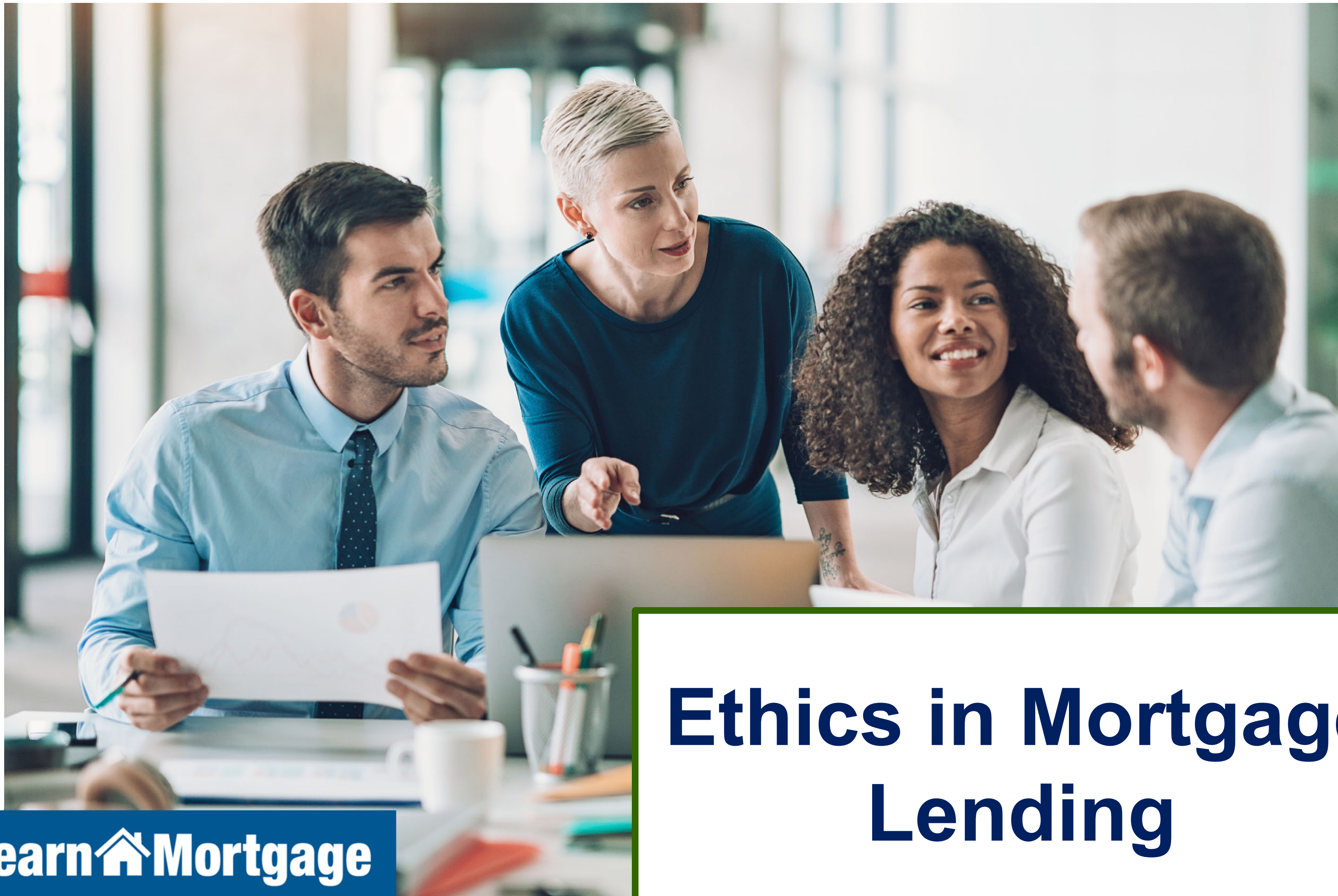
Chapter 11



Ethics in Mortgage Lending

Learn Mortgage

Chapter Objectives

- Define ethics and discuss purpose of codes of ethics
- Recognize material facts in an advertisement
- Define the bait and switch advertising strategy
- List classes that are protected from illegal discrimination
- Identify scenarios that violate RESPA’s prohibition against kickbacks
- Recognize indicators of mortgage fraud
- Identify participants and their roles in mortgage fraud schemes
- Identify predatory lending practices

Ethical and Legal Considerations

- **Ethics in the Mortgage Industry**
  - Serve mortgage lending needs of public in ethical manner
  - Treat everyone equally
  - Be honest
  - Give full disclosure of all terms and conditions
  - Don't take advantage of people
  - Keep good documentation
  - Adhere to a code of ethics from professional organization
    - National Association of Mortgage Brokers Code of Ethics

Ethical and Legal Considerations

- **Penalties for Unethical Behavior**
  - Action by state licensing and regulatory authority
  - Civil lawsuits filed by injured parties
  - Disciplinary action by professional associations
  - Filing of criminal charges in very serious cases

Ethics in Advertising

- **Regulations**
  - TILA; Regulation Z
    - Advertisement is a commercial message in any medium that promotes, directly or indirectly, a credit transaction
  - Federal Trade Commission Act
    - Grants FTC authority to protect consumer interests
    - Section 5 prohibits unfair and deceptive practices of any kind
  - Mortgage Acts and Practices (MAP) Rules
    - Implemented by Regulation N
    - Prohibits misrepresentations in a commercial communication regarding mortgage products
    - Enforced at state level

