely notice of the cancellation.

- **Three-Year Rescission Period:** The three-year rescission period is available to a borrower who did not receive a notice of the right to rescind or accurate Truth-in-Lending disclosures at the time that he/she entered an agreement for a mortgage loan.

**Loans Not Subject to the Right of Rescission**

The right to rescind does not apply to all types of lending transactions. It is only available for loans that are secured by the borrower’s principal dwelling. Generally, no right to rescind exists for:

- Residential mortgages to purchase or construct a home
- Refinancing of credit already secured by the borrower’s principal dwelling with the same creditor that made the first loan
- A lending transaction with a state agency

New home equity credit lines, refinances, and home improvement loans secured by the borrower’s principal dwelling are examples of the types of loans that are subject to a right of rescission.

**Recipients of the Right to Rescind Notice**

Notice to the borrower of the right to rescind is due at the time of closing. Both the form and content of the notice and the correct identity of the recipients of the notice are critically important in complying with TILA.

The borrower who signs a lending agreement is not the only party who must receive notice of the right to rescind. Under TILA, lenders must also provide two copies of the notice to each party with an ownership interest in the principal dwelling that serves as security for the loan.

**Format and Content of the Right to Rescind Notice**

The notice of the right to rescind must consist of a document that is separate from other TILA disclosures, and it must clearly and conspicuously disclose the following:

- The lender’s retention or acquisition of a security interest in the borrower’s principal dwelling
- The borrower’s right to rescind
- Instructions on how to exercise the right to rescind, including a form the borrower has the option of using, stating the lender’s business address
- The date that the right of rescission expires
- A description of the effects of rescission for the consumer
**Deadlines for Exercising the Right to Rescind**
In order to rescind a loan during the three-business-day cooling-off period, a borrower must comply with the deadlines for exercising the right to rescind.

**Three-Business-Day Deadline**
If the loan is for closed-end credit, any party with an ownership interest in the property can exercise his/her right to rescind the transaction until midnight on the third business day after the last of the following events occurs:

- The signing of the loan agreement
- The date of the receipt of Truth-in-Lending disclosures
- The date of the receipt of the notice of the right to rescind

Open-end loans also include the right to rescind for three business days after any of the following:

- The date the credit plan is open
- The date there is an increase on the credit limit
- The date a security interest is added or increased to secure an existing credit plan

In calculating the time limitations for exercising the right to rescind, note that **business days include Saturdays**. Regulation Z states that a business day is any day other than Sunday and a federal public holiday.

**Three-Year Extended Right to Rescind for All Loans**
For both closed-end and open-end lending transactions, a three-year right to rescind exists for the following violations by the lender:

- Failure to provide a rescission notice that complies with Regulation Z
- Failure to provide a TILA notice that includes **material disclosures**, such as the annual percentage rate, the finance charge, the amount financed, the total number of payments, and the payment schedule. If the loan is a HOEPA loan, the lender must include disclosures related to HOEPA. Since October 1, 2009, material disclosures also include those required for loans designated as higher-priced mortgage loans.

The three-year rescission period is measured from the date of the consummation of the lending transaction. However, the right to rescind expires in less than three years if the principal dwelling used as security for the loan is sold before the three-year period expires.

**Consequences of Rescission**
If a borrower decides to exercise the right to rescind, he/she must provide written notice within the three-business-day rescission period. When multiple parties have rescission rights in a particular transaction, any one of them may exercise the right to terminate the transaction.
A borrower’s decision to rescind a transaction has the following consequences:

- The lender no longer has a security interest in the property – public records must be corrected to show this.
- The lender has 20 calendar days to return any money or property paid by the borrower in connection with the transaction such as broker fees, application fees and third party settlement fees.
- After the lender has completed the requirements of terminating its security in the borrower’s home and returning money or property to the borrower, the borrower must return to the lender any money or property that was delivered to him/her.

**Waiver of Right to Rescind**

A borrower can waive the right to rescind in situations in which credit is needed “…to meet a bona fide financial emergency.” The waiver must be in writing and include:

- A description of the emergency
- Signatures of all parties that have a right to rescind a particular transaction

As with the waiver of the waiting period related to the TIL Disclosure, waiver of the right to rescind must be made by the borrower in a dated, written statement. Mortgage professionals are prohibited from providing any type of pre-printed form for the purposes of rescission.

**Advertising Requirements Under TILA and Regulation Z**

TILA and Regulation Z prohibit the advertisement of lending terms that a lender or creditor is not actually prepared to offer. The law and the regulations also seek to prevent publication of advertisements that are deceptive and misleading.

When the lending market began declining and foreclosure rates began rising, the Federal Reserve added new provisions to the advertising requirements of Regulation Z to create greater protections for consumers. In addition to creating new rules to ensure that advertisements for mortgage loans are accurate, the Federal Reserve created a list of deceptive and misleading practices that are prohibited in the advertisement of closed-end mortgage loans. These rules became effective on October 1, 2009, and they built upon protections that Regulation Z already offered to consumers.

Regulation Z encourages the presentation of balanced information in advertisements by prohibiting the promotion of an attractive lending term, such as low monthly payments, without the disclosure of less attractive terms, such as a high interest rate or balloon payments. Regulation Z requires the additional information to be included whenever a trigger term, such as “low monthly payments,” is used in an advertisement.

Finance charges, payment terms, and down payment requirements are examples of trigger terms. The new rules broaden the list of advertised lending terms that trigger the need to disclose additional information. Both existing trigger terms and those created by the new rules are discussed below.
When an advertisement employs a trigger term, Regulation Z requires the **clear and conspicuous** presentation of other relevant terms and the presentation of that information **with equal prominence** so that consumers will not have to read the fine print to gain an accurate description of the loan that the advertisement is promoting.

**Advertising Rules for Closed-End Loans**

An advertising requirement that applies specifically to closed-end loans is the requirement to use the term “annual percentage rate” in any advertisement that states a rate of finance. If the rate is subject to an increase after closing on the loan, the advertisement must include this information. Regulations that went into effect on October 1, 2009 state that if the loan is secured by a dwelling, the advertisement cannot state any other rate other than a simple annual rate or periodic rate that applies to unpaid balances.

**Trigger Terms**

Regulation Z creates a list of trigger terms for closed-end loans, but even without the exact use of these terms, information related to them can trigger the need for additional disclosures. For example, the Federal Reserve has indicated that it is not only the explicit use of terms such as “down payment” or “finance charge” that trigger the need to make additional disclosures. “These provisions apply even if the triggering term...may be readily determined from the advertisement. For example, an advertisement may state “80% financing available,” which is in fact indicating that a 20% down payment is required.”

Following are the trigger terms for closed-end loans as well as examples that the Federal Reserve has provided of other language that has the same meaning and effect as the trigger terms:

- Amount or percentage of any down payment
- Number of payments or period of repayment
- Amount of any payment
- Amount of any finance charge

Use of any of these terms in an advertisement triggers the requirement to **clearly and conspicuously** include the following additional information that is applicable:

- Amount and percentage of the down payment
- Terms of repayment, including any balloon payment
- “Annual percentage rate,” using that term, and an indication of whether the rate is subject to increase

(12 C.F.R. § 1026.16(b))

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7 Official Staff Commentary to Regulation Z Section 226.24, Paragraph 24 (d)
Trigger Terms for Closed-End Loans
The advertisement of interest rate and payment information for closed-end loans requires the clear and conspicuous disclosure of additional information. When an advertisement provides a simple rate of interest and more than one rate will apply during the term of the loan, the advertisement must include the following information “with equal prominence and in close proximity” to the advertised rate:

- Each simple annual rate of interest that will apply
- The period of time that each rate of interest will apply
- The Annual Percentage Rate (APR)

The regulations provide that the APR “…may be disclosed with greater prominence than the other information.” 8 In its Staff Commentary, the Federal Reserve states that an advertisement meets the standard for showing the APR with equal prominence and close proximity to the advertised interest rate or payment amount if it is immediately next to or directly above or below it.

When an advertisement states any information on credit, it must also include the following information in a clear and conspicuous manner:

- The amount of each payment that will apply over the term of the loan, including any balloon payment
- The time period that each payment will apply
- If the advertisement is for a first-lien mortgage, an indication that advertised payments do not include taxes and insurance

Advertising Rules for Home Equity Plans
Regulation Z creates the following requirements to encourage the presentation of balanced information in advertisements for home equity loans.

Trigger Terms
Trigger terms for home equity plans include references to any of the following:

- Finance Charge
- Real estate transaction fees, such as appraisal, title, credit report, and closing fees
- Payment terms
- Any other terms presented in a Truth-in-Lending disclosure statement

Including any information in an advertisement about these lending terms and fees triggers the requirement to clearly and conspicuously include the following additional information:

- Any loan fee that is a percentage of the credit limit

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8 Official Staff Commentary to Regulation Z Section 226.24
• An estimate, stated in a dollar amount, of any fee to open the plan
• The annual percentage rate
• The maximum annual percentage rate that may be imposed under a variable rate plan

Advertisements for home equity plans often promote features such as a low APR, minimum periodic payments, and tax advantages. As discussed in the following sections, the advertisement of these terms triggers requirements to provide additional information.

**Discounted and Premium Rates**
A discount or premium rate is an *initial* APR that is not based on the index and margin used to make rate adjustments for variable-rate home equity plans. Advertising a discounted or premium rate triggers the requirement to include the following additional information:

• The period of time that the discount or premium rate will be in effect
• A reasonably current APR for the loan, if it were fully indexed, and the presentation of this information with *equal prominence* to the discount rate.
• Advertisements must include the fully indexed rate *in close proximity* to the discount rate

The Federal Trade Commission offers the following example of an advertisement with balanced information on the initial discounted APR and the APR in effect after the first few months of the loan term:

7.5% *APR FOR THE FIRST SIX MONTHS!* After first six months, *APR is 10.5% (as of November 1), subject to increase based on market conditions.*

**Minimum Payments**
Advertising a minimum periodic payment triggers the requirement to include a statement, if applicable, that a balloon payment may result. For example:

• Even if a balloon payment is uncertain or unlikely, the advertisement of a minimum periodic payment must include, with *equal prominence* and *in close proximity*, a statement that a balloon payment may result.
• If a balloon payment will occur when the borrower makes only the minimal and non-amortizing payments under the plan, advertisement of a minimum periodic payment must include, with *equal prominence* and *in close proximity*, a statement that a balloon payment will result as a consequence of making only the minimum payments.

**Tax Deductible Interest**
Home equity plans have been popular since the Tax Reform Act of 1986 was enacted. This law includes a provision that prohibits consumers from deducting the interest paid on unsecured loans from their income taxes. Since 1986, countless consumers have obtained home equity loans to pay off unsecured debt, such as credit card balances, and have deducted the interest they pay on their secured home equity loans.
Lenders often advertise the tax benefits of home equity loans. Regulation Z specifically prohibits the use of advertisements that include any misleading statements regarding the tax benefits of a home equity plan.

The regulations require the disclosure of additional information when lenders advertise home equity loans that exceed the value of the home used to secure the loan. Consumers have accepted loans such as 125% home equity plans, under the misconception that all interest is deductible. Advertisements for loans that exceed the fair market value of the home must **clearly and conspicuously** inform consumers that:

- The interest on the portion of the credit that exceeds the fair market value of the home is not deductible from federal income taxes
- The borrower should consult a tax advisor regarding the deductibility of interest and charges

**Trigger Terms for Home Equity Plans**

Under Regulation Z, any reference to promotional rates and payments triggers a requirement to provide additional information **in a clear and conspicuous manner with equal prominence and in close proximity to each listing of the promotional rate or payment.** The additional information required by the advertisement of promotional rates and payments includes:

- The time period that the promotional rate or payment will apply
- The APR that will apply under the home equity plan
- The amounts and time periods of any payments that will apply under the home equity plan

These requirements apply to advertisements even if there is no use of the term “promotional rate” or “promotional payments.” This point of the requirement is to ensure borrowers have a clear understanding that promotional rates and payments are not the same as fully indexed rates and payments.

**Prohibitions in Advertising**

Regulation Z includes a list of seven prohibited practices when advertising closed-end mortgage loans. The prohibitions are based on “…an extensive review of advertising copy and other outreach efforts…” that allowed the Federal Reserve to identify misleading and deceptive practices in the advertisement of mortgage loans. ⁹

Following are the seven practices that are prohibited in closed-end mortgage loans and some of the examples that the Federal Reserve offers, in its Staff Commentary, of prohibited advertisements:

- **Misleading advertising of “fixed” rates and payments:** Today, mortgage products are complex, and there are many that combine fixed and variable rates, such as a stepped-rate

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⁹ Rohner, Page 148
mortgage with an initial lower rate that is subject to an increased fixed rate. The use of the word “fixed” in advertisements for these types of loans is prohibited unless there is conspicuous and equally prominent information about variable rates and increasing payments.

- **Misleading comparisons in advertisements:** Comparisons between an advertised mortgage and a hypothetical loan that a consumer may have are prohibited unless the ad includes the requisite disclosures regarding APRs and payments. An advertisement to “save $300 per month on a $300,000 loan” is an implied and prohibited comparison between the payment due on the advertised loan and a consumer’s current loan payments.

- **Misrepresentations about government endorsement:** Statements that lead consumers to the incorrect assumption that a mortgage product is endorsed by the government are illegal.

- **Misleading use of the current lender’s name:** Some lenders and mortgage brokers have made direct solicitations that lead consumers to the incorrect assumption that their own lender is contacting them with information on mortgage products.

- **Misleading claims of debt elimination:** claiming debt elimination when one debt merely replaces another debt.

- **Misleading use of the term counselor:** An advertisement cannot refer to a for-profit lender, mortgage broker, or its employees as a “counselor”

- **Misleading foreign-language advertisements:** Some advertisements target immigrants who lack fluency in English by advertising favorable lending terms in their first language, while providing information on the additional and less favorable lending terms in English.

Regulation Z prohibits the use of misleading terms in advertisements for home equity loans. “Free Money!” is an example that the regulations give of a misleading and, therefore, prohibited term. As stated above, Regulation Z also prohibits misleading statements regarding tax deductions for interest paid on home equity loans.

**Calculating APR**

The APR was designed to represent the true cost of credit by creating a number that includes the interest rate on a loan as well as other costs involved in securing it. Regulation Z sets up different rules for the calculation of APR for closed-end credit and APR for open-end credit.

**Calculating APR on Closed-end Loans**

For closed-end transactions, the APR is defined as, “...a measure of the cost of credit, expressed as a yearly rate, that relates to the amount and timing of value received by the consumer to the amount and timing of payments made.” (12 C.F.R. § 1026.22(a)(1)) The finance charge, amount financed, and total payments are all factors that go into the computation of the APR.
**Tolerance for Errors**

If there is an error on the Truth-in-Lending Disclosure Statement, the lender has 60 days from the date the error is discovered to correct the error. The APR tolerance for closed-end transactions is 1/8 or one percentage point. The tolerance for the finance charge on a closed-end transaction is $5 if the amount financed is less than or equal to $1,000 and $100 if the amount financed is greater than $1,000. Clearly, the $100 tolerance is the one that is applicable in most mortgage lending transactions.