Title 15 USC § 41-58; 12 CFR § 1014.3 and § 1026.2

Ethics in Advertising

- **Misrepresentation and Material Facts**
  - Puffing
    - An opinion that is not necessarily intended as a representation of fact
    - May be made unintentionally or through negligence
  - Form of Fraud
    - A misrepresentation is made to a consumer with the intent to deceive
  - Misrepresentation of Material Fact
    - A fact that, if known, might have caused a reasonable consumer to make a different decision
    - Serious violation; grounds to rescind a contract

12 CFR § 1014.3

Ethics in Advertising

- **Bait and Switch**
    - Luring consumers in with promises of low rates and specific products then steering otherwise qualified buyers to other terms so MLO can earn higher fee
    - Must not discourage the purchase of advertised merchandise or switch to higher-priced product
  - Not Bona Fide Offer
    - Refusal to show or sell; disparagement of product; failure to have available; refusal to take application for
  - Switch After Sale/Sale Not Made In Good Faith
    - Accepting a fee for advertised product then switch to higher-priced product; failure to deliver within reasonable timeframe; disparagement of product terms

12 CFR § 1014.3

11.1 Knowledge Check

MLO Jack advertises refinance loans with 0 points and 3.8% APR just to get prospective borrowers in the door and then tells them that such terms are not available because of their debt, income, or another factor. In reality, Jack did not intend to originate any loan with those terms. Jack is guilty of

A. bait and switch advertising.

B. predatory lending.

C. puffing.

D. steering.

11.2 Apply Your Knowledge

1. MLO Jane advertises what she calls "5 for 5" mortgage loans: 5% down and 5% fixed-rate interest for 30 years. A qualified borrower arrives and starts the loan process, paying for a credit report, and completing a loan application. However, Jane does not lock in that interest rate. She knows that rates are going up, so she sits on the application for an extra week, and then tells the borrower that the best she can do is 5 3/4%. **Would this be considered an example of a bait and switch tactic? Why or why not?**

Yes

11.2 Apply Your Knowledge (cont.)

2. MLO Alex advertises that he will close loans in 14 business days, even though he knows that his average close takes 47 days. His ad brings in 100 new customers, and he works hard to close a few of those loans in 14 days so that his advertisement remains legitimate.

   Would this be considered an example of a bait and switch tactic? Why or why not?

   Yes

Ethics in Advertising

- **Unfair and Deceptive Practice**
  - Dodd-Frank Act
    - Unlawful for any provider of consumer financial products or services or a service provider to engage in any unfair, deceptive, or abusive act or practice
    - Provides CFPB with rule-making, supervisory, and enforcement authority to prevent, detect, and penalize
  - CFPB Guidance
    - Established a standard of items that constitute what is an unfair, deceptive, and/or abusive act

https://www.consumerfinance.gov/policy-compliance/guidance/

Ethics in Advertising

- **Unfair and Deceptive Practice**
  - Unfair Practices
    - The act causes or is likely to cause substantial injury (monetary harm) to consumers,
    - The injury is not reasonably avoided by consumers, and
    - The injury is not outweighed by countervailing benefits to the consumers or to competition.
  - Deceptive Practices
    - The representation, omission, act, or practice misleads or is likely to mislead the consumer,
    - The consumer's interpretation of representation, omission, act, or practice is reasonable under the circumstances, and
    - The misleading representation, omission, act, or practice is material.

https://www.consumerfinance.gov/policy-compliance/guidance/

Ethics in Advertising

- **Unfair and Deceptive Practice**
  - Abusive Practices
    - Materially interfere with the ability on the part of the consumer to understand a term or condition of a consumer financial product or service, or
    - Reasonably take advantage of:
      - A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service,
      - The inability of the consumer to protect its interests in selecting or using a consumer financial product or service, or
      - The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

https://www.consumerfinance.gov/policy-compliance/guidance/

Ethics in Advertising

- **Examining Advertisement**
  - FTC examines reasonableness from the perspective of the ad's targeted audience
- **FTC Consumer Alerts**
  - Understand all terms and conditions
  - Don't be tempted by ads that don't disclose all terms
  - APR is critical and may be hidden or buried
  - Important payment information may be excluded; be prepared to ask
  - Consider shopping with several lenders
  - Negotiating is acceptable

http://www.consumer.ftc.gov/

Ethics in Advertising

- **Evaluating Buzzwords**
  - Consider whether the use of such words or terms is fair, accurate, and complete within the context of an advertisement
    - Low fixed rate; should also indicate how long it will be fixed
    - Very low rates; is this low payment or interest rate; must inform consumers of all details to avoid payment shock
    - Very low payment amounts; is it interest-only or an adjustable rate; ad must tell the whole story

http://www.consumer.ftc.gov/

Ethics in Advertising

- **Internet Advertising**
  - – Same laws apply
    - Must be truthful and not misleading
    - Must have evidence to back up claims
    - Cannot be unfair
  - – Disclosures must be clear and conspicuous
    - Adhere to FTC's .Com Disclosures: Information about Online Advertising

http://www.consumer.ftc.gov/

Ethics in Advertising

- **Better Business Bureau Advertising Guidance**

✓ Does your advertising result in satisfied customers?

✓ Do you avoid impossible promises and guarantees?

✓ Is the advertised merchandise or program readily available?

✓ Is it your intent to sell what is advertised?

✓ Do you avoid using misleading inferences?

✓ Do advertised terms agree with the facts?

✓ Is the advertisement easy to understand without asterisks and fine print?

✓ Do you agree with your comparatives?

✓ Are you attracted by your ad?

11.3 Apply Your Knowledge

Determine if these examples of advertising ideas, terms, and slogans might be considered deceptive to the public.