Tolerances for finance charge errors are not allowed for open-end credit disclosures. Credit disclosures for open-end plans must be accurate.

**Calculating APR for Home Equity Loans**

For initial disclosures and advertising purposes, the APR for home equity plans “...shall be computed by multiplying each periodic rate by the number of periods in a year.” (12 C.F.R. § 1026.14(b)) For example, if the periodic rate is 1.50% and the lender charges that amount each month, the APR is 18%. Unlike the APR for closed-end loans, which shows the costs associated with the loan, the APR for open-end loans does not include the costs of securing the credit. Therefore, when shopping for a home equity plan, consumers must compare APRs and separate lists of costs for competing products.

**Recent Regulatory Changes Regarding Loan Originator Compensation**

On September 24, 2010, the Federal Reserve Board published a new rule in The Federal Register that addresses the compensation of loan originators. The effective date of the rule was April 1, 2011. This rule amends Regulation Z by creating special prohibitions and restrictions for the compensation of loan originators. The stated purpose of the rule is “…to protect consumers in the mortgage market from unfair or abusive lending practices that can arise from certain loan originator compensation practices....”

The new rule applies to mortgage brokerage companies. It also applies to individuals who are employed as loan originators by mortgage brokers and to individuals who are employed by traditional depository lenders. The law defines these individuals and entities as follows:

- **Loan Originator**: A loan originator includes “…any person who for compensation or other monetary gain arranges, negotiates, or otherwise obtains an extension of credit for another person” (12 C.F.R. § 1026.36(a)). The regulations specifically provide that this definition also includes:
  - **Employees of a Creditor**: The definition of “loan originator” includes the employees of a creditor as well as the employees of a mortgage broker who are engaged in arranging, negotiating, or obtaining a mortgage loan for consumers. (12 C.F.R. § 1026.36(a)1.).
  - **An Originator Engaged in Table-funding**: The definition of “loan originator” includes an originator that closes a loan in his/her/its own name, and immediately

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assigns the loan to the creditor that provided the funding for the loan (12 C.F.R. § 1026.36(a)1.(ii))

- **Mortgage Broker:** A mortgage broker includes companies that earn compensation by arranging, negotiating, or otherwise obtaining a mortgage loan for consumers. The term also includes the employees that are engaged in loan origination activities (12 C.F.R. § 1026.36(a)2.).

**Loans Subject to the Rule**

The new rule prohibiting certain types of loan originator compensation practices applies to all closed-end loans secured by a dwelling, including first-lien and subordinate mortgages. It also applies to “reverse mortgages that are not home equity lines of credit” (12 C.F.R. § 1026.36(1.))

The loans not subject to the rules are:

- Home equity lines of credit (HELOCs) when the credit line is an open-end credit plan
- Timeshare transactions

(12 C.F.R. § 1026.36(f))

Remember that the definition of “dwelling” under TILA’s Regulation Z is “…a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence” (12 C.F.R. § 1026.2(19))

Under this rule, “compensation” is broadly defined as any financial incentive, including salaries, commissions, merchandise, and vacations. Compensation includes fees charged by loan originators, but does not include bona fide third party charges.

The new rule consists of three prohibitions:

- **Prohibition Against Compensation Based on Loan Terms and Conditions:** Yield spread premiums (YSPs) are an example of this type of prohibited compensation. However, this prohibition has a much broader application and is not limited to those transactions in which an originator knowingly imposes more onerous lending terms, such as a higher interest rate, for the sole purpose of earning a better commission. An example provided in the rule is as follows:
  
  - Assume that consumer A and consumer B receive loans from the same loan originator and the same creditor. Consumer A has a credit score of 650 and consumer B has a credit score of 800. Consumer A’s loan has a 7% interest rate, and consumer B’s loan has a 6.5% interest rate because of the consumers’ different credit scores. If the creditor pays the loan originator $1,500 in compensation for consumer A’s loan and $1,000 in compensation for consumer B’s loan, because the creditor varies compensation payments in whole or in part with a consumer’s credit score, the originator’s compensation would be based on the transactions’ terms and conditions (12 C.F.R. § 1026.36(d)(1) 2.))
• **Prohibition Against Double Compensation:** The rule prohibits loan originators from accepting direct compensation from borrowers and indirect compensation from a creditor in the same transaction. The prohibition does not apply to salaries or to hourly wages that are not paid to a loan originator in connection with a particular transaction. For example, if a mortgage broker pays its employees a regular salary that does not vary based on the terms and conditions of each mortgage loan transaction, these loan originators/employees may receive direct compensation from borrowers.

• **Prohibition Against Steering:** The rule prohibits loan originators from steering consumers towards a mortgage product in order to increase the amount of compensation earned.

Since consumers actually look to loan originators for direction when it comes to choosing a mortgage product, the rule creates a “safe harbor,” defining those circumstances in which the guidance offered by loan originators does not constitute illegal steering. Factors that are significant in determining if compensation practices meet the safe harbor requirement include:

- **The number of loans offered:** The rules do not establish a minimum number but anticipate that a consumer will receive a few viable loan options
- **Options from more than one creditor:** Originators should secure and present options from the creditors with whom they regularly conduct business

There are many nuances to this rule, and, as a result, compliance poses challenges. Furthermore, the Dodd-Frank Act addresses very similar limitations on loan originator compensation, and it is possible that in implementing the law, the CFPB may write new regulations that revise the provisions of the current regulation that it inherited from the Federal Reserve.

**Penalties for Violations of TILA and Regulation Z**

Penalties for violations of the law are different for closed-end loans and HELOCs:

- **Closed-end:** Penalties are a minimum of $400 and a maximum of $4,000
- **HELOCs:** Penalties are a minimum of $100 and a maximum of $1,000

In individual civil actions, TILA allows claimants to recover actual damages resulting from the creditor’s failure to comply with TILA and attorney’s fees. Claimants may also receive statutory damages equal to twice the amount of the finance charge.

Class actions limit total recovery to $500,000 or 1% of the creditor’s net worth, whichever is less, regardless of the size of the class. Willful and knowing violations of TILA are subject to a criminal penalty of $5,000, a year of imprisonment, or both.

**Discussion Scenario: Disclosure Requirements**

Golden Doubloon Finance was just licensed as a mortgage banker in several new states and immediately began a massive advertising campaign. Because of low interest rates, customers
flocked in and business was booming. Davey Jones, the managing principal of Golden Doubloon, quickly hired a huge team of new loan originators and got them licensed in record time.

Over the next nine months, business was steady, and there was some LO staff turnover. Jones and his management staff were careful to ensure only licensed individuals handled origination tasks, but often the team was new and inexperienced. More often than not, the administrative staff had to rush to advise borrowers of adjustments caused by miscommunications in fees a day or less prior to settlement.

Amidst the chaos of prosperous business, Jones acquired a share in a title company, Ahoy Title. Frequent business referrals from Golden Doubloon allowed Ahoy to share in the success.

It soon came time for several of the state regulators to conduct routine business office examinations of Golden Doubloon. Without exception, all of the regulators came back with the same findings – consumer disclosures were not in order.

Discussion Questions

- Based on the facts in the scenario, what are some disclosure requirements that might not have been met?
- At a minimum, what are the disclosures that should have been issued to borrowers?
- How can mortgage professionals ensure they are meeting disclosure requirements?

Discussion Feedback

Based on the information presented in the scenario, Golden Doubloon’s high turnover may have had a significant impact on proper disclosure. It is important to note that licensing requirements were met, meaning the LOs were likely educated on disclosure requirements. However, the company either did not have policies and procedures in place to ensure disclosures were made, or the policies/procedures were not enforced.

Some of the primary disclosures that could have been missing include:

- Good Faith Estimate – provided within three business days of application
- Affiliated business arrangement disclosure – provided at the time a referral is made
- TIL Disclosure Statement – provided within three business days of application (and no less than seven business days prior to settlement)
- TIL Re-disclosure – provided no less than three business days prior to settlement if the APR/finance charges are inaccurate

Mortgage professionals can ensure they meet disclosure requirements by:

- Establishing and following procedures to ensure disclosures are made pursuant to state and federal laws for all loan applicants without exception
- Ensuring re-disclosure requirements are met if re-disclosure is necessary
The Home Ownership and Equity Protection Act (HOEPA)

HOEPA Overview
The federal government addressed predatory lending for the first time in 1994 with the adoption of the Home Ownership and Equity Protection Act (HOEPA). HOEPA creates certain protections under the Truth-in-Lending Act (TILA) for loans with high interest rates and high fees.

Regulatory Agencies
The Board of Governors for the Federal Reserve (The Board) was the federal agency responsible for issuing implementing regulations for HOEPA. The regulations for HOEPA are set forth in Section 32 of Subpart E of Regulation Z and are sometimes referred to as Section 32 loans. The Dodd-Frank Act greatly expanded the scope of HOEPA, as discussed in the following section on “Loans Regulated by HOEPA,” and now the CFPB is responsible for issuing TILA regulations, including amendments to TILA added by HOEPA.

Enforcement authority for HOEPA is the same as it is for other provisions of TILA, with the Federal Trade Commission sharing some enforcement authority with the CFPB.

Closed-End Loans Regulated by HOEPA
HOEPA currently applies only to closed-end home equity loans and closed-end loans made to refinance existing mortgages if the loans trigger the HOEPA interest rate threshold or the points and fees threshold. In order to be covered by HOEPA, the loans must be secured by the borrower’s principal dwelling.

The current thresholds for HOEPA loans are:

- **Interest Rate Threshold:** For first-lien mortgages, the rate trigger is 8 percentage points above the rate for Treasury securities with a comparable term. For subordinate liens, the rate trigger is 10 percentage points above the Treasury securities with a comparable term.
- **Points and Fees Threshold:** Adjusted annually based on the annual percentage change reflected in the Consumer Price Index, the points and fees trigger for 2013 is $625 or 8% of the loan amount. Points and fees include items in Regulation Z’s definition of “finance charge” and mortgage broker fees, closing agent fees, third party charges if the lender required the use of a particular third party, insurance premiums for optional credit insurance products, and some real estate-related fees.

Loans Exempt from HOEPA
The provisions of HOEPA do not apply to the following:

- Open-end loans, such as home equity lines of credit
- Loans to purchase or build a home (Dodd-Frank will cause purchase loans to be covered)
- Reverse mortgage transactions
Loans that do not meet the rate and fee triggers
Loans that are *not* secured by the borrower’s principal dwelling

**Disclosures and Notifications Required by HOEPA**

Loans that fall within the scope of HOEPA are subject to the TILA disclosure requirements for closed-end loans. These include the following disclosures:

- A Truth-in-Lending Disclosure Statement that includes the APR, finance charge, amount financed and total of payments
- For adjustable-rate mortgages (ARMs), disclosure requirements include (but are not limited to) a statement that the rate may increase, the index and margin used to adjust the APR, the frequency of adjustments, limitations on increases, and the Customer Handbook on Adjustable-Rate Mortgages (CHARM) booklet
- Notices of the right to rescind, provided to all those with an ownership interest in the mortgaged property

The first two disclosures are due within three business days after the completion of a loan application. The notice of the right to rescind is due at closing.

HOEPA loans are also subject to additional disclosure requirements. Regulation Z requires the presentation of each of these disclosures in “conspicuous type size.” The additional disclosures for HOEPA loans include the following.

**Special HOEPA Disclosure:** HOEPA loans must include a special disclosure that states:

*You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.*

Many subprime borrowers are first-time borrowers and do not qualify for a prime loan because they have not had the opportunity to establish their creditworthiness. Having no experience in lending transactions, some do not understand that the completion of a loan application does not obligate them to accept a loan. The special notice is intended to alert subprime borrowers who are pressured by predatory lenders into completing detrimental lending transactions.

**Notice of Balloon Payment:** When balloon payments are not prohibited, as discussed in the following section, the lending agreement must state the existence of a balloon payment.

HOEPA includes special requirements for the disclosure of balloon payments because many victims of predatory loans do not realize that their repayment agreement includes a balloon payment until it is due. If unable to make a balloon payment, a borrower’s only options are to refinance the loan or to default on it.
Amount Borrowed: In a mortgage refinancing, there must be a statement of the total amount borrowed, as shown on the face amount on the promissory note. This disclosure is accurate if it is not more than $100 above or below the amount that must be disclosed.

Notice of the Inclusion of Insurance Premiums: If the “amount borrowed” includes premiums for optional insurance products or debt cancellation coverage, a statement that these premiums are included must accompany the disclosure of the amount borrowed.

The statements of the amount borrowed with an accompanying statement of the amount of any insurance premiums are intended to deter the covert packing of unnecessary insurance products into a loan.

Variable-Rate Disclosure: If the mortgage has an adjustable rate, the disclosure must include a statement that the monthly payment may increase, showing the maximum monthly payment amount based on the information on rate increases provided in the Truth-in-Lending Statement.

The recent rash of foreclosures has coincided with scheduled rate increases in adjustable rate mortgages. The disclosure of the maximum monthly payment is intended to alert borrowers to the payment shock that they will face when interest rates reset.

Recipients of the Disclosures
The recipients of HOEPA disclosures include:

- Any consumer who is primarily liable on the obligation (presumably, this means co-signors, but neither the regulations not the Official Staff Commentary clarify this point)
- Those with a right to rescind the transaction (each person with an ownership interest in the property used to secure the loan)

Deadline for HOEPA Disclosures
The disclosures for HOEPA loans are due at least three business days (all days other than Sunday and federal holidays) prior to the consummation of the mortgage. The disclosures are made prior to the time of closing so that the loan applicant will have at least a three-business-day waiting period to consider whether it is best to proceed with the transaction.

Right to Waive the Waiting Period
HOEPA allows for the waiver of the three-business-day waiting period if the funds to be obtained from a loan are needed to meet a “bona fide personal emergency.” In order to waive the three business day waiting period and to proceed directly to closing, the borrower must:

- Give the lender a dated and written statement that describes the emergency (the use of printed forms is not allowed)
- Signatures from all parties who are entitled to the waiting period (the recipients of the disclosures)
HOEPA Prohibitions

Lending Terms Prohibited by HOEPA
HOEPA creates strict limitations on the use of the following terms in a loan that meets the law’s rate or fee thresholds.

Balloon Payments: Balloon payments are not allowed for loans with terms of less than five years. There is an exception for loans with terms of less than one year if the loan is a bridge loan that is related to the purchase or the construction of a home that will be the borrower’s principal dwelling. As discussed in the previous section, balloon payments are frequently found in predatory loans, without the borrower’s knowledge.