1. **We have loans with an APR of 4.607%**

   Not Deceptive

2. **Interest rates from 2.00%**

   Deceptive

3. **Very Low Monthly Payments**

   Deceptive

11.3 Apply Your Knowledge

4. **An Internet advertisement contains a hyperlink that directs the consumer to a disclosure page with the details of the advertised loan**

Not Deceptive

5. **A licensed MLO has a Facebook "fan page" where he describes various loan programs as well as a range of interest rates available, but does not display his NMLS unique identifier number or his employing broker information**

Deceptive

Anti-Discrimination Laws

- **Civil Rights Act of 1866**
  - 1866: Prohibits public and private racial discrimination in any property transaction in the United States
  - 1868: Court upheld; prohibits all racial discrimination, private or public, in the sale and rental of property
  - **Enforcement**: Person who has been unlawfully discriminated against can sue for compensatory or punitive damages

Title 42, Section 1981(a) of the U.S. Code/

Anti-Discrimination Laws

- **Fair Housing Act**
  - Title VIII of the Civil Rights Act of 1968
  - Extends protection against race, color, religion, sex, disability, and familial status
- **Americans with Disabilities Act**
  - Further expands protection for disabled

42 USC § 3601 et seq.

Anti-Discrimination Laws

- **Fair Housing Act**
  - Exemptions
    - Rental of a room or unit in a dwelling of no more than four independent units, provided the owner occupies one unit as a residence
    - Single-family home sold or rented by a private owner without the use of a broker
    - Housing operated by organizations
    - Housing operated by private clubs

42 USC § 3601 et seq.

Anti-Discrimination Laws

- **Fair Housing Act Violations**

✓ Refusing to rent/sell property after good faith offer

✓ Refusing to negotiate sale/rental of residential property

✓ Taking action that would make residential property unavailable to any person

✓ Making any representation that property is not available for inspection/sale/or rent when it is available

✓ Using discriminatory advertising that indicates limitation/preference

✓ Coercing, intimidating, threatening, or interfering with anyone for exercising rights granted by the Act

✓ Discriminating in the terms/conditions of any sale/rental of residential property or providing any services/facilities

42 USC § 3601 et seq.

11.4 Knowledge Check

1. A lender may decline to make a mortgage loan in a particular neighborhood if the

A. area is largely a commercial district.

B. foreclosure rate in the area is higher than 50%.

C. property is in a declining market area and no protected class is singled out.

D. racial demographics of the neighborhood indicate a high percentage of minority borrowers.

11.4 Knowledge Check

2. The Fair Housing Act prohibits discrimination against all the following EXCEPT

A. age.

B. familial status.

C. religion.

D. sex.

Ethics: Prohibited Discrimination

- **Discrimination in Mortgage Lending**
  - Based on a person's membership in a protected class, lenders must not:
    - Refuse to make a mortgage loan
    - Refuse to provide information regarding loans
    - Impose different terms or conditions on loan
    - Discriminate in the appraisal of property
    - Refuse to purchase a loan
    - Set different terms or conditions for purchasing a loan

42 USC § 3601 et seq.

Ethics: Prohibited Discrimination

- **Prohibited Discriminatory Practices**
  - Blockbusting
    - Try to induce owners to sell home by suggesting that ethnic/racial composition of neighborhood is changing with implication property values will decline
  - Steering
    - Channel prospective real estate buyers/tenants to or away from particular neighborhoods based on their race, religion, or ethnic background
  - Redlining
    - Refusal to make loans (or make less favorable loans) on property located in particular neighborhood for discriminatory reasons

42 USC § 3601 et seq.

Ethics: Prohibited Discrimination

- **FHA Anti-Discrimination Advertising Requirements**
  - Include Equal Housing Lender slogan in broadcast
  - Display Equal Housing Opportunity poster in every branch where mortgage loans are made
  - Display the Equal Housing Opportunity logo on all printed promotional material
- **Enforcement**
  - Person discriminated against may file a written complaint with HUD within 1 year of alleged violation
  - U.S. Attorney General may bring civil suit against anyone engaged in ongoing pattern/practice of discriminatory activities

42 USC § 3601 et seq.

Ethics: Prohibited Discrimination

- **Prohibited Discrimination Against Same-Sex Married Borrowers**
  - United States Supreme Court; Obergefell et al. V. Hodges, Director, Ohio Department of Health, et al. decided June 26, 2015
  - Same-sex couples have right to marry
  - Cannot be discriminated against due to sexual preference
  - A mortgage lender may not discriminate against married same-sex couples for any loan program

42 USC § 3601 et seq.

Equal Credit Opportunity Act

- **About ECOA**
  - Original legislation adopted in 1974
  - Implemented by Regulation B
  - Enforced by the CFPB
  - Ensures all consumers are given equal chance to obtain credit
  - Applicants must be informed of their rights
    - ECOA Disclosure

12 CFR § 1002

Equal Credit Opportunity Act

- **About ECOA**
  - Requires that anyone who grants credit or sets terms of credit not discriminate based on:
    - Race or Color
    - Religion or National Origin
    - Age (provided the applicant has the capacity to contract; i.e., 18 years old)
    - Sex or Marital Status
    - Receipt of income from public assistance programs
    - Exercised rights under the Consumer Credit Protection Act

12 CFR § 1002

Equal Credit Opportunity Act

- **About ECOA**
  - Must be followed when
    - Taking loan applications
    - Evaluating an application
    - Approving or denying a loan
  - Sets Forth Qualifying Income Requirements
    - Consider income adequacy and stability
    - Do not consider income sources

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Application Evaluation**
  - **Qualifying Income Requirements**
    - Must consider reliable public assistance income the same as other income
    - Must consider reliable income from part-time employment, Social Security, pensions, and annuities
    - Must consider reliable alimony, child support, or separate maintenance payments if the borrower chooses to provide this information
    - Must accept someone other than a spouse as a co-signer, if needed

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Application Evaluation**
  - **Qualifying Income Requirements**
    - Creditors must disclose to consumers what their rights are under ECOA, including right to receive appraisal report copy
    - Credit bureaus must maintain separate credit files on married spouses, if requested
    - Credit applicants may file discrimination complaints or bring a civil lawsuit for alleged discrimination
    - Creditors must maintain records of application and related information for 25 months (12 months for business credit) after notifying the applicant of action taken

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Application Evaluation**
  - **Qualifying Income Prohibitions**
    - Must not refuse to consider public assistance income the same way as other income
    - Must not discount income because of sex or marital status
    - Must not discount or refuse to consider income because it comes from part-time employment or pension, annuity, or retirement benefits programs
    - Must not refuse to consider regular alimony, child support, or separate maintenance payments
    - Must not discriminate against applicants who exercise right of nondisclosure of income source

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Application Evaluation**
  - **Qualifying Income Real Success Best Practices**
    - When a lender may ask about spouse
      - Applicant relying on spouse for income
      - Joint application
      - Loan is secured by property
      - State that recognizes dower or curtesy rights
    - How to ask about spouse
      - May not ask if applicant is widowed or divorced
      - May ask married, unmarried, or separated

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Application Evaluation**
  - **Qualifying Income Real Success Best Practices**
    - How to ask about children
      - May ask questions about expenses related to dependents
      - May not ask applicant about plans to have/raise children

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Application Evaluation**
  - **Age Consideration Allowed**
    - Applicant is too young to sign contracts, generally under age 18
    - Creditor would favor applicants age 62 and older
    - It is used to determine meaning of other factors important to creditworthiness, such as to determine if an applicant's income might drop because of pending retirement
    - It may be used in a valid credit scoring system that favors applicants depending on their age
  - **Citizenship Status Inquiry Allowed**
    - The applicant's permanent residence and immigration status in the US is a factor in determining creditworthiness

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Credit Decision Requirements**
  - **Time Requirement**
    - Must provide credit decision to applicant within 30 days after receipt of a complete application
  - **Decision Notification**
    - Approved: Commitment Letter
    - Incomplete: Notice of Incomplete Application
    - Denied or offered less favorable or different terms: Statement of Adverse Action

12 CFR § 1002

Equal Credit Opportunity Act

- **ECOA Credit Decision Requirements**
  - Adverse Action Requirements
    - Include specific reasons for the decision or inform the applicant of the right to request specific reasons for the decision within 60 days of a credit decision
  - Right to Appraisal Copy Disclosure
    - Must disclose that borrowers have a right to a copy of the appraisal report used in the decision process upon completion of the appraisal or no later than 3 business days before settlement

12 CFR § 1002

Equal Credit Opportunity Act

- **HMDA Reporting Requirements**
  - Purpose
    - Monitor compliance with equal credit and equal housing law with focus on ethnicity, sex, and race discrimination
    - Reveal patterns of discriminatory practices
  - Data Collection
    - Collect information about the sex, race, and ethnicity of the borrower and co-borrower during application process
    - Enter data on mortgage loan application (URLA Section 8) for home purpose or improvement, refinancing, or subordinate refinancing
    - Borrower may decline to answer; if declined, MLO completes for in-person/face-to-face applications

12 CFR § 1003

Equal Credit Opportunity Act

- **Enforcement**
  - CFPB-enforced
  - Penalties for Violations
    - Liability for punitive damages can apply only to nongovernmental entities
    - For individual actions, up to $10,000 in punitive damages
    - For class actions, the lesser of $500,000 or 1% of the creditor's net worth
    - A civil action may be brought in the appropriate United States district court within 2 years after the date of the occurrence of the violation

12 CFR § 1003

Community Reinvestment Act

- **About the CRA**
  - Purpose
    - Enacted in 1977 to encourage financial institutions to help meet local credit needs of low- and moderate-income neighborhoods
  - CRA Examination Requirement
    - Federal agencies must periodically evaluate depository institution’s record in helping meet credit needs of its entire community
    - Examinations may include mortgage lenders; differs by state

12 U.S.C § 2901 et seq

11.5 Apply Your Knowledge

Match the timeframe with requirement.

Timeframe	Requirement
30 days	A creditor has ___ after receipt of a "complete application" to provide credit decision.
60 days	A consumer has _____ to request additional reasoning after receipt of an adverse action.
3 business days	No later than ___ before settlement, borrower has right to appraisal report copy.

Ethics: Prohibited Discrimination

- **Intentional and Unintentional Discrimination**
  - Disparate treatment: Intentional decisions to treat people differently based upon protected characteristics
  - Disparate impact: Practices that are intended to be neutral but are shown to have a negative impact upon a particular protected class

Ethics: Prohibited Discrimination

- **Discrimination in Municipal Actions**
  - Exclusionary zoning laws have the effect of denying housing to minorities or other protected classes
  - Ordinances limiting low-cost housing have a disparate impact on minority groups; in effect, excluding them from certain communities
- **Discrimination in Advertising**
  - Certain phrases used in residential mortgage advertising could convey either overt or tacit discriminatory preferences or limitations
  - Advertising content must not be construed as being in violation of the Fair Housing Act

42 USC § 3601 et seq.

Kickbacks and Referral Fees

- **RESPA Prohibits Unethical Behavior**
  - No giving or accepting a fee, kickback, or any thing of value in exchange for referrals of settlement services on federally-related mortgage loan
    - **Thing of value**: Any payment, advance, funds, loan, service, other consideration
    - **Referral**: Any action that influences selection of a service provider
  - No fee splitting and receiving unearned fees for services not performed