Prepayment Penalties: Prepayment penalties for HOEPA loans are only enforceable during the first two years after consummation of the loan. During these two years, prepayment penalties are only allowed if:

- The funds used to pay the penalty are not from a refinancing with the lender or an affiliate of the lender, and
- The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation, and
- The borrower’s total monthly debt cannot exceed 50% of his/her gross monthly income, with income verification made using IRS W-2 forms, payroll receipts, bank records, or other third-party documents that offer “reasonably reliable evidence” of the borrower’s income or assets.

If a borrower pays off a loan balance before the loan term is over, the lender does not earn the interest that it anticipated earning on the loan. Prepayment penalties allow lenders to recoup losses that occur with the early payment or prepayment of a loan. Prepayment penalties are rarely included in prime loans, but are often included in subprime lending agreements.

Prepayment penalties hurt borrowers with high-cost loans because they discourage borrowers from refinancing when interest rates fall or when they qualify for a loan with a better rate. HOEPA discourages prepayment penalties by prohibiting the use of funds obtained in a refinancing to pay them.

Due on Demand Clauses: Due on demand clauses are only allowed to protect the creditor from misrepresentation or from any action by the borrower, such as failure to make payments, which adversely affects the lender’s security for the loan.

A due on demand clause allows the lender to demand payment of the entire loan balance prior to the end of the loan term. Predatory lenders have used due on demand clauses to force borrowers into new loans at even higher interest rates. They do this by threatening to demand immediate repayment of the loan balance if the borrower will not refinance.

Negative Amortization: Loans that meet the HOEPA interest rate and fee thresholds cannot include a payment schedule that results in negative amortization.
Negative amortization occurs when a lender establishes a repayment schedule that does not demand sufficient funds from the borrower to pay the full amount of interest due with each periodic payment. The lender adds the unpaid interest to the principal, resulting in a principal balance that increases over time. Payment terms which lead to negative amortization are often found in predatory loans.

**Increased Interest Rate after Default:** HOEPA loans cannot include terms that allow interest rates to increase after the borrower defaults on a payment. Predatory lenders have been known to include a provision in mortgage lending agreements stating that the interest rate is subject to an increase if the borrower defaults on the loan.

**Advanced Payments:** HOEPA prohibits the consolidation of more than two periodic payments and payment of this amount, in advance, from the proceeds of a loan.

**Lending Practices Prohibited by HOEPA**
If a loan meets the interest rate or the fee thresholds established under HOEPA, the following practices are prohibited:

**Refinancing Within One Year:** No HOEPA loan can be refinanced within 12 months of the initial extension of credit unless the refinancing is in the borrower’s interest. This prohibition applies, not only to the lender funding the loan, but also to loan servicers and assignees. The use of affiliates or nonaffiliated lenders to refinance a loan within the first year is also prohibited.

The purpose of this prohibition is to prevent “loan flipping.” Loan flipping is one of the most common predatory lending practices, and it involves the repeated refinancing of a loan within a short period of time. Borrowers who succumb to loan flipping schemes are usually struggling to meet the payments on existing high-cost loans. They may be enticed by offers to secure more affordable terms through refinancing.

Unfortunately, refinancing usually does little to improve the financial plight of beleaguered borrowers. These borrowers rarely have cash to cover closing costs. They finance these costs by adding them to the principal, or work with brokers who will pay the closing costs from the additional commission that they earn when borrowers accept mortgages at higher interest rates. With each financing, struggling borrowers incur additional costs and increase their loan balances.

**Direct Payments to Home Improvement Contractors:** HOEPA prohibits direct payments to home improvement contractors, unless payment is a joint payment to the borrower and the contractor, or is made to a third party escrow agent pursuant to written agreement between the lender, borrower, and the contractor.

Some of the most outrageous accounts of predatory lending practices have involved fraudulent schemes in which unethical mortgage brokers and home improvement contractors coordinate their efforts to fleece unsuspecting homeowners. The Department of Housing and Urban Development (HUD) conducted a joint study with the Treasury Department showing that these schemes usually take place in low-income neighborhoods.
Using aggressive door-to-door sales tactics, home improvement contractors target consumers whose homes need repairs and who are not likely to pursue bids from other contractors. Elderly housebound homeowners are often the recipients of these solicitations. After persuading the homeowners to allow them to do the work, the contractors urge the use of a particular mortgage broker for financing. When the closing takes place and the funds are secured, the broker pays the home improvement contractor immediately. The contractor performs little or no work, and the homeowner realizes too late that he/she is the victim of fraud.

**Failure to Notify Assignee:** The assignment of a HOEPA loan must include a notice stating:

Notice: This is a mortgage subject to special rules under the federal Truth-in-Lending Act. Purchasers or assignees of this mortgage could be liable for all claims and defenses with respect to the mortgage that the borrower could assert against the creditor.

**Lending Without Regard to Repayment Ability:** HOEPA prohibits lending based on the amount of equity in a borrower’s home without also considering the borrower’s ability to repay. The law states that there is a presumption of lending without regard to repayment ability if the lender engages in a pattern or practice of making HOEPA loans without verifying and documenting the ability of borrowers to repay their mortgages.

It is a common predatory lending practice to make loans without verifying whether borrowers or others who are obligated to repay the loan, such as co-borrowers or cosigners, have the ability to repay. Unscrupulous lenders and mortgage brokers are willing to make loans without verification of income and employment and without a meaningful assessment of debt to income ratios. In extreme cases, lenders have given loans to elderly borrowers on fixed incomes in spite of the fact that monthly payments would exceed their incomes. This predatory lending practice is often referred to as “equity stripping.”

The current law requires lenders to assess repayment ability by considering the loan applicant’s current and expected income, current debt, and employment. Amendments to Regulation Z, which went into effect on October 1, 2009, are much more specific regarding the information that lenders must have in order to verify repayment ability. Since October 1, 2009, an evaluation of repayment ability must include the following considerations in addition to current and “reasonably expected” income, assets other than home equity, current obligations, and employment:

- Assets other than the equity in the borrower’s home
- Mortgage-related obligations, which must include expected property taxes and insurance for the new loan
- Verification of income using IRS W-2 forms, tax returns, payroll receipts, bank records, or other third-party records that give “reasonably reliable evidence” of the borrower’s income and assets
Under the new regulations, there is a presumption of compliance if the assessment of repayment ability includes the considerations outlined above as well as consideration of the borrower’s debt-to-income ratio and the borrower’s ability to make the largest payment of principal and interest that is scheduled in the first seven years after consummation of the loan.

**Evading HOEPA:** It is a violation of HOEPA to avoid its requirements by documenting closed-end loans as open-end loans.

**Penalties for HOEPA Violations**

Congress enacted HOEPA as an amendment to the Truth-in-Lending Act (TILA). Therefore, penalties for violations of HOEPA are the same as those imposed under TILA.

**Prohibitions for Loans Secured by a Principal Dwelling**

The prohibitions that are reviewed in the previous section are limited to loans that meet the interest rate and fee triggers under HOEPA. In amendments that it made to Regulation Z in 2008, the Federal Reserve created new prohibitions that relate to all loans secured by a borrower’s principal dwelling. These regulations relate to two issues: The appraisal of a principal dwelling that secures a loan and the servicing of mortgages on principal dwellings. These regulations were effective on October 1, 2009.

**Prohibited Appraisal Practices**

The regulations provide that no lender, mortgage broker, or their affiliates can directly or indirectly influence the judgment of an appraiser who is assessing the value of a principal dwelling. Illegal influence includes encouraging an appraiser to misstate or misrepresent the value of the principal dwelling used to secure a loan. The regulations provide the following examples of actions that violate this prohibition:

- Implying to an appraiser that current or future retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling
- Excluding an appraiser from consideration for future engagement because the appraiser reports a value of a consumer's principal dwelling that does not meet or exceed a minimum threshold
- Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan
- Failing to compensate an appraiser because the appraiser does not value a consumer's principal dwelling at or above a certain amount
- Conditioning an appraiser's compensation on loan consummation

(12 C.F.R. § 1026.42(c))

The regulations also include examples of actions that a lender or mortgage broker can take without violating the prohibition against influencing the opinion of an appraiser:

- Asking an appraiser to consider additional information about a consumer's principal
dwellings or about comparable properties

- Requesting that an appraiser provide additional information about the basis for a valuation
- Requesting that an appraiser correct factual errors in a valuation
- Obtaining multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value
- Withholding compensation from an appraiser for breach of contract or substandard performance of services as provided by contract
- Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance

**Prohibited Servicing Practices**

When servicing a loan that is secured by a borrower’s principal dwelling, loan servicers cannot:

- Fail to credit a payment on the day of its receipt
- Impose a late fee or delinquency charge for any payment other than the payment that is actually late
- Fail to provide an accurate statement of the payoff amount within a reasonable time after requested

(12 C.F.R. § 1026.36(c))

**Regulations for Higher-Priced Mortgages**

The Federal Reserve’s 2008 revisions to Regulation Z included the creation of a new set of rules that apply to mortgages defined as “higher-priced mortgages.” The primary goal of these rules is to ensure that there are some protections for subprime loans that do not meet the interest rate or fee triggers of HOEPA. The protections offered by these new rules include:

- Requiring consideration of the borrower’s repayment ability
- Limiting prepayment penalties
- Requiring escrow accounts for taxes and insurance

These protections were effective on October 1, 2009.

**Loans Protected by the Higher-Priced Mortgage Regulations**

In July 2008, the Federal Reserve published its amendments to Regulation Z that define a new category of mortgages as “higher-priced mortgage loans” – also known as Section 35 loans. The thresholds for identifying these mortgages are low enough to include virtually all subprime closed-end loans that are secured by the borrower’s principal dwelling. The regulations define a higher-priced mortgage loan as a consumer transaction that:

- Is secured by the borrower’s principal dwelling, and
- Has an annual percentage rate that exceeds the “average prime offer” by 1.5 percentage points for loans secured by a first lien, and 3.5 percentage points for loans secured by a subordinate lien, or
- The APR exceeds the average prime offer rate by 2.5 percentage points in the case of a first-lien jumbo loan

(12 C.F.R. § 1026.35(a))

The Federal Reserve publishes average prime offer rates on the Internet. They represent the average of interest rates, indexes, margins, points, and other information relevant to loan pricing for prime rate loans. 11

The definition of “higher-priced mortgage loans” specifically excludes:
- A transaction to finance the initial construction of a dwelling
- A bridge loan with a term of 12 months or less
- A reverse mortgage
- A home equity line of credit that is subject to the TILA requirements for home equity credit plans

The primary objective of the Federal Reserve in establishing this definition of higher-priced mortgages was to “…cover the subprime market and generally exclude the prime market.” 12

Requirements for Higher-Priced Mortgage Loans
Compliance with the following rules is required when making a higher-priced mortgage loan:

Consideration of Repayment Ability: When making a higher-priced mortgage loan, lenders cannot make loans on the basis of the equity available in the borrower’s home unless also evaluating the borrower’s repayment ability. An assessment of repayment ability must include the following considerations:
- Assets other than the equity in the borrower’s home
- Current debt obligations
- Mortgage-related obligations, which must include expected property taxes and insurance for the new loan
- Employment
- Verification of income using IRS W-2 forms, tax returns, payroll receipts, bank records, or other third-party records that give “reasonably reliable evidence” of the borrower’s income and assets

11 http://www.federalreserve.gov/releases/h15/update/
Note that these are the same considerations that apply when assessing the repayment ability under HOEPA transactions.

**Imposition of Limits on Prepayment Penalties:** When making a higher-priced mortgage loan, the loan may include a prepayment penalty only if the terms of the loan:

- Do not allow the penalty to be in force after the first two years of the loan term
- The source of funds for paying the penalty is not funds from a refinancing by the lender or one of its affiliates
- The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation

**Establishment of an Escrow Account for Taxes and Insurance:** Lenders cannot make a higher-priced mortgage loan and secure it with a first lien on a borrower’s principal dwelling unless also establishing an escrow account for taxes and mortgage-related insurance such as hazard insurance, liability insurance, and insurance protecting the lender in the event that the borrower defaults.

The borrower may seek cancellation of the escrow account after the first year of the loan term by filing a written request with the lender or loan servicer that is received no sooner than 365 days after consummation of the loan. Note that it is at the lender’s discretion to honor the request.

There are two exceptions for this requirement. If the loan is secured by shares in a cooperative, or if the loan is secured by a condominium unit and the condominium association has an obligation to maintain insurance, then the lender is not required to establish an escrow account.

**Homeowners Protection Act (HPA - 12 U.S.C. 4901 et seq.)**

**HPA Overview**

Congress passed the Homeowners Protection Act (HPA) in 1998 to facilitate the cancellation of private mortgage insurance (PMI). Lenders may require borrowers to purchase PMI when they make down payments of less than 20%, and the loan-to-value ratio is high. Borrowers who have little money to invest in the purchase of a home are more likely to default on their loans, and PMI allows lenders to protect their interests while making these riskier loans. PMI helps consumers by enabling them to secure a loan when they have little cash for a down payment. The cost of PMI varies depending on loan product and/or insurer, and is calculated as a percentage of the total amount of the loan.

Generally, borrowers can request that lenders cancel PMI when the equity in their homes exceeds 20%. Based on a borrower’s payment history, the lender may honor the request or continue to collect PMI until 78% loan-to-value (22% equity position) is reached. The Homeowner’s Protection Act provides for the automatic termination of PMI as borrowers build equity, and the risk of loss from default decreases.
Regulatory Agency
Prior to the transfer of power to the CFPB in July 2011, the federal agencies responsible for enforcing compliance with the HPA were the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and the Farm Credit Administration. The CFPB is now responsible for enforcing the HPA.

Loans and Entities Covered by the HPA
The Homeowners Protection Act applies to residential mortgages on single-family homes used as the borrower’s principal dwelling. The law is applicable to lenders, loan servicers, and insurers.

Loans Exempt from the HPA
The provisions of the Homeowners Protection Act do not apply to:

- Government-insured FHA or VA loans
- Loans protected by PMI paid for by the lender

In addition to these exemptions, there are special exceptions for loans defined under the Act as high-risk loans. For these loans, PMI is in place for a longer period of time but will terminate automatically following the date that is the midpoint of the amortization period if the borrower is current on his/her payments.

Definition of Terms in the Homeowners Protection Act

Good payment history: A borrower has a “good payment history” if he/she did not make a mortgage payment that was 60 days or more past due during the 12-month period beginning 24 months before the date on which the mortgage reaches the cancellation date and did not make a mortgage payment that was 30 days or longer past due during the 12-month period preceding the date on which the mortgage reaches the cancellation date.

Final Termination: The termination of PMI occurs when the loan does not qualify for earlier cancellation or termination. Final termination takes place on the first day of the month after the mid-point of the loan’s amortization period.

High-Risk Loans: Loans that do not meet the conforming loan limits established by Fannie Mae and Freddie Mac.

Disclosures and Notifications Required by HPA

The disclosures required by the law depend on the date that the loan is consummated. For mortgages that closed before July 29, 1999, there is only one disclosure requirement. This is the requirement to provide the borrower with an annual notice advising him/her that, in certain circumstances, it is possible to cancel PMI. The notice must include an address and a telephone number that the borrower can use to obtain more information on canceling PMI.

For loans that closed on or after July 29, 1999, there are numerous disclosure and notification requirements. The primary purpose of the disclosure requirements is to advise borrowers that
they have the option of canceling their PMI when the loan-to-value ratio on the property securing
the loan reaches 80%. If borrowers do not pursue the option of canceling their PMI, termination
automatically occurs when the loan-to-value ratio reaches 78% of the original value of the
property and when the date at which that is projected to occur arrives (based on the initial
amortization schedule). A subsequent notification will advise borrowers that the automatic
termination has occurred. Note that the requirements differ slightly for fixed-rate loans and
ARMs.

Disclosures for Fixed-Rate Mortgages: If PMI applies to a fixed-rate mortgage, the lender
must provide the borrower with each of the following at the time of the closing:

- An initial amortization schedule
- Written notice that the borrower can request cancellation of PMI on the cancellation date
  (the date that the loan-to-value ratio will reach 80%)
- Written notice that the borrower can accelerate payment on the loan, thereby reaching an
  80% loan-to-value ratio and the ability to cancel PMI ahead of schedule
- Written notice that cancellation of PMI is automatic on the termination date (the date
  when the loan-to-value ratio reaches 78% of the original value of the property)

Disclosures for ARMs: When PMI applies to an ARM, the adjustable rate prevents the lender
from knowing the exact date that the loan-to-value ratio will reach 80%. At the time of closing,
the lender must provide the borrower with:

- A written notice that the borrower can request cancellation of PMI on the cancellation
  date (the date that the loan-to-value ratio will reach 80%), and that the loan servicer will
  notify the borrower when the cancellation date is reached
- Written notice that cancellation of PMI is automatic on the termination date (the date
  when the loan-to-value ratio reaches 78% of the original value of the property), and that
  the loan servicer will notify the borrower when the cancellation date is reached

Disclosures for High-Risk Loans: If PMI applies to a loan defined under the Homeowner’s
Protection Act as a high-risk loan, the lender must provide the borrower with a notification
stating:

- PMI is not required when the borrower reaches the midpoint of the amortization of the
  loan
- Termination of PMI is automatic at the midpoint of the amortization period if the
  borrower is current on payments

Annual Disclosures: Loan servicers are required to provide borrowers with an annual notice
that reminds them of their right to the cancellation or termination of their PMI. The notice must
also provide an address or telephone number that borrowers can use to contact their loan
servicers with questions about the ability to cancel PMI. The law allows loan servicers to
include this annual disclosure with the RESPA disclosure regarding escrow accounts.
Notification of Cancellation or Termination: Within 30 days of the cancellation or termination of PMI, PMI will automatically terminate when the LTV ratio reaches 78% of the original value of the property and when the date on which that is projected to occur arrives (based on the initial amortization schedule).

Practices Prohibited by the Homeowners Protection Act

The receipt of any payments or premiums for PMI after the date of termination or cancellation is prohibited. Within 45 days after the cancellation or termination of PMI, the law requires the return of any unearned premiums to the borrower.

Penalties for Violations of the Homeowners Protection Act

The law provides for higher penalties for entities that are subject to the enforcement authority of the FDIC, the OTS, the NCUA, or the Farm Credit Administration. For these entities, penalties in individual actions are not to exceed $2,000. In a class action lawsuit, penalties may not exceed the lesser of $500,000 or 1% of the net worth of the liable party.

For entities not subject to federal regulators, the penalties in individual actions cannot exceed $1,000, and in class action lawsuits, penalties cannot exceed the lesser of $500,000 or 1% of the gross revenues of the liable entity violating the law.

Borrowers must bring actions for violations of the law within two years of the discovery of the violation.


S.A.F.E. Act Overview

In the spring of 2008, the meltdown of the subprime mortgage market led to the introduction of many bills in Congress to address the market conditions that led to the crisis. The combined result of many of these legislative proposals appeared in the Housing and Economic Recovery Act of 2008 (HERA), which was signed July 30, 2008. The goals of HERA include:

- Strengthening regulation of the government sponsored entities
- Providing additional Federal Housing Administration programs to assist homeowners
- Addressing problems caused by the foreclosure crisis
- Establishing a nationwide licensing database and education standards for the mortgage industry

The S.A.F.E. Act is Title V of HERA and has had the most immediate impact on mortgage professionals such as loan originators and brokers. Provisions of the S.A.F.E. Act establish application and reporting requirements for state-regulated loan originators and mortgage brokers. The Act requires each state to participate in the Nationwide Mortgage Licensing System.
Federal Mortgage-Related Laws

(NMLS) created by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR).

Each state has its own version of the S.A.F.E. Act which must meet the minimums required by the federal S.A.F.E. Act, but states may exceed the requirements of the federal Act.

**Requirements of the S.A.F.E. Act**

**Licensing/Registration:** The Act requires federally regulated loan originators to register with the NMLS and state-regulated loan originators to become licensed through the NMLS. Licensing and registration creates a unique identifying number for each loan originator, enabling regulators to track the activities of registrants/licensees.

**Background Checks:** Loan originators must submit to a comprehensive background check including submission of fingerprints, civil and criminal history and credit report as part of their application for licensure. Individuals who have been convicted of a felony in the seven years prior to application are not eligible for licensing. Felony convictions involving charges such as fraud, dishonesty and money laundering may render an individual permanently ineligible for licensure.

**Education/Testing:** Prior to licensing, loan originators are required to obtain **20 hours** of NMLS-approved education which covers specific topics relevant to the mortgage profession (three hours of federal laws and regulations, three hours of ethics, fraud, consumer protection and fair lending, and two hours of training in the nontraditional mortgage marketplace).

License candidates must also pass a written exam administered through the NMLS with a passing score of 75%. On June 30, 2011 the Department of Housing and Urban Development (HUD) issued a final rule concerning implementation of the S.A.F.E. Act. The final rule clarified the number of test attempts a mortgage loan originator licensing candidate is permitted. A loan originator who fails his/her initial attempt is permitted two additional test attempts. He/she must wait 30 days between each test attempt. If, on the third test attempt, the loan originator does not pass, he/she must wait six months (180 days) prior to attempting the test again.

Following licensure, loan originators are required to obtain **eight hours** (three hours of federal mortgage laws and regulations, two hours of ethics, fraud, consumer protection and fair lending, and two hours of training related to the nontraditional mortgage marketplace; states could add law to the requirement) of NMLS-approved education annually.

**Demonstration of Financial Responsibility:** Individual states will set the guidelines for how loan originators will demonstrate financial responsibility and general fitness. However, examples include net worth requirements, surety bond requirements, payment into a state fund and minimum credit score requirements.
**Consumer Protection Under the S.A.F.E. Act**

The S.A.F.E. Act created a number of consumer protection provisions. In addition to encouraging responsible behavior within the industry by mandating licensing/registration and education requirements, the Act also:

- Provides consumers with access to information about registrants/licensees, such as enforcement actions, etc.
- Facilitates collection and distribution of consumer complaints between state regulators

**Discussion Scenario: S.A.F.E. Compliant Licensing**

On September 23, 2009, Linus Loans applied for his mortgage loan originator license to conduct origination activities in a particular state in the north east. As part of the application, he filed a Uniform Individual Mortgage License/Registration and Consent Form (NMLS Form MU4). Linus listed Fantastic Funding Corporation and Laughing Loans, Inc. as his sponsors. Both companies are licensed correspondent mortgage lenders under the licensing law of Linus’ state.

In a previous career, Linus was a securities dealer, making big bucks on Wall Street. However, something was awry with Linus Loans’ security transactions. From November 2002 to February 2003, Linus falsely notarized the signatures of two persons without having actually witnessed these signatures. This was a violation of the NASD Rules of Conduct. Conduct Rule 2110 and the National Association of Securities Dealers (NASD) brought an action against Linus. On October 1, 2007, as a result of the action, he entered into a consent agreement with NASD barring him from association with any NASD member and subjecting him to a statutory disqualification as defined in the Securities Exchange Act of 1934. Linus Loans did not admit or deny the findings in the consent agreement, and there was not a hearing in the matter.

**Discussion Questions**

- **What disclosures must Linus Loans make on his Form MU4?**
- **What is the likely outcome of Linus’ application and why?**

**Discussion Feedback**

Linus Loans is required to disclose on his Form MU4 that a state or regulatory agency found that he had made a false statement or omission or had been dishonest, unfair or unethical. Additionally, he must disclose that he was barred from association with entities in the securities industry or from engaging in a financial services-related business.

While the S.A.F.E. Act requires licensing application through the NMLS, state regulators continue to approve or deny applications. Licensing applications that are found to include false information or omissions of material fact are subject to denial or revocation under state licensing laws. Additionally, many states prohibit employment with more than one licensed lender or broker at one time. If Linus was seeking licensure in a state with such a provision, his license could be denied for this reason as well.
Loan originators can ensure they are compliant with licensing requirements by:
- Submitting complete and truthful information on licensing applications
- Obtaining education that is compliant with their state’s statutory requirements
- Meeting all other jurisdictional requirements which establish the ethical, financial and professional fitness to operate in the mortgage industry

**Home Mortgage Disclosure Act (HMDA - 12 U.S.C. 2801 et seq.)**

**HMDA Overview**

The primary concern behind the enactment of the Home Mortgage Disclosure Act (HMDA) was the need to identify urban areas where the availability of home financing at reasonable terms was limited. In order to achieve this overall goal, HMDA has three specific purposes, which are to:
- Determine if depository institutions are meeting the housing needs of their communities (particularly in urban neighborhoods)
- Identify discriminatory lending practices patterns, which can result in enforcement actions to ensure compliance with fair lending laws
- Determine how to distribute public-sector investments where they are needed

The method that HMDA establishes for achieving its goals and purposes is to require both depository and non-depository institutions to collect data at the time that they receive loan applications and submit the data to the federal agency that supervises their lending activities.

**Regulatory Agencies**

Before the creation of the CFPB, the Federal Reserve was responsible for issuing regulations for implementation of HMDA. Now, the CFPB is primarily responsible for writing implementing regulations. These regulations are known as Regulation C (12 C.F.R. § 1003) The supervision of institutions subject to HMDA and enforcement of the law is now shared by the CFPB and the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Department of Housing and Urban Development.

**Institutions and Loans Covered by HMDA**

The law applies to depository institutions such as banks, credit unions, and savings associations that meet the following criteria:
- Assets that exceed an annually published threshold on the preceding December 31st (The exemption threshold for 2012 is $41 million, which means that depository institutions with assets of $41 million or less as of December 31 2011 are exempt from requirements to collect data in 2012)
- A home or branch office in a metropolitan statistical area (MSA) on the preceding December 31st
• Origination of at least one home-purchase loan or refinancing of a home-purchase loan, secured by a first lien on a one-to four-family dwelling within the preceding calendar year

• The institution is federally insured or regulated, or the mortgage loan(s) made by the institution was (were) insured, guaranteed or supplemented by a federal agency, or the loan(s) was (were) intended for sale to Fannie Mae or Freddie Mac

The law also applies to non-depository mortgage lending institutions that meet the following criteria:

• Origination of home-purchase loans and refinances that either equal at least 10% of its loan-origination volume (measured in dollars) or that equal $25 million or more within the preceding year

• A home or branch office in a metropolitan statistical area on the preceding December 31st

• Total assets as of the preceding December 31st of more than $10 million, including the assets of any parent corporation or the origination of at least 100 home purchase loans, including refinances of home purchase loans, within the previous year

The loans that are subject to HMDA include applications for and originations and purchases of the following types of loans:

• Purchase loans, which includes real property and not personal property (such as travel trailers or automobiles)

• Home improvement loans

• Refinances

Data collection is also required when a loan origination or the denial of a loan application results from a response to a pre-approval lending program.

Exempt Institutions

The reporting requirements do not apply to:

• Institutions that do not meet the criteria outlined above

• State-chartered or state-licensed institutions that are subject to state disclosure laws with reporting requirements that are substantially similar to those of HMDA

Definitions of Terms Related to HMDA

Loan Application Register (LAR): A LAR is the form used for the reporting of HMDA data.

Metropolitan Statistical Area (MSA): Urbanized area with a population of at least 50,000 and identified by the Office of Management and Budget based on census data.
**Reporting Requirements of HMDA**

HMDA requires the institutions that are covered by the law to collect extensive data about each mortgage loan application and origination. The information reported includes:

- The type of loan or loan application
- The purpose and amount of the loan
- Whether the application was a request for pre-approval and whether it resulted in a denial or an origination
- The action taken on the loan
- The location of the property related to the loan
- The owner/occupant status of the property
- Ethnicity, race, sex, and income of the applicant
- The difference between the loan’s APR and the yield on Treasury securities with comparable periods of maturity if the difference is greater than three percentage points for first liens on a principal dwelling or greater than five percentage points for loans secured by subordinate liens
- Identification of a loan that is subject to HOEPA

As a result of amendments to HMDA that Congress made under the Dodd-Frank Act, there are many additional data collection requirements under the law. However, financial institutions are not required to report additional data until the first January 1 that occurs nine months after the CFPB issues final regulations to implement these provisions of the law.

The collection of HMDA data helps federal regulators to determine if different or more onerous lending terms are offered to different loan applicants on the basis of personal characteristics such as race, ethnicity, or sex. The supervisory agencies, such as federal banking regulatory agencies, compile the information submitted to them by lending institutions and the Federal Financial Institutions Examination Council aggregates, and reports it within each MSA.

As mentioned in the section on ECOA, exceptions are made to fair lending provisions prohibiting inquiries about personal characteristics. In order to meet the reporting requirements of HMDA, a mortgage professional may request information on a loan applicant’s race, ethnicity and sex when completing the loan application. The applicant may decline to answer, in which case the mortgage professional must make a best guess based on visual observation.

**Penalties for Violations of HMDA**

Civil monetary penalties can result from the failure to report data, failure to report data in a timely manner, and failure to report data accurately. The regulatory agencies that monitor compliance use a penalty matrix and consider factors such as good faith, previous violations and financial resources of the entity in calculating penalties.
Fair Credit Reporting Act (FCRA - 15 U.S.C. 1681 et seq.)

FCRA Overview
Congress enacted the Fair Credit Reporting Act (FCRA) in 1970 to ensure the accuracy, fairness, and privacy of consumers’ personal information that is assembled and used by consumer reporting agencies. In order to protect the rights of consumers, the law creates special obligations and restrictions for Consumer Reporting Agencies (CRAs), and for furnishers and users of consumers’ personal information.