12 CFR § 1024.14

Kickbacks and Referral Fees

- **Allowable Fees**

✓ Payment to attorney for services rendered

✓ Payment by title company to appointed agent for services performed regarding title insurance

✓ Payment by lender to its duly appointed agent/contractor for services performed in origination, processing, or loan funding

✓ Employers payment to employees for referral activities

✓ Payment to any person of a bona fide salary or compensation or other payment for goods or facilities furnished or services performed

✓ Payment pursuant to cooperative brokerage/agent referral arrangements

✓ Normal promotional and educational activities that are not conditioned referral

12 CFR § 1024.14(g)

Kickbacks and Referral Fees

- **Allowable Multiple Services Fee**
  - Lawful if a person already providing a service in a mortgage transaction, is in a position to refer settlement service providers, and also can provide additional settlement services; must be actual, necessary, and distinct
- **Allowable "Required Use" Discounts**
  - Discounts on a combination of settlement services lawful if the use of any such combination is optional to the purchaser and the lower price for the combination is not made up by higher costs elsewhere in the settlement process

12 CFR § 1024.14

Kickbacks and Referral Fees

- **Violations of Section 8**
  - Criminal Case
    - Fines up to $10,000
    - Imprisonment up to 1 year
  - Civil Case
    - Amount up to 3 times the amount of the charge paid for the service

12 U.S.C. 2607(d)

11.6 Apply Your Knowledge

XYZ Mortgage encourages their borrowers to employ attorney Bob to perform title searches and related settlement services in connection with their transaction. XYZ and Bob have an understanding that in return for the referral of this business, Bob provides legal services to XYZ's officers or employees at abnormally low rates or for no charge. **Since the borrower is not required to use the attorney, is anyone in violation of RESPA?**

Yes

Mortgage Fraud

- **Defining Fraud**
  - **Fraud**: Intentional or negligent misrepresentation or concealment of material facts
  - **Negligence**: Unintentional breach of a legal duty
  - **Actual Fraud**: Intentional misrepresentation or concealment of a material fact
  - **Constructive Fraud**: Negligent misrepresentation or concealment of a material fact
  - **Mortgage Fraud**: Misrepresentation or concealment used in an attempt to obtain a mortgage loan

Mortgage Fraud

- **Mortgage Fraud Schemes**
  - Fraud for profit; usually perpetrated by industry insiders
  - Fraud for property; usually perpetrated by borrowers

Mortgage Fraud

- **Borrower Schemes**
  - Schemes to obtain ownership to a property under false or fictitious pretenses
    - False application information or false documentation
    - Act as straw buyer
    - False credit or financial enhancement
  - Schemes to get out from under an unsustainable mortgage payment
    - Buy and Bail
    - Short Sale Fraud
    - Arson

Mortgage Fraud

- **Lender and Broker Schemes**
  - Examples: Falsifying loan documents, make loans to straw buyers, illegally flip properties, and then quickly sell to secondary market
  - Purpose: Profit from loan fees, yield spread premiums, or commissions
- **Appraiser Schemes**
  - Examples: Intentionally inflate or deliberately understate an appraisal in collusion with a real estate agent, mortgage broker, or lender
  - Purpose: Loans falsely approved; sell homes at higher value or purchase home at lower price

Mortgage Fraud

- **Reg Z Appraisal Requirements**
  - Lender Prohibited Acts Related to Appraisal
    - Imply that retention of appraiser depends on amount at which appraiser values a consumer's principal dwelling
    - Exclude appraiser from future consideration because the appraiser reports a value that does not meet minimum threshold
    - Tell appraiser minimum reported value needed to approve loan
    - Fail to compensate appraiser because appraiser does not value a dwelling at or above certain amount
    - Condition appraiser's compensation on loan consummation

12 CFR § 1026.42

Mortgage Fraud

- **Reg Z Appraisal Requirements**
  - Lender Allowable Acts Related to Appraisal
    - Asking appraiser to consider additional information about dwelling or comparable properties or to correct factual errors
    - Obtaining multiple appraisals of a consumer's principal dwelling when adhering to a policy of selecting the most reliable appraisals rather than the appraisals that state highest value
    - Withholding compensation from appraiser for breach of contract or substandard performance of services as provided by contract

12 CFR § 1026.42

Mortgage Fraud

- **Fraud Committed by Other Industry Insiders**

- ✓ Attorneys: Bogus deeds
- ✓ Accountants: Falsify tax returns or profit and loss statements
- ✓ Title Companies: Charge for services never provided; complete incorrect title reports
- ✓ Real Estate Agents: Assist in preparing false docs; find straw buyers; steer borrowers for kickback
- ✓ Government Workers: Falsify deeds and records
- ✓ Rehabbers and FSBO (For Sale By Owner): Use sub-par material; remove materials, provide straw buyers; improperly influence others
- ✓ Investment Property Owners: Falsify rent rolls or property occupancy/condition

11.7 Knowledge Check

If a real estate agent accepted flyers from a mortgage company (containing marketing information about the real estate agent and the MLO) and distributed them at an open house,

A. only the MLO is violating RESPA.

B. only the real estate agent is violating RESPA.

C. both are violating RESPA.

D. neither are violating RESPA.

Mortgage Fraud

- **Illegal Property Flipping Scheme**
  - Property Flipping
    - Investor remodels a property and quickly sells it for profit
  - Illegal Property Flipping
    - Generally requires collusion between the seller, buyer, appraiser, and lender/broker
    - Property is purchased at low price, appraised at inflated price without justification, and resold for much higher price typically soon after initial purchase
    - Typically ends with a mortgage lender forced to foreclose on a property with a value that is insufficient to satisfy its lien