Regulatory Agency
Prior to the creation of the CFPB, the implementation and enforcement of FCRA was shared by federal banking regulatory agencies and the Federal Trade Commission. The transfer of authority to the CFPB in July 2011 placed general rulemaking authority with the CFPB as well as general authority to enforce compliance with FCRA and its implementing regulations. However, the FTC retains some rulemaking and enforcement authority. In a memorandum of understanding entered between the CFPB and the FTC, the agencies have agreed to give one another a 30-day notice prior to the publication of an advance notice of proposed rulemaking and to “consult promptly” on guidance documents that address unfair, deceptive, or abusive acts or practices under FCRA. The regulations promulgated pursuant to FCRA are known as Regulation V and are found in 12 C.F.R. Section 1022.

Covered Transactions
FCRA applies to any transaction that involves the use of credit reports, consumer investigatory reports, and employment background checks.

Exempt Disclosures
The privacy requirements do not apply to disclosures of limited information to government agencies, to the FBI and to counter-terrorism investigations.

Definition of Terms Related to FCRA

Consumer Report: The communication of any information from a consumer reporting agency that relates to a consumer’s credit worthiness, credit standing, credit capacity, character, personal characteristics, or mode of living which is used or expected to be used in order to determine the consumer’s eligibility for credit or insurance to be used for personal, family, or household purposes or to evaluate a consumer for employment.

Consumer Reporting Agency (CRA): Any person who regularly engages for fees or on a cooperative nonprofit basis in the practice of assembling or evaluating of consumer credit information in order to provide consumer reports to third parties.

Investigative Consumer Report: A consumer report containing information about a consumer’s character, general reputation, personal characteristics, and mode of living that is obtained through personal interviews.
File: All the information about a consumer that is recorded and retained by a CRA.

Adverse Action: Adverse Action has the same meaning that it has under ECOA, and also means any denial or unfavorable change in insurance coverage, or a denial of employment based on a consumer report.

Disclosures and Notifications Required by FCRA

FCRA creates a number of obligations for users and furnishers of credit information as well as the credit reporting agencies (CRAs) which receive and report credit information.

Obligations of CRAs: (Examples of CRAs are Equifax, Experian, and TransUnion, which are often referred to as “The Big Three.”)

- **CRA Disclosures to Consumers**: If requested by a consumer, CRAs must clearly and accurately disclose all information in the consumer’s file, the sources of the information, and the identification of each person that procured a consumer report. The disclosure must also include a summary of the consumer’s rights under FCRA. Unless otherwise authorized by the consumer, the disclosure must be in writing.

- **CRA Notification to Users**: CRAs must provide notices to any person who regularly and in the ordinary course of business furnishes information to a CRA and to any person who receives and uses a consumer report. The notice to furnishers and users must advise them of their responsibilities under the FCRA.

CRAs have the burden of protecting consumer privacy when reporting credit information.

Obligations of Furnishers: (Loan servicers, lenders, and creditors that receive loan and credit line payments are examples of furnishers of information that CRAs place in consumers’ files.)

- **Notification to CRAs of Corrections**: If the furnisher of information regularly and in the ordinary course of business provides information to CRAs and determines that the information provided is not complete or accurate, the furnisher has a duty to correct the information and to provide the corrections to all CRAs that received inaccurate information.

- **Notice of Dispute**: If a consumer disputes the accuracy and completeness of information provided by a furnisher, the furnisher cannot report the disputed information to a CRA without providing notice of the dispute.

- **Notice Regarding Delinquencies**: A furnisher that reports information on a delinquent account must provide the CRA with the month and year of the commencement of the delinquency that immediately precedes an action for collection.

- **Duties after Receipt of Notice of Dispute**: Upon receipt of a notice of dispute from a CRA, a furnisher must conduct an investigation, report the results to the CRA that provided notice of the dispute, report any inaccuracies to all CRAs that received the inaccurate information, and delete the inaccurate information. Furnishers have 30 days
from the CRA’s receipt of a dispute to investigate the dispute and rectify any inaccuracies.

**Obligations of Users:** (A lender or mortgage broker that uses a consumer report in the process of making a mortgage loan is an example of a user of information collected by a CRA.)

- **Certification of Permissible Purpose:** Users must provide a Consumer Reporting Agency with a certification that states the permissible purpose for which the user is requesting the consumer report. Permissible purposes include consumer requests for reports, such as a consumer’s request for a credit report required by a mortgage lender. Another permissible purpose is to determine a consumer’s eligibility for a license, such as the loan officer license under certain state laws.

- **Notification of Adverse Action:** When a user takes any type of adverse action based on information in a consumer report, the user must provide the consumer with written, oral, or electronic notification which includes contact information for the CRA that provided the report. The notification must include a statement that the CRA did not make the adverse decision and must advise the consumer of the right to obtain a free disclosure of his/her file and of the right to contact the CRA to dispute the accuracy and completeness of the report.

- **Notification of Adverse Action Based on Information from Affiliates:** If adverse action is based on information from an entity that is affiliated with the user by common ownership or control, the user must notify the consumer of the adverse action and of the right to obtain a disclosure of the nature of the information relied on in taking the adverse action.

Lenders, brokers and other “users” of credit information have the burden of protecting consumer privacy when using credit information.

**Practices Prohibited by FCRA**

- FCRA prohibits a CRA from furnishing a consumer report for any reason other than a permissible purpose. Permissible purposes include providing a report pursuant to the written instructions of the consumer to whom the report relates and providing a report in connection with a credit transaction involving the extension of credit to the consumer.

- FCRA prohibits those who furnish information to a CRA from knowingly providing inaccurate information.

- FCRA prohibits the release of a consumer report without the written permission of the consumer.

- No CRA can write a consumer report containing outdated negative financial information such as bankruptcies over ten years old and other negative information such as paid tax liens and civil judgments that are more than seven years old unless the consumer report relates to a credit transaction involving a principal amount of $150,000 or more.

- CRAs cannot release disputed information in a consumer report without indicating that the consumer disputes the accuracy and completeness of the information.
Penalties for Violations of FCRA

- **Civil Liability for Willful Noncompliance**: Any person who willfully fails to comply with consumer-protection provisions of FCRA is liable to the injured consumer for actual damages of not less than $100 and not more than $1,000, punitive damages, costs of bringing the action, and attorney’s fees.

- **Civil Liability for Negligent Noncompliance**: Negligent failure to comply with the law may result in the payment of actual damages, costs, and attorney’s fees to the injured consumer.

- **Criminal Penalties for Obtaining Information under False Pretenses**: Any person who obtains information about a consumer under false pretenses will be fined and/or imprisoned for not more than two years.

- **Criminal Penalties for Unauthorized Disclosures by Officers and Employees**: Officers or employees of a CRA who knowingly and willfully provide information about a consumer to a person not authorized to receive the information will be fined and/or imprisoned for no more than two years.

**Fair and Accurate Credit Transactions Act of 2003 (FACTA - 15 U.S.C. 1681 et seq.)**

**FACTA Overview**

In 2003, Congress added additional provisions to FCRA with the enactment of the Fair and Accurate Credit Transactions Act (FACTA). Congress adopted these additional provisions in order to address the problem of identity theft, to facilitate consumers’ access to the information retained by CRAs, and to improve the accuracy of consumer reports.

Regulatory oversight and covered and exempt transactions for FACTA are the same as FCRA.

**Disclosures, Notifications, and Actions Required by FACTA**

**Obligations for CRAs**: Most of the disclosures, notifications, and actions required by FACTA are the duties of consumer reporting agencies. These statutory duties include:

- **Providing Notice of Consumer Rights**: FACTA creates requirements for the issuance of a Victim’s Notice of Rights when a consumer reports identity theft to a consumer reporting agency.

- **Issuing Free Credit Reports**: In order to encourage consumers to self-monitor their credit reports as a means of detecting identity theft, Congress requires each of the three national credit bureaus (Experian, Equifax, and TransUnion) to provide a free credit report annually, when requested by the consumer.

- **Creating a Fraud Alert**: At the request of a consumer who believes that he/she is or may be the victim of fraud, CRAs must create a fraud alert for the consumer’s file and
include it with any credit scores generated for the consumer. CRAs must keep the fraud alert in the file for 90 days.

- **Creating an Extended Fraud Alert**: After receipt of an identity theft report, CRAs must create an extended fraud alert, maintain it in the file, and include it with any credit report generated for the consumer for a period of seven years.

- **Creating an Active Duty Alert**: At the request of an active duty consumer, CRAs must create a statement that the consumer is on active duty for the military and include the statement with any credit reports generated for the active duty consumer. CRAs must keep the active duty alert in the file for not less than 12 months.

- **Forwarding Fraud Alerts and Active Duty Alerts to Other CRAs**: When one of the three national credit bureaus receives a consumer’s request for fraud alert or an active duty alert, it must forward the information to the other CRAs.

- **Disclosing Credit Scores**: Consumers have a right to purchase a copy of their credit scores. With disclosure of a credit score, CRAs must explain that the CRA credit score may be different from a lender’s credit score, and provide a list of factors used to compute the score and a list of factors that negatively impacted the score.

- **Blocking Information**: CRAs must block the reporting of any information in a consumer’s file that the consumer identifies as information that resulted from identity theft and must notify the furnisher of the information that the blocked information may be the result of identity theft. The block must be effective within four business days of receipt of copies of the consumer’s identity, his/her identity theft report, and a description of the information in the consumer’s file that relates to transactions that he/she did not make.

- **Notification of Decision to Decline or Rescind a Block**: In certain circumstances in which the CRA reasonably determines there is not a basis for blocking the information, it can decline the request for a block or rescind a block and must provide prompt notification to the consumer.

**Obligations for Mortgage Professionals**: FACTA creates some special disclosures, notifications, and actions for mortgage professionals:

- **Disclosure of Credit Score**: In mortgage lending transactions, the “person who makes or arranges loans” must provide mortgage loan applicants with information about the credit score used to evaluate their creditworthiness and must provide this information with a notice that advises them of the importance of reviewing their credit scores and of their right to contact the CRA or the lender that generated the credit score.

- **Response to Consumer’s Request for Information on Fraudulent Transactions**: When identity theft occurs in lending transactions, mortgage professionals must comply with the alleged victim’s written request for copies of any records of transactions conducted by a person who made unauthorized use of the victim’s identity. The request must include verification of the victim’s identity and proof of a claim of identity theft. Response to these requests is due 30 days after receipt of the request.
Compliance with the FTC Disposal Rule: The Disposal Rule applies to all people and businesses that use consumer reports. The rule applies to all information in a CRA file that a lender or mortgage broker uses to establish the creditworthiness of a consumer and requires “reasonable methods” to ensure that unauthorized access to or use of consumer information cannot occur as a result of its disposal. “Reasonable methods” include conducting due diligence to verify compliance with the Disposal Rule by any third party that is employed to dispose of consumer information. Acceptable disposal methods include methods which do not allow for the reconstruction of consumer information, such as burning, shredding or pulverizing the documents.

The Rule is aimed at preventing identity theft by ensuring credit reports are disposed of properly and disposal methods do not result in reading or reconstruction of credit information. Lenders, mortgage brokers, and other mortgage professionals that are subject to the Gramm-Leach-Bliley Act must incorporate a program for the disposal of information in their security program required by the Safeguards Rule.

Definition of Terms Related to FACTA

Active Duty Alert: A statement in a consumer reporting agency’s file for a particular individual, stating that the consumer is on active duty for the military.

Creditor: FACTA and FCRA use the same definition as ECOA for creditor. It is any person who regularly extends, renews or continues credit.

Identity Theft: Fraud or attempted fraud using the identifying information of another person.

Identity Theft Report: The FTC defines an identity theft report as “...a report that alleges theft with as much specificity as the consumer can provide.” FTC regulations list information a theft report “may” include, stating that its list is “for illustrative purposes only,” and advising consumers that different companies may have different requirements when receiving identity theft reports. Generally, reports must include an affidavit stating general information about the theft and the victim and a list of the fraudulent accounts opened in the victim’s name.

Practices Prohibited by FACTA

If a consumer requests information about transactions, which were allegedly made with the unauthorized use of his/her identity, businesses (including mortgage brokers and mortgage lenders) cannot charge a fee for providing the information. Penalties for violations of FACTA are covered under FCRA’s regulations.

FTC Red Flags Rule

Red Flags Rule Overview

The Red Flags Rule is a measure included in FACTA to address identity theft. “Red flag” is defined under federal regulations as “…a pattern, practice, or specific activity that indicates the
possible existence of identity theft” (16 C.F.R. §681.1 (b)(9)). While the Red Flags Rule was effective January 1, 2008, with compliance required by November 1, 2008, enforcement was delayed several times. A bill signed by President Obama in December 2010, called the Red Flag Program Clarification Act of 2010, narrowed the scope of creditors who must comply with the requirements, and enforcement of the regulations was effective December 31, 2010. The 2010 amendments did not impact mortgage lenders.

It is worth noting the distinctions offered regarding personal information under the Gramm-Leach-Bliley Act and its Safeguards Rule, and the protections offered under the Red Flags Rule. Both the Safeguards Rule and the Red Flags Rule are intended to prevent the release of personal financial information. The primary difference is that the Safeguards Rule focuses on the methods of securing personal information, and the Red Flags Rule focuses on the methods of detecting a security breach. The Red Flags rule is interpreted and enforced by the FTC.

**Businesses and Accounts Subject to Rule**
The Red Flags Rule applies to financial institutions and to creditors that offer or maintain “covered accounts.” Financial institution, creditor, and covered accounts are all terms defined under the regulations, and the meanings of these terms determine the types of business entities and accounts that are subject to the Red Flags Rule. These terms are defined as follows:

**Financial Institutions:** A state or national bank, a state or federal savings and loan association, a mutual savings bank, a state or federal credit union, or any other person that, directly or indirectly, holds a transaction account belonging to a consumer.

**Creditor:** As established under FACTA, a creditor is defined as someone who regularly extends credit or arranges for the extension of credit, including finance companies and mortgage brokers.

**Covered Accounts:** The types of accounts generated by these entities that are subject to special protection under the Red Flags Rule include accounts:

- Offered or maintained by a financial institution or creditor
- Intended for personal, family, or household purposes
- Designed to permit multiple payments or transactions

**Mortgage loans** are cited in the regulations as an example of the types of accounts covered by the regulations.

The Red Flags Rule protects customers, who are defined as a person who has a “covered account” with a financial institution or a creditor. In the field of mortgage lending, a customer would be a loan applicant or a borrower who applies for or obtains a mortgage from a mortgage broker or a financial institution.

**Requirements of the Red Flags Rule**
The Red Flags Rule requires creditors and financial institutions to establish an **Identity Theft Prevention Program.**
The program must have provisions for:

- Identifying patterns, practices, or specific activities that may indicate the possible existence of identity theft
- Detecting irregularities when obtaining information from a person opening an account or accepting a change of address on existing accounts
- Preventing and mitigating identity theft by responding appropriately to the types of risks posed by particular types of accounts
- Updating the identity theft program periodically to identify new risks to the security of personal information

*The Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation* provides comprehensive information for developing an Identity Theft Prevention Program. These Guidelines are located in Appendix A of 16 C.F.R. Section 681. The Guidelines:

- Give examples of the specific types of risk factors
- Suggest appropriate responses when evidence of identity theft emerges
- Describe appropriate ways to update the program when new methods of detecting identity theft are available and when mergers and acquisitions or other business changes occur that might impact the security of customer information

**Illustrations of Red Flags**

The Guidelines include an extremely helpful list of “red flags” that financial institutions and creditors can use to identify threats to the security of covered accounts. Individuals responsible for the implementation of an Identity Theft Prevention Program should be acquainted with each red flag on the list.

The Guidelines break these warning signs into a number of categories:

- **Notifications or warnings from a CRA**, such as a notice that there is activity on an account that is inconsistent with the account’s prior history
- **Suspicious Documents**, such as documents that show evidence of tampering or documents containing information that is inconsistent with prior information provided
- **Suspicious Personal Identifying Information**, such as information that does not match the information found in the consumer report
- **Suspicious Activity Related to the Covered Account**, such as irregular payment activity
- **Notices from Customers, Identity Theft Victims, Law Enforcement** that fraudulent activity is associated with the account

The Guidelines are available online through the Government Printing Office. ¹³

Application to Small Businesses

When publishing the final version of the Red Flag Rules, the FTC noted that small businesses are also vulnerable to identity theft and need to establish programs to prevent it. However, the Small Business Administration (SBA) commented that certain requirements, particularly the production of a written program, could be overly burdensome for small businesses. \(^{14}\)

The FTC disagreed with the assertion that the requirements are too burdensome. However, in order to facilitate compliance with the rule, the FTC delayed enforcement of the rule until November 1, 2009 to give all creditors and financial institutions time to develop Identity Theft Prevention programs.

The Dodd-Frank Act

In July 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in response to the collapse of the economy that began with the 2007 meltdown of the mortgage lending market. The law addresses a broad range of issues that relate to financial and investment activities, including mortgage lending and investing.

The Dodd-Frank Act is divided into 16 titles. These titles address a range of financial issues including the improved regulation of banks, savings and loans, non-bank financial companies, hedge fund advisers, and swap dealers and participants. The titles in the law that directly impact mortgage lending and investing include:

- Title IX, or Investor Protections and Improvements to the Regulations of Securities, with provisions authorizing stricter regulation of investors and credit rating agencies
- Title X, or the Consumer Financial Protection Act of 2010, which authorizes the creation of the CFPB, provides for the transition of regulatory authority from other federal regulatory agencies to the CFPB, and outlines the Bureau’s regulatory and enforcement responsibilities
- Title XIV, or the Mortgage Reform and Anti-Predatory Lending Act, with provisions that apply directly to mortgage originators, servicers, and appraisers

These titles in the Dodd-Frank Act set the regulatory boundaries for the origination and securitization of mortgage loans.

As a result of the authority extended to the CFPB under the Dodd-Frank Act, the CFPB is now the principal federal regulator for all depository and non-depository entities that offer home loans to consumers. Title XIV, the Mortgage Reform and Anti-Predatory Lending Act, is the section of the Dodd-Frank Act that poses the principal compliance concerns for loan originators who are not affiliated with depository institutions.

\(^{14}\) The SBA defines a small business as one that has assets of $165 million or less.
Title XIV is divided into eight subtitles:

- **Subtitle A** addresses **Residential Mortgage Loan Origination Standards** and creates:
  - A prohibition against incentives for loan originators to earn additional compensation by steering consumers towards particular loans or loans with particular lending terms, and
  - Limitations on loan originator compensation

- **Subtitle B** addresses **Minimum Standards for Mortgages**, and directs the CFPB to adopt rules addressing:
  - The establishment of standards for determining a borrower’s ability to repay a home loan
  - The creation of a rebuttable presumption of the ability of a consumer to repay a home loan if the loan meets the standards that are established for a “qualified mortgage”

- **Subtitle C** addresses **High-Cost Mortgages** and directs the CFPB to broaden the application of disclosure requirements and prohibited practices to a wider range of loans by:
  - Extending the HOEPA provisions to purchase money mortgages and open-end home equity lines of credit
  - Lowering the interest rate and points and fees thresholds for HOEPA loans
  - Adding a prepayment penalty trigger, which provides that a loan is a high-cost home loan if it includes a prepayment penalty provision that is in force for more than 36 months after closing or if the loan allows prepayment penalties to exceed more than 2% of the amount prepaid
  - Imposing homeownership counseling requirements
  - Strengthening prohibited lending terms and practices

- **Subtitle D** authorizes the creation of an **Office of Housing Counseling** within HUD

- **Subtitle E** addresses **Mortgage Servicing**, and requires the CFPB to create new rules for loan servicers. Proposed rules address the following matters that relate to loan servicing:
  - Monthly mortgage statements
  - Reminders to borrowers before interest rates reset
  - Options for forced-place insurance
  - Options for avoiding foreclosure
  - Prompt crediting of payments
  - Accurate recordkeeping
  - Prompt correction of errors
  - Delinquent borrower access to servicer personnel
Evaluation of delinquent borrowers for foreclosure options

Subtitle F addresses Appraisal Activities, and requires:
- Stricter appraisal standards for “higher risk mortgages”
- Stricter standards to ensure the independence of appraisers

Subtitle G addresses Mortgage Resolution and Modification. With so many homeowners in trouble on their mortgages, Congress created the Home Affordable Modification Program (HAMP) under the 2008 Emergency Economic Stabilization Act. Since implementation of the HAMP program seemed unsuccessful, Congress tried to make it easier for consumers to obtain loan modifications by:
- Requiring mortgage servicers participating in the program to provide data to borrowers that is used in performing a net present value (NPV) analysis if their requests for loan modifications are denied
- Making a net present value calculator available on the Internet that homeowners can use to determine whether their mortgages would be accepted or rejected for modification
- Making reasonable efforts to provide a website that homeowners can use to apply for mortgage modifications

Subtitle H addresses Miscellaneous Provisions, which include:
- Acknowledgment of the need to reform Fannie Mae and Freddie Mac
- A directive for an inter-agency study on foreclosure rescue and loan modification scams
- Reauthorization of the Emergency Mortgage Relief Program
- Authorization for more funds for the Neighborhood Stabilization Program

As a result of regulatory changes dictated by the Dodd-Frank Act, the CFPB has been engaged in ongoing rulemaking proceedings. Many of the new rules will be finalized in 2013, while some of the more controversial and difficult rules, such as those that create an “integrated disclosure” that combines the TIL Statement and the GFE, will not be finalized until some unknown future date.

**Mortgage Assistance Relief Services (MARS)**

In 2010, the FTC issued rules that apply to all for-profit companies that offer mortgage assistance relief services (MARS) through telemarketing and other marketing media. The FTC issues these rules in response to:
- Deceptive and abusive practices in the marketing of MARS
- Misrepresentations made by for-profit mortgage relief companies that they are affiliated with the government, a nonprofit organization, a lender, or loan servicers
• The failure of struggling homeowners to realize that they can take advantage of free homeownership counseling services through state or HUD programs

The need for these rules resulted from the growing number of scams that target homeowners who are in default on mortgage payments and facing the possibility of foreclosure. Promising “foreclosure rescues” and loan modifications to reduce monthly mortgage payments, these scams rob homeowners of dwindling financial resources with fraudulent offers for a solution.

**Definition of Terms Related to the MARS Rule**

**Consumer:** Consumers are defined as “…any natural person who is obligated under any loan secured by a dwelling” (12 C.F.R. §1015.2).

**Mortgage assistance relief service provider:** The required disclosures, notices, and prohibited practices under the MARS Rule apply to “mortgage assistance relief service providers,” who are defined as any person who “…provides, offers to provide, or arranges to provide any mortgage assistance relief service…” (12 C.F.R. §1015.2).

**Mortgage assistance relief service:** These services include any plan, program, or service offered in exchange for compensation to assist in:

- Stopping, preventing, or postponing foreclosure or repossession of a consumer’s dwelling
- Negotiating or arranging for modification of terms in a home loan to reduce the interest rate, principal balance, monthly payments, or fees
- Obtaining a forbearance or modification in the timing of loan payments
- Negotiating for or arranging an extension of time for a consumer to cure a default, reinstate a home loan, or redeem a dwelling
- Obtaining a waiver of an acceleration clause or balloon payment provision in a home loan
- Negotiating, obtaining, or arranging a deed in lieu of foreclosure, short sale, or other alternative disposition of a consumer’s home

(12 C.F.R. §1015.2)

**Prohibited Representations for MARS Providers (12 C.F.R. §1015.3)**

When advertising or marketing MARS services, providers of these services are prohibited from representing that a consumer cannot or should not contact his/her mortgage lender or loan servicer. MARS providers are also prohibited from representing “…the benefits, performance, or efficacy of any mortgage assistance relief service unless, at the time such representation is made, the provider possesses and relies upon competent and reliable evidence that substantiates the representation is true” (12 C.F.R. §1015.3(c)). This evidence must be based on tests and research conducted by experts.
MARS providers are also prohibited from making **misrepresentations** related to:

- The likelihood of obtaining or arranging particular results, such as a loan modification
- The amount of time that it will take to achieve results
- The amount of money or debt relief that a consumer may save or realize by using mortgage assistance relief services
- The terms or conditions under which any refund, either full or partial, will be made by the MARS provider

MARS providers are prohibited from misleading consumers by:

- Implying that the provider is affiliated, endorsed or approved by the U.S. government, a governmental homeowner assistance plan, a federal or state agency, a nonprofit housing counselor, or by the lender or loan servicer that made or services the consumer’s home loan
- Suggesting that they will receive legal representation
- Stating that the consumer is not obligated to make scheduled payments
- Asserting that the provider has completed services that he/she/it agreed to perform and should receive payment

The MARS Rule absolutely prohibits the collection of any fee or payment until a written agreement between the consumer and the consumer’s lender or loan servicer has been executed. This agreement must incorporate the offer of mortgage assistance relief that the provider has negotiated with the lender or servicer (12 C.F.R. §1015.5(a)). At the time that a MARS provider offers this written agreement to a consumer, it must also give the consumer the notice and the disclosure that is described in the subsequent section.

**Disclosure Requirements for MARS Providers (12 C.F.R. §1015.4)**

The MARS Rule establishes one set of disclosures for “general commercial communications” and another for “consumer-specific communications.” Commercial communications are defined as any type of written or oral statement made using any mode of communication or broadcasting and includes examples that range from newspaper advertisement to infomercials (12 C.F.R. §1015.2).

“**General commercial communication**” is defined as commercial communication that is not directed towards a specific consumer and that occurs before a consumer agrees to allow a MARS provider to seek mortgage assistance relief on his/her behalf. MARS providers must make the following disclosures in all general commercial communications:

- “(Name of company) is not associated with the government, and our service is not approved by the government or your lender.”
- “Even if you accept this offer and use our service, your lender may not agree to change your loan.”
“Consumer-specific commercial communication” is defined as commercial communication that is directed at a specific consumer and that occurs before a consumer agrees to allow a MARS provider to seek mortgage assistance relief on his/her behalf. MARS providers must make the following disclosures in all consumer-specific commercial communications:

- “You may stop doing business with us at any time. You may accept or reject the offer of mortgage assistance we obtain from your lender [or servicer]. If you reject the offer, you do not have to pay us. If you accept the offer, you will have to pay us (insert amount or method of calculating the amount) for our services.”
- “(Name of company) is not associated with the government, and our service is not approved by the government or your lender.”
- “Even if you accept this offer and use our service, your lender may not agree to change your loan.”

Both the general and the consumer-specific commercial communications are required to be “clear and prominent.” In order to ensure that these disclosures are clear and prominent, the rule requires that printed advertisements have a heading next to the disclosure that states: “IMPORTANT NOTICE.” These words must be in bold print that is two sizes larger than the font size of the disclosures. Verbal communications, including telephone calls, must include the same disclosures, which must be prefaced with the statement, “Before using this service, consider the following information...” (12 C.F.R. §1015.4 (a)(3)).

All communications, whether general or consumer-specific, that expressly or implicitly represent that consumers should temporarily or permanently discontinue mortgage payments must include a disclosure stating, “If you stop paying your mortgage, you could lose your home and damage your credit rating” (12 C.F.R. §1015.4 (c)). Since the regulations also prohibit MARS providers from stating the consumer is not obligated to make scheduled payments, it would be difficult for MARS providers to make such a representation without violating the rule.

Notice and Disclosure Requirements Due When Offering Mortgage Relief (12 C.F.R. §1015.5)

When securing an agreement between a consumer and the lender or servicer that holds the consumer’s home loan, MARS providers must give the consumer a notice from the loan holder or the loan servicer that describes any differences in lending terms between the consumer’s existing loan and the modified loan. Terms that should be addressed in the notice should include:

- The principal balance
- Interest rate
- Number of payments
- Monthly amounts owed for principal, interest, taxes, and insurance
- Loan term
- Any outstanding payments
This notice will allow a consumer to make a quick comparison between the terms of his/her existing mortgage and the loan that he/she will have after the proposed modifications are made. This notice must be “clear and prominent,” and must have a heading that states “IMPORTANT INFORMATION FROM YOUR [name of lender or servicer] ABOUT THIS OFFER.” This heading must be in bold print that is two sizes larger than the font size of the disclosures (12 C.F.R. §1015.5 (c)(2)).

If a MARS provider secures an agreement between a consumer and the lender holding the consumer’s home loan or between the consumer and the loan servicer that accepts the consumer’s payments, this agreement must include a disclosure stating “This is an offer of mortgage assistance relief we obtained from your lender [or servicer]. You may accept or reject the offer. If you reject the offer, you do not have to pay us. If you accept the offer, you will have to pay us (insert amount or method of calculating the amount) for our services” (12 C.F.R. §1015.5 (b)).

Additional Protections under the MARS Rule

The MARS Rule offers additional protections to consumers by:

- **Prohibiting Waivers:** Consumer protections offered through the Rule’s notice and disclosure requirements and prohibited practices may not be waived, and attempts to obtain a waiver are a violation of the Rule (12 C.F.R. §1015.8)

- **Extension of Liability:** The Rule extends liability to any person who provides "substantial assistance or support to any mortgage assistance relief provider when that person knows or consciously avoids knowing that the provider is engaged in any act or practice that violates this rule” (12 C.F.R. §1015.6)

Recordkeeping Requirements (12 C.F.R. §1015.9 (a))

MARS providers must retain the following records for a period of 24 months. The 24-month period is measured from the date the record is created. The requirements apply to:

- Contracts between consumers and MARS providers
- Copies of all written communication between a consumer and a MARS provider that occurred before the consumer entered into an agreement with the provider
- Consumer files with names, contact information, payments made, and MARS provided “...to the extent the mortgage assistance relief provider keeps such information in the ordinary course of business ” (12 C.F.R. §1015.9 (a)(4))
- Copies of sales scripts, training materials, commercial communication, websites, weblogs, and other MARS marketing materials
- Copies of required notices and disclosures
- Copies of records to demonstrate compliance with training and monitoring requirements and resolution of consumer complaints
Compliance Monitoring Requirements (12 C.F.R. §1015.9 (b))

MARS providers must “take reasonable steps sufficient to monitor” both employees and independent contractors for compliance with the MARS Rule.