Mortgage Fraud

- **Illegal Flipping Scheme Attributes**
  - Schemers do not wait long time periods to sell, often only weeks or perhaps a few months at most
  - Mixed-value areas where higher-priced homes are located near lower-priced homes in poor repair and home values fluctuate
  - Homes involved are in poor condition; only cosmetic or exterior repairs made
  - Out of town lender, not familiar with area, used

12 CFR § 1026.35(c)(4)(A)(B)

Mortgage Fraud

- **FHA Response to Flipping Schemes**
  - Requires sellers to own property for at least 3 months prior to a new sale involving FHA-insured financing
  - Impose additional requirements for resales ranging from 91-180 days:
    - The owner of record must be the seller
    - A second appraisal is required and must match a resale threshold percentage established by HUD; if there is more than a 5% difference in property value between the two appraisals, the lower value must be used
    - The second appraisal may not be paid for by the borrower
    - Resale price must not be more than 100% over the price paid by the seller to acquire the property

12 CFR § 1026.35

Mortgage Fraud

- **Air Loan Scam**
  - Loans made on non-existent properties
- **Deed Scam**
  - Seller's signature on the deed is forged; the real homeowner is not even aware the property is being fraudulently transferred
- **Double Sold Loans**
  - Loan is sold to a fraudulent company
  - Borrower signs multiple copies of the same documents and the MLO submits each "set" of the loan papers to different lenders

Mortgage Fraud

- **Unrecorded or Silent Second**
  - A second mortgage is placed on an asset for down payment funds that are not disclosed to the original lender on the first mortgage; buyer does not pay second mortgage
- **Disappearing Second**
  - Seller holds and presents fake second mortgage and presents to the lender as if it were an actual mortgage to induce the bank to loan a higher amount without the need for mortgage insurance; once the transaction closes, seller destroys the mortgage

Mortgage Fraud

- **Email/Mail Scams**
  - E-mail messages or letters promise to eliminate mortgage loans or get rid of credit card debt in return for paying a fee; consumer pays the money but gets nothing in return
- **Identity Theft**
  - Thieves impersonate homebuyers and sellers using actual, verifiable identities that give the mortgage transactions the appearance of legitimacy

11.8 Knowledge Check

1. **Illegal property flipping could involve all the following EXCEPT the seller**
   A. cosmetically remodeling the home only so it looks good to prospective buyers.
   B. obtaining a higher than market appraised value.
   C. purchasing the home at below market price.
   D. selling the property at market value.

11.8 Knowledge Check

2. The FHA will insure a flipped home under all the following conditions EXCEPT

A. the buyer must pay the lender for the second appraisal.

B. the flipped home requires a second appraisal.

C. the seller must be the owner of record

D. the transaction must be an “arm’s length transaction.”

11.8 Knowledge Check

3. Identity theft consists of all the following EXCEPT

A. altering the bank statement of another person to acquire access to the account.

B. co-signing an auto loan for a relative.

C. using another’s credit card without permission to purchase a flat screen television.

D. using a deceased person’s Social Security number for personal gain.

Mortgage Fraud

- **Red Flags**
  - Steering buyers to specific lender
  - Stated income
  - No money due at closing
  - Sale subject to seller acquiring title
  - Difference in sale price
  - Sale price changes to fit appraisal
  - Related parties involved
  - Funds paid to undisclosed third parties
  - Cash paid to seller outside of escrow
  - Cash paid to borrower

Mortgage Fraud

- **Elder Abuse**
  - Elderly homeowners are made to apply for and obtain mortgage loans they do not want
  - A child or caregiver brings elderly consumer to an application appointment for mortgage loan
  - If senior homeowner appears confused or does not appear to be a willing participant in the loan process, the other party may be exercising coercion
  - MLO should take the consumer's application, but before actively proceeding, conduct one-on-one conversation with senior borrower

Mortgage Fraud

- **Mortgage Fraud Enforcement**
  - Fraud Enforcement and Recovery Act
    - Makes it a felony to falsify loan documents; holds private mortgage brokers and companies accountable under federal fraud law
  - FBI Tracking via Suspicious Activity Reports
  - Lenders Stay Current using MARI, etc.
  - Penalties
    - Fine up to $1,000,000, imprisoned up to 30 years, or both

18 U.S. Code § 1344

11.9 Apply Your Knowledge

Jack is technically a straw buyer in this situation, since he used his personal information to apply for a loan on a property where he did not intend to live and for which he did not intend to make mortgage payments.

Jack could possibly even be criminally liable for making a fraudulent statement (that he would live in the house, a requirement of an FHA loan) on a matter related to transaction with a federal agency.

At the very least, he now has a stain on his credit report and no longer has his basement to himself!

11.9 Apply Your Knowledge

Doug could be on the verge of perpetrating a fraud scheme called a disappearing second. The lender thinks it has an 80% LTV loan; when it may actually be 90% LTV.

If Stu goes along with facilitating this deal, he could be guilty of a material omission if he does not inform the lender of seller Doug's plans. He may want to remove himself from this transaction.

There is no law against someone selling his property to a cousin, even at a discounted price. However, mortgage fraud scams often involve family members. Full disclosure is important.

11.9 Apply Your Knowledge

This is an example of a short sale fraud, and also a flipping scheme.

Since he never intended to make payments on the mortgage loan, Joe can be seen as a straw buyer.