This requirement involves monitoring of all communications with consumers, including:

- Monitoring telemarketing of mortgage assistance relief services with blind recording and testing of verbal communications by sales staff and customer service
- Establishing a procedure for receiving and responding to consumer complaints, including investigating complaints and taking corrective action against an employee or independent contractor who has failed to comply with the Rule

The Rule states that corrective action “…may include training, disciplining, or terminating…” an individual who is not complying with the MARS Rule (12 C.F.R. §1015.9 (b)(3)).

Exemptions (12 C.F.R. §1015.7)

Attorneys are exempt from some of the requirements of the MARS Rule if they:

- Provide mortgage assistance relief services as part of their legal practice
- Are licensed to practice law in the state where the consumer who is seeking relief resides or in the state where the consumer’s dwelling is located
- Comply with other state laws that require conduct similar to that required by the MARS Rule

There is no doubt that this is an exemption that is subject to interpretation. The definition of “practice of law” varies in each state. In Pennsylvania, the definition frequently alluded to is one provided by the State Supreme Court, which defines the practice of law as the use of knowledge in three areas including advising clients, preparing legal documents, and appearing in public tribunals, such as courts. Attorneys affiliated with MARS providers are likely to be engaged in these types of activities. However, in determining whether an exemption applies, state and federal enforcement agencies are likely to make this determination based on the primary focus of the attorney’s professional activities. If the attorney is primarily engaged in the practice of law, the exemption will apply; if he/she is primarily involved in mortgage-related services while employed by a mortgage company, the exemption may not apply.

Some of the provisions of the MARS Rule that exempt attorneys must still comply with are those related to advance fees and disclosures. Attorneys must not accept advance payments, although the restriction on fees does not apply if the attorney deposits consumer funds into a client trust account. Attorneys are also required to comply with the MARS Rule by providing the notices required when offering a contract between the consumer and the lender or servicer, although the

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restriction on fees does not apply if the attorney deposits consumer funds into a client trust account.

It is important for loan originators to know that most states have adopted laws and rules that regulate the activities of entities and individuals that offer mortgage assistance relief services. The requirements vary greatly from state to state, with some imposing licensing requirements on those who offer to modify loans or to provide other forms of relief and others that create prohibited practices and disclosure requirements that are stricter than those created under the MARS Rule. Therefore, mortgage professionals that offer mortgage assistance relief services should not assume that compliance with the MARS Rule constitutes full compliance with all applicable laws.

The USA PATRIOT Act

Overview of the Patriot Act

Drafted and enacted in record time, the USA PATRIOT Act (Patriot Act) became law only a few weeks after the terrorist attacks of September 11, 2001. The portions of the Patriot Act that impact mortgage lending transactions are contained in Title III, which is called the “International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.” Money laundering is the filtering of ill-gotten money through a series of transactions in order to prevent the tracing of the funds to their original illegal source. In the findings that it included in Title III, Congress explained how money laundering and terrorism are related, stating “...money laundering... provides the financial fuel that permits transnational criminal enterprises to conduct and expand their operations to the detriment of the safety and security of American citizens…” (H.R. 3162 §302(a)(1)).

The stated purposes of Title III include Congress’ goal “…to strengthen the provisions put into place by the Money Laundering Control Act of 1986…” (H.R. 3162 §302(b)(2)). Through the Patriot Act, Congress made amendments to the Money Laundering Control Act and the Bank Secrecy Act to strengthen these laws and the ability of the U.S. government to take action to address money laundering.

Regulatory Agency

Congress authorized The Department of Treasury to implement Title III of the Patriot Act. An agency within the Treasury Department known as the Financial Crimes Enforcement Network (FinCEN) has primary responsibility for investigating, identifying, and reporting information on money laundering and other financial crimes.

Lending Institutions Covered by Title III of the Patriot Act

The requirements of Title III of the Patriot Act apply to “financial institutions,” which are defined to include 24 specific types of entities including:

- Federally-regulated banks
- Branches and agencies of foreign banks located within the U.S.
- Credit unions
- Non-federally regulated private banks
- Persons involved in real estate closings and settlements
- Loan or finance companies

The types of business and financial institutions covered by the law are extensive. The definition of “financial institution” is so broad that it includes not only traditional financial institutions, but also businesses such as casinos, pawnbrokers, and automobile salesmen. Despite this broad definition, the first set of regulations that the Department of Treasury and FinCEN wrote in 2002 applied primarily to regulated depository institutions, and the regulations created a “temporary exemption” for ten entities defined as financial institutions. Loan or finance companies were included in the list of temporarily exempt entities (31 C.F.R. §1010.205(b)(ii)).

As of February 6, 2012, the temporary exemption for loan or finance companies came to an end. With a new rule issued on that date, FinCEN defined “loan or finance company” to include “Residential Mortgage Lender or Originator.” Under the regulations, a residential mortgage lender or originator (RMLO) includes persons to whom debt for a residential mortgage loan is initially payable and a person who accepts, offers or negotiates the terms of a residential mortgage loan (31 C.F.R. §1010.100 (kkk)).

These new regulations that are applicable to RMLOs were effective on April 3, 2012. FinCEN established a delayed compliance date of August 13, 2012 to give those entities and individuals that are subject to its provisions time to implement a plan for complying with the new rules.

**Actions Required by Title III of the Patriot Act and the New Regulations**

In order to achieve compliance with the new regulations, which create specific responsibilities for them under Title III of the Patriot Act, RMLOs must:

- **Create an Anti-Money Laundering (AML) Program:** This must be a written program, approved by senior management, “…that is reasonably designed to prevent the loan or finance company from being used to facilitate money laundering or the financing of terrorist activities” (31 C.F.R. §1029.210(a)). This program must include procedures for complying with the reporting requirements of Subchapter II of the Patriot Act, a compliance officer, ongoing training for employees, and independent testing to ensure maintenance of an adequate program.

- **Make Suspicious Activity Reports:** RMLOs must file suspicious activity reports (SARs) if there is evidence that funds involved in a transaction which was conducted or attempted through them involve funds derived from or intended to disguise an illegal activity, was designed to evade the Bank Secrecy Act, was not the sort of transaction that the customer would normally be involved in, or involved the use of the RMLO to conduct criminal activity. SARs are filed with FinCEN.

- **Report Receipt of Currency In Excess of $5,000:** Receipt of currency in excess of $5,000 is reportable.
There are also deadlines, recordkeeping and information-sharing requirements under the regulations. RMLOs must file a SAR within 30 days after an “initial detection” of suspicious activity. However, if an RMLO has information that requires immediate attention, he/she/it must immediately notify “appropriate law enforcement” by telephone in addition to filing a SAR. RMLOs must retain SARs and supporting documentation for five years from the date of filing a SAR.

In the preamble to the new regulations, FinCEN has indicated that it is likely to expand its definition of “loan or finance company” to other types of businesses. It began its “incremental approach to implementation of regulations” by creating requirements for RMLOs because it has conducted studies which indicate that RMLOs “…are in a unique position to assess and identify money laundering risks and fraud while directly assisting consumers with their financial needs and protecting the sector from the abuses of financial crime.” 16

**Gramm-Leach-Bliley Act (GLB Act)**

**GLB Act Overview**

The purpose of the privacy provisions of the Gramm-Leach-Bliley (GLB) Act is to ensure that financial institutions, including mortgage brokers and lenders, protect nonpublic personal information of consumers by:

- Advising consumers of the financial institution’s policies with regard to the use and exchange of personal information
- Offering consumers the opportunity to limit the use and exchange of their personal information
- Creating a security program to protect personal information from unauthorized release and disclosure

**Regulatory Agency**

Before the creation of the CFPB, implementation and enforcement of the GLB Act was carried out by the federal banking regulatory agencies and the FTC. Now, the CFPB is responsible for implementation and enforcement of the law and the GLB Act regulations, which are known as Regulation P (12 C.F.R. 1016 et seq.).

**Information and Persons Protected by the GLB Act**

The GLB Act applies to “nonpublic personal information,” which the law defines as “…personally identifiable financial information provided by a consumer to a financial institution; resulting from any transaction with the consumer or any service performed for the consumer; or otherwise obtained by the financial institution.” (15 U.S.C. §6809(4)) Examples that the FTC gives of personally identifiable information include:

- Information from a credit report

Information that a consumer provides to obtain a loan

The GLB Act protects the privacy of “nonpublic personal information” that is provided by individual “consumers” and “customers.” The law establishes different standards of privacy protection for consumers and customers, with the strictest standards applying to relationships with customers.

In the context of mortgage lending, a customer relationship and the requirements for protecting customer information exist when:

- A customer completes an application for a loan
- A customer obtains a loan from a lender or mortgage broker
- A financial institution obtains the servicing rights for a loan

**Information Exempt from Protection by the GLB Act**

The GLB Act does not extend protection to publicly available information, which includes:

- Information in government real estate records
- Information from a telephone book or information included on a public and unrestricted web site
- Listed telephone numbers provided by customers

**Definition of Terms Related to the GLB Act**

**Affiliate:** Any company that is controlled by or is under common control with another company.

**Consumer:** Defined in the FTC Privacy Rule as “...an individual who obtains, from a financial institution, financial products or services which are to be used primarily for personal, family, or household purposes,” the rule clarifies that consumers are individuals who conduct isolated transactions with a financial institution, such as arranging for a wire transfer, using an ATM, or cashing a check.

**Customer:** A consumer who has a “customer relationship” with a financial institution.

**Customer Relationship:** A customer relationship exists when a consumer has a continuing relationship with a financial institution. The FTC has held that a customer relationship exists during the arrangement for or brokering of a mortgage loan and during the servicing of a loan.

**Financial Institution:** In the GLB Act, the term is broadly defined as “...any institution the business of which is engaging in financial activities or activities that are incidental to financial activities.” The Federal Trade Commission has held that brokering loans is a financial activity and that mortgage brokers are, therefore, subject to the GLB Act.

**Financial Activities:** The FTC includes “brokering loans” as an example of financial activity covered by the GLB Act.
Nonpublic Personal Information: The GLB Act defines the term, “nonpublic personal information” as “…personally identifiable information” provided by a consumer to a financial institution for a financial transaction or service or personal financial information otherwise obtained by a financial institution.

Disclosures and Notifications Required by the GLB Act

The GLB Act requires financial institutions always to notify customers, and sometimes to notify consumers, of their policies and practices regarding the collection of nonpublic personal information and the sharing of it with third parties. Notices must include information on safeguarding the privacy of nonpublic personal information. If financial institutions plan to share consumer or customer information, they must also provide notice of the right to opt-out of the sharing of information.

Following are the requisite notices under the GLB Act:

Initial Privacy Notice: The requirements for the initial privacy notice differ for consumers and customers. Financial institutions are not required to provide consumers with a privacy notice unless they intend to share the consumer’s information with nonaffiliated third parties. Financial institutions must always provide customers with a conspicuous privacy notice in writing or in electronic form that clearly describes the financial institution’s practice of sharing nonpublic personal information with affiliates and third parties. The notice must specify the types of information shared and the types of affiliated and nonaffiliated parties that will receive the information. The initial privacy notice to customers is due “…not later than when you establish a customer relationship…”

Opt-Out Notices: Financial Institutions that intend to share nonpublic personal information must provide consumers and customers with a notice of their right to opt-out of the sharing of information. The notice must include a description of the type of information that the financial institution may disclose, and “reasonable means” to opt-out, such as opt-out forms which are easy to complete or toll-free telephone numbers to representatives who will accept the opt-out information. No specific timeframe is given under the law other than consumers must be provided with a reasonable opportunity to opt-out. Note: The initial privacy document and opt-out notice can be included in one document.

Annual Privacy Notices: Financial institutions are required to send annual privacy notices to customers, and these notices must contain the same information that is included in the initial privacy notice, including notice of the right to opt-out and information on exercising the right to opt-out.

Exceptions to the Opt-Out Notice Requirements

The requirement to provide opt-out notices includes some exceptions. The exceptions include:

- Disclosures to a third party in order to complete a transaction requested by a consumer or customer (This exception would include disclosures made by mortgage brokers to settlement service providers in order to close a mortgage loan.)
Disclosures to financial institutions that share joint-marketing agreements

Practices Prohibited by the GLB Act

- **Prohibition on the Sharing of Account Numbers:** With a few limited exceptions, the GLB Act prohibits the sharing of account numbers for marketing purposes.
- **Limitations on the Re-disclosure and Reuse of Information:** If a third party obtains nonpublic personal information that is released pursuant to an exception or as a result of a customer’s failure to opt-out, the third party can only use the information for limited purposes.

Penalties for Violations of the GLB Act

The GLB Act does not include specific penalty provisions for violations of the law’s privacy provisions. However, each of the regulatory agencies that are authorized to enforce the law has the authority to bring enforcement actions and to impose penalties. For example, the FTC could bring an action for a mortgage broker’s violations of the GLB Act and could impose the penalties allowed under the Federal Trade Commission Act. The Federal Trade Commission Act allows for penalties up to $10,000.

Safeguards Rule

The provisions of the GLB Act require compliance with the Safeguards Rule. The intention of the Safeguards Rule is to ensure the protection of privacy of personal information with the creation, implementation and maintenance of an effective security program.

Institutions Covered by the Safeguards Rule

The FTC’s Safeguards Rule covers all the “financial institutions” (as defined under the GLB Act) that are within its jurisdiction. Financial institutions within the jurisdiction of the FTC include mortgage brokers.

Security Program

A company’s security program designed to meet the requirements of the Safeguards Rule must include the following elements:

- A designated company representative to coordinate the program
- Identification of internal and external risks which affect the security of customer information
- Regular testing, monitoring and adjustment of the security program
- Oversight of service providers who have access to customer information

Privacy Protection/Do-Not-Call

Privacy rights are a significant concern for mortgage professionals who are involved in the solicitation, origination, processing, closing and servicing of mortgage loans. Multiple laws protect the privacy of borrowers, and violation of these laws can result in serious liability. In
addition to the Gramm-Leach-Bliley Act, which protects the financial privacy of consumers, federal and state laws protect consumers from unwanted solicitations from mortgage bankers and mortgage brokers.

The Do-Not-Call Implementation Act was signed into law in 2003 as part of earlier legislation – the Telemarketing Consumer Fraud and Abuse Prevention Act and the Telemarketing Sales Rule. The Do-Not-Call Implementation Act authorized the Federal Trade Commission (FTC) to implement and enforce the Do-Not-Call Registry. The FTC’s authority covers interstate calls, while the Federal Communications Commission (FCC) covers calls made to and from points within the same state.