For the short sale to go through, it's also very likely that Joe and Patrick did not reveal their relationship. Short sales that involve relatives and friends are a significant red flag.

Predatory Lending

- **What is it?**
  - Lenders take advantage of ill-informed or desperate consumers through excessively high fees, misrepresented loan terms, frequent refinancing that does not benefit the borrower, and other prohibited acts
  - Motive is profit

Predatory Lending

- **Prohibiting Regulations**
  - Loan Originator Final Rule
    - May not base MLO’s compensation on the transaction’s terms or conditions, other than the mortgage loan amount
  - Mortgage Reform and Anti-Predatory Lending Act
    - MLOs must not steer borrowers to any loan that the borrower lacks the ability to repay or that has predatory characteristics, such as equity stripping, excessive fees, or abusive terms

12 CFR § 1026.36; TILA Section 129C(d),

Predatory Lending

- **Prohibiting Regulations**
  - TILA
    - Prohibits a creditor from financing any premiums or fees for credit insurance in connection with any residential mortgage loan or with any extension of credit under an open-end consumer credit plan secured by the consumer's principal dwelling

12 CFR § 1026.36; TILA Section 129C(d),

Predatory Lending

- **Predatory Lending Excessive Fee Schemes**
  - Charging fees >4-5% of loan amount
  - Charging multiple fees under a variety of names alleging services done on the borrower’s behalf
  - Charging high prepayment penalties that lock borrowers into abusive loans and discourage payoff of profitable loans

Predatory Lending

- **Predatory Equity Skimming Schemes**
  - Loans exceeding borrower's ability to repay
  - Home improvement scams where lender offers financing for repairs that exceed loan value
  - Loan flipping which involves refinancing repeatedly, usually with minimal to no net tangible benefit to the borrower
  - Extreme lending where often as much as 50% or more of income is going toward the mortgage payment

Predatory Lending

- **Predatory Foreclosure Rescue Scams**
  - Phony counseling or phantom help where scammer charges upfront fee with false promise to help homeowner negotiate a deal with a lender; BUT steals money
  - Rent-to-buy scheme where homeowner is told to surrender title to remain in his home as a renter with the offer to buy it back over next few years; BUT terms for buying back become impossible
  - Bait and switch scheme where rescue scam artist provides loan documents to sign to make a mortgage current; BUT buried in documents is one that surrenders title

Predatory Lending

- **Former Indicator**
  - Change of loan terms before closing; 3/7/3 Rule impedes this scheme
- **HUD / Schemes Used by MLOs**
  - Encourage lies on application
  - Knowingly lend more than borrower can afford
  - Charge high-interest rates based on race/national origin
  - Charge fees for unnecessary or nonexistent products and services
  - Pressure borrowers into higher-risk loans
  - Target vulnerable borrowers
  - Strip homeowner equity

Predatory Lending

- **HUD / Red Flags to Borrower**
  - Lenders tell borrowers they are the only option
  - Price of house out of sync with neighborhood
  - Borrowers asked to sign documents with blanks
  - Borrowers given false information about protection provided by FHA-insured loans
  - Cost or loan terms different than what was agreed to
  - Promises that refinancing can solve credit problems

11.10 Apply Your Knowledge

Consider the following scenarios and determine if they are examples of predatory lending.

1. Allen faces possible foreclosure and contacts a mortgage lender whose ad promises to save his home. At closing, Allen sees that the lender changed the terms of the loan that they had agreed to, but he felt he had no choice but to go ahead with the loan or lose the house. Is this a case of predatory lending? Why or why not?

Yes

11.10 Apply Your Knowledge

2. Bill takes an application for a cash-out loan from a woman on a fixed income so she can pay her real estate taxes. Bill does not advise her to make sure the new loan collects for real estate taxes, hoping in a few years she will need to get a new loan for the same reason. Is this a case of predatory lending? Why or why not?

Yes

11.10 Apply Your Knowledge

3. Kara has some credit issues and is trying to bounce back from a recent bankruptcy. Still, she is interested in buying a home. She finds a mortgage broker who can secure a loan for her, but only if she pays 20% down and consents to an interest rate that is higher than that offered to consumers with perfect credit. Is this a case of predatory lending? Why or why not?

Probably not; more information needed

11.10 Apply Your Knowledge

4. Pamela has applied for a loan with XYZ Mortgage Company. The MLO tells her that because she is a single woman, she can only be approved for the loan if she takes out a credit insurance policy to cover the mortgage in the event of her death. The insurance policy requires a significant one-time fee at closing. Is this a case of predatory lending? Why or why not?