As a result of the Dodd-Frank Act, the CFPB shares enforcement authority for the Telemarketing Sales Rule. In their memorandum of understanding, the FTC and the CFPB will consult on rulemakings under the Telemarketing Sales Rule regarding the use of telemarketing to offer consumer financial products and services.

The telemarketing legislation is intended as a consumer protection law that allows consumers to restrict unwanted sales calls from coming into their homes. Consumers are required to take the initiative to place their names on the Do-Not-Call Registry.

Under the original provisions of the Telemarketing Act, consumers were required to renew their entry in the registry every five years. Following amendments made by the Do-Not-Call Improvement Act of 2007, phone numbers added to the registry become permanent.

The provisions of the Telemarketing Act and Sales Rule apply to any business or individual engaged in the practice of telemarketing. Telemarketing is generally defined as calls made as part of a plan or program to persuade consumers to purchase goods or services.

**Requirements of the Do-Not-Call Provisions**

Mortgage professionals involved in sales and telemarketing practices must provide a truthful and prompt verbal disclosure of the following information:

- The identity of the caller
- The fact that the purpose of the call is to sell goods or services
- The nature of the good/services being sold
- Assurance that no purchase or payment is required to participate in any type of promotion

One of the most important procedures required by the Telemarketing Sales Rule is the requirement for businesses that conduct telemarketing to access the Do-Not-Call Registry every 31 days. This requirement is aimed at ensuring telemarketing call lists are updated with the names and phone numbers that are newly registered.

Unless a mortgage professional limits his or her calls to individuals with whom there is an established business relationship, or individuals who have provided written agreements to accept
calls, it is illegal to initiate calls without obtaining access to the Do-Not-Call Registry. Access to the Registry is available to telemarketing professionals on a fee basis. Fees are assessed based on the number of area codes accessed, and the FTC establishes an annual maximum fee.

**Recordkeeping**
Mortgage professionals engaged in telemarketing are required to maintain records of all telemarketing activities for a period of 24 months from the date the materials were produced.

Examples include:

- Advertising, brochures, telemarketing scripts, and promotional materials
- Name and last known address of each customer, the goods/services purchased and the amount paid for them
- Name, last known home address and telephone number of current and former employees
- Any authorizations or informed consent agreements from consumers who agree to receive telemarketing calls

**Prohibitions of the Telemarketing Sales Rule**

The Telemarketing Sales Rule and its provisions create a number of prohibited practices for sales and telemarketing professionals. Several important points which can impact mortgage professionals include prohibitions on the following abusive practices:

- Use of threats, intimidation or profane language
- Placing calls to consumers before 8:00 a.m. or after 9:00 p.m. – it is important to consider the local time of the consumer
- Making false or misleading statements
- Requiring payment of a fee in advance of obtaining a loan or other extension of credit
- Charging a consumer for goods or services without consent
- Failing to transmit a telephone number so that it can be read by a call recipient’s Caller ID
- Initiating a call to a consumer listed on the Do Not Call Registry

**Exceptions to the Do-Not-Call Provisions**

The requirements of the Telemarketing Sales Rule and its provisions do not apply if a consumer has an established relationship with a mortgage professional. In the case of an established relationship, a mortgage professional is permitted to place calls to customers, even if their phone numbers are on the Do-Not-Call Registry.

A critical component to this exception is the law’s definition of an established business relationship. An established business relationship is a relationship between a seller and a consumer based on a financial transaction that they have shared within the 18-month period that immediately precedes any sales call. Additionally, mortgage professionals are permitted to
contact consumers for a period of three months following a relationship that is based on an inquiry by the consumer.

Regardless of the existence of an established business relationship, if a consumer specifically asks a mortgage professional not to contact them, the request must be honored.

**Penalties for Violations of the Telemarketing Sales Rule**

Violations of the Telemarketing Sales Rule are regarded as unfair and deceptive trade practices under the Federal Trade Commission Act. Penalties are $16,000 for each violation, and when violations continue, each day is considered a separate violation.

Under certain circumstances, a company which violates telemarketing provisions may be exempt from liability. The FTC considers whether the mortgage professional has established procedures for complying with the provisions, trains its personnel on the procedures and regularly monitors compliance.

**Discussion Scenario: Privacy Concerns**

A homeowner comes into the office of a mortgage broker, who operates as a sole proprietor, and makes some general inquiries about interest rates. The homeowner used the services of the mortgage broker one year earlier to secure a first mortgage, and he is now interested in a home equity loan so that he can cash in on the equity that he has gained in his home.

The broker offers the homeowner a loan application, suggesting that the information in the application will enable her to give the homeowner suggestions on products that might suit his needs. The homeowner declines to complete an application. However, he leaves his name and home phone number, suggesting that the broker call him if rates decrease.

A week later, when interest rates drop a quarter of a percentage point, the mortgage broker decides to call the homeowner. Following standard office procedure, the broker’s secretary checks the office’s recently updated list of numbers compiled from the Do-Not-Call Registry, and finds that the homeowner’s name is on the registry.

The broker calls the homeowner, telling him that she can give him low interest rates with better lending terms than other mortgage brokers can offer. The homeowner gives the mortgage broker the information necessary to complete the loan application and asks her to begin processing his application as soon as possible. To facilitate the processing of his application, he agrees to mail a copy of his recent tax return to the mortgage broker’s secretary.

Because the homeowner is anxious to complete the transaction, the mortgage broker immediately contacts settlement service providers. She calls only those service providers who have adequate security programs, which they have reviewed with her, and who have signed a contract agreeing to secure and protect the privacy of the personal information of customers. In her office, the broker begins assembling the information that is needed in order to proceed with the closing. She
asks her secretary to e-mail her a copy of the homeowner’s file that she has retained since his last closing, and uses this information to identify mortgage products that she will recommend.

On the day of the settlement, which occurs three weeks after receipt of the loan application, the mortgage broker includes a privacy statement with the other closing documents. She does not include an opt-out notice with the initial privacy notice. The lender that is funding and servicing the loan also provides the homeowner with a privacy statement that includes notice of the right to opt-out and a form for the use in exercising the right to opt out. The homeowner signs the opt-out form when he signs the other closing documents.

**Discussion Questions**

- Based on your understanding of privacy laws, what procedures did the broker follow which kept her in compliance?
- What procedures did she fail to follow that cause compliance issues?
- What are some policies a mortgage professional can put in place to ensure privacy violations are not a concern?

**Discussion Feedback**

The mortgage broker was operating in compliance with the Telemarketing Sales Rule by maintaining procedures in the office to prevent calls to persons listed on the Do-Not-Call Registry and maintaining an updated call list. The broker’s call to the homeowner was not in violation of the Telemarketing Sales Rule because she had a business relationship with the homeowner that was established for less than 18 months before placing a call to him. Recent inquiries by the homeowner and his request for a call in the event that interest rates dropped are also indicators that the mortgage broker shared an established business relationship with the homeowner, allowing call in spite of the fact that his name was on the Do-Not-Call Registry.

However, the content of her call was not in compliance with the law. Promising low interest rates and the most competitive lending terms without reviewing the homeowner’s updated financial information were misleading statements that she used to induce the homeowner to complete a mortgage application. She should have refrained from making these representations until she knew they were true, based on verification of the homeowner’s current financial status. Technically, the unrealistic representations were an unfair and deceptive trade practice, subject to action by the FTC.

The mortgage broker provided the homeowner with a privacy notice at the time of the closing but violated the GLB Act by failing to provide an initial privacy notice within the time frame prescribed by the law. The FTC Privacy Rule specifically provides that an initial privacy notice is due when a customer relationship is established and that the establishment of a customer relationship occurs when a consumer “Enters into an agreement or understanding with you whereby you undertake to arrange or broker a home mortgage loan....” (16 C.F.R. §313.3(i)(E))

In its Financial Privacy Rule, the FTC includes an exception for situations in which providing notice will “...substantially delay the customer’s transaction.” (16 C.F.R §313.4(e)(2)(ii)) Under this exception, subsequent delivery of the notice is allowed when the customer relationship is
established over the phone and the customer requests “...prompt delivery of the financial product or service.” (16 C.F.R. §313.4(e)(2)(ii)(A))

With the homeowner requesting that the mortgage broker process his application right away, delayed delivery of the privacy notice would have been acceptable. However, delayed delivery of the privacy notice until the time of closing rendered the notice meaningless.

As long as she entered into agreements with the settlement service providers stating that they would not disclose the homeowner’s personal information, the mortgage broker did not violate the law by failing to provide an opt-out notice. Opt-out notices are not required for the sharing of information with settlement service providers.

Other privacy concerns represented in the scenario relate to the safeguarding of customer information. In order to operate her business in compliance with the Safeguards Rule, the mortgage broker would need a security system that includes: Training for her secretary; protection of nonpublic personal information, such as the mailed or faxed copies of tax returns; and protection of the information stored and transmitted on the mortgage broker’s computer.

Mortgage professionals can ensure they are in compliance with privacy concerns by:

- Maintaining policies and procedures which include checking the Do-Not-Call Registry and updating telemarketing lists every 31 days
- Ensuring nonpublic personal information is safeguarded at all times – including during its use, storage and disposal
- Providing disclosures as required by federal and state laws

**Mortgage Fraud Laws**

The Federal Bureau of Investigations (FBI) defines mortgage fraud as: “...the intentional misstatement, misrepresentation, or omission by an applicant or other interested parties, relied on by a lender or underwriter to provide funding for, to purchase, or to insure a mortgage loan.” 17

Costing the mortgage industry billions of dollars each year, fraud threatens the overall soundness of the entire mortgage market. It is a crime that impacts mortgage lenders, insurers, and purchasers. Often referred to as the fastest growing white collar crime and as a problem of epidemic proportions, mortgage fraud is receiving increasing attention from the FBI, the Internal Revenue Service (IRS), the Department of Housing and Urban Development (HUD) and from federal and state legislators.

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Two Types of Mortgage Fraud

The FBI categorizes mortgage fraud in two ways: Fraud for Profit and Fraud for Housing. The focus of most anti-fraud efforts is on Fraud for Profit, also known as Industry Insider Fraud.

Fraud for Profit (also known as Industry Insider Fraud)

This type of fraud involves the conspiratorial involvement of unscrupulous individuals coming from all areas of the mortgage lending industry. Individuals can include mortgage bankers, mortgage brokers, loan officers, underwriters, processors, real estate agents, appraisers, and lawyers. Using inflated appraisals, falsified loan documents, and straw buyers to secure fraudulent loans, these industry insiders are the cause of an estimated “…80 percent of all reported fraud losses….”

Fraud for Housing

The FBI distinguishes Fraud for Profit from Fraud for Housing, which occurs when a borrower misrepresents his/her employment history, credit history, intention to occupy a property as a primary residence, or income in order to improve his/her chances of securing a mortgage. Originators should not be tempted to “help” loan applicants to obtain a loan with the use of inaccurate information. They should also advise loan applicants that it is illegal to include false information in an application or to use fraudulent documents for verification of income and employment.

Industry insider fraud and fraud for housing are both illegal, but industry insider fraud results in much greater losses, and is therefore the primary focus of federal anti-fraud operations. Although industry insiders may continue to pocket ill-gotten profits gained in mortgage fraud schemes, those who are caught are certain to face stiff penalties, including imprisonment.

Mortgage Fraud Investigations

The FBI, HUD, and the IRS conduct investigations for mortgage fraud, and make referrals to the Department of Justice when there is sufficient evidence for prosecution.

Federal Laws Relating to Mortgage Fraud

In 2009, Congress responded to the increasing epidemic of mortgage fraud with the enactment of The Fraud Enforcement and Recovery Act (FERA). FERA was enacted to facilitate the prosecution of those who commit mortgage fraud and to increase the financial resources that are available to investigate and prosecute fraud cases. FERA revised the federal criminal code by specifically providing that the law against defrauding a financial institution includes actions related to the “mortgage lending business.” FERA defines “mortgage lending business” as “…an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce” (18 U.S.C. §27).

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Other federal laws that are commonly used to address mortgage fraud include statutes against mail fraud, bank fraud, wire fraud, making false statements to a financial institution, money laundering, and conspiracy. These laws are described below. All of them carry stiff criminal penalties. Mail fraud, bank fraud and making false statements to a financial institution also have a statute of limitations of ten years for prosecution – longer than other federal laws.

**Mail Fraud (18 U.S.C. §1341)**

Mail fraud is the knowing use of the mail system to carry out a fraudulent scheme. Amendments to the law include not just use of the U.S. Postal Service but also the use of any private or commercial mail carrier, such as Federal Express or United Parcel Service.

Penalties for mail fraud can include fines, imprisonment of not more than 20 years, or both. If the violation affects a financial institution, a person can be fined not more than $1 million, imprisoned not more than 30 years, or both.

It is not necessary for a violator to complete the mailing. Prosecutors need only to show that the defendant understood that, in the common course of business, a mail service would be used to carry out a fraudulent scheme.

**Bank Fraud (18 U.S.C. §1344)**

Bank fraud is the use of a fraudulent scheme to unlawfully obtain money or property from a federally-insured financial institution. Penalties for bank fraud include fines of not more than $1 million, imprisonment of not more than 30 years, or both.

**Conspiracy (18 U.S.C. §371)**

Federal law contains a general conspiracy statute that protects the government from fraud and other offenses. The law specifically addresses conspiracies “…to defraud the United States or any agency thereof.” Therefore, the law applies to fraudulent actions against government agencies such as HUD and the Federal Housing Administration.


Money laundering is a term that describes financial transactions that are used to distance illegally obtained funds from their original criminal source. It is a common misperception that money laundering laws apply strictly to funds and proceeds from drug trafficking, terrorist activities, and organized crime.

The laws against money laundering are complex, but there are two federal laws that prosecutors are likely to rely on in establishing that a defendant has attempted to launder funds obtained from a fraudulent lending transaction.
Penalties for violations of federal money laundering provisions are severe and can include a fine of $500,000 or twice the value of the property involved in the transaction, whichever is greater, imprisonment for up to 20 years, or both.

Additionally, simply depositing more than $10,000 of fraudulently obtained money in a bank account can constitute money laundering. Penalties for violations of this money laundering provision can include fines and imprisonment for terms of up to ten years.

**False Statements to a Financial Institution (18 U.S.C. §1014)**

Many actions for mortgage fraud are based on violations of this law, which states that it is a crime to knowingly make false statements or to overvalue land or property in order to influence the decision of lending institutions. Offering false information to a lender in order to obtain a loan is an action that is clearly covered by this law.

Penalties for violations of this law are severe, providing that those convicted “...shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.” False statements that can lead to fines and imprisonment include inflated appraisals used to secure a mortgage, and any false statements in a lending transaction, such as falsely stating that a home will be used as a primary residence.

**Fraud in Connection With Identification Documents (18 U.S.C. §1028)**

Many cases of mortgage fraud involve the use of false identification documents, including the use of stolen personal information. It is a violation of federal law to produce or use false identification documents. The law provides for three levels of penalties, depending on the nature of the act. Prison sentences can be as long as 15 years.