Yes

Also maybe discrimination

11.11 Apply Your Knowledge

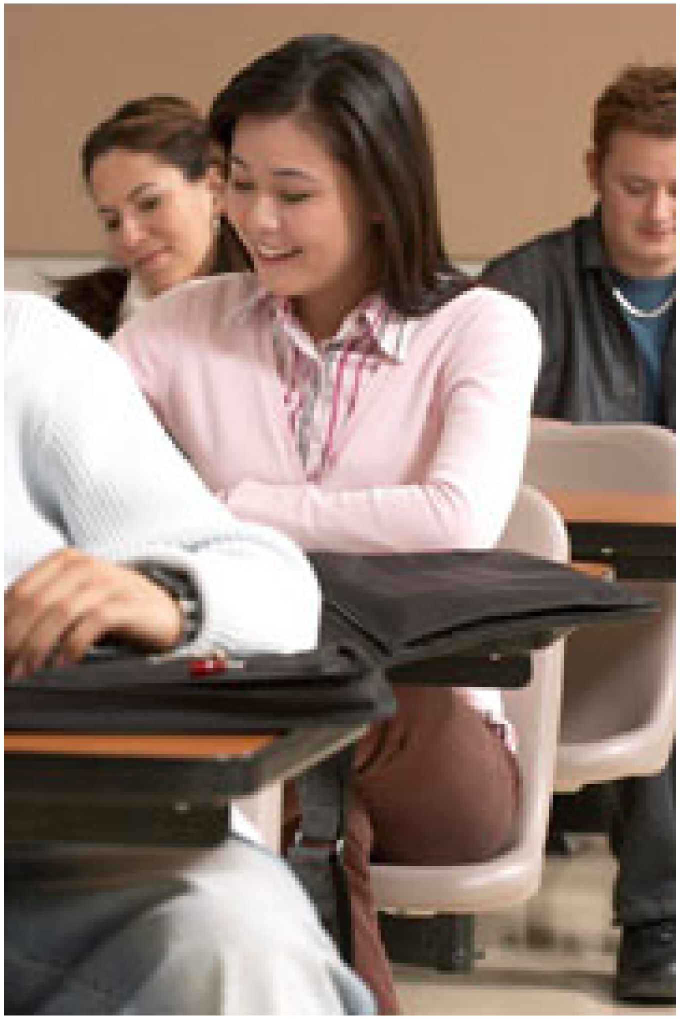
You are not required to take Velma's loan application as long as your refusal is not based on Velma's membership in a protected class; however, you might have a hard time proving that.

Ensure Velma understands all conditions and terms associated with an ARM. She needs to understand that the interest rate she will pay when adjusted according to the terms in the note will be set based off a standard index over which neither she nor her lender has any control. It could be lower. It could also be higher.

11.11 Apply Your Knowledge

If you submit the loan application, take extra special care to confirm that you have made all required disclosures and that she acknowledges the receipt of them

Chapter 11



Chapter Quiz

Chapter 11 Quiz

1. **The Civil Rights Act of 1866 prohibits what type of discrimination in property transactions?**
   A. familial status
   B. race
   C. religion
   D. sex

Chapter 11 Quiz

2. **The Fair Housing Act prohibits discrimination based on race, color, religion, sex,**
   A. age, disability/handicap, familial status, or national origin.
   B. disability/ handicap, familial status, marital status, or national origin.
   C. disability/handicap, familial status, or national origin.
   D. disability, national origin, or marital status.

Chapter 11 Quiz

3. Which law requires lenders to document how they are serving the lending needs within the communities in which they do business?

A. Equal Credit Opportunity Act

B. Fair Credit Reporting Act

C. Fair Housing Act

D. Home Mortgage Disclosure Act

Chapter 11 Quiz

4. As set forth by Regulation Z, an MLO is lawfully able to

A. ask appraiser to consider additional information about dwelling or comparable properties.

B. condition appraiser’s compensation on loan consummation.

C. fail to compensate appraiser because appraiser did not value dwelling at certain amount.

D. tell appraiser a minimum reported value of a dwelling that is needed for loan approval.

Chapter 11 Quiz

5. The Statement of Adverse Action must include specific reasons for the decision or inform the applicant of the right to request specific reasons for the decision within ____ days of a credit decision.

A. 15

B. 30

C. 45

D. 60

Chapter 11 Quiz

6. Mortgage fraud can be committed by

A. any party to a mortgage loan.

B. appraisers only.

C. borrowers only.

D. lenders and brokers only.

Chapter 11 Quiz

7. Which of the following BEST describes the prohibition set forth by Section 8 of RESPA?

A. prohibits business colleagues from exchanging any thing of value for new business

B. prohibits any thing of value in exchange for referrals

C. prohibits the exchange of customer contact information between businesses

D. prohibits the exchange of referrals

Chapter 11 Quiz

8. **Predatory lending involves all of the following EXCEPT**
   A. forcing the borrower to refinance a loan with inferior terms.
   B. misrepresenting the loan terms by the lender.
   C. requiring excessively high fees, such as for credit life insurance.
   D. requiring private mortgage insurance.

Chapter 11 Quiz

9. Which situation is LEAST likely to be an example of predatory lending?

A. ABC Mortgage Co. offers a subprime loan to Mark, who is coming out of bankruptcy.

B. Dave shows up at closing and finds that the lender has changed the terms of the loan.

C. Ellie was 12 days late paying her mortgage and the lender raised the interest rate 1/4%.

D. Frank paid off his mortgage loan early with lottery winnings and the lender charged a $12,000 prepayment penalty.

Chapter 11 Quiz

10. Which situation does NOT involve a straw buyer?

A. Ann revises her pay stubs so she can qualify for a loan to buy her dream house.

B. Bob's brother signs an application for a primary residence loan to acquire a house for Bob because his credit is better than Bob's.

C. Dave agrees to secure a home loan for his friend in Dave's name, claiming he will live there even though he will not.

D. Tina allows her name and credit to be used in an illegal property flipping scheme in exchange for $10,000.

Chapter 11 Quiz

11. Cindy's customer, Tom, purposely does not tell her that he just co-signed his nephew's auto loan. The credit report shows neither that loan nor a credit inquiry, and so that debt is not considered when the lender preapproves him for a larger mortgage than he should have. Did Cindy do anything wrong?

A. No, she can't be held responsible if Tom withholds information that does not show on his credit report.

B. Yes, she colluded with Tom to withhold material information.

C. Yes, she committed actual fraud by approving a purposely false application.

D. Yes, she committed constructive fraud by not confirming Tom's debts.

Chapter 11 Quiz

12. Which of the following is NOT an indicator of predatory lending?

A. charging excessive prepayment penalties

B. falsifying loan documents

C. increasing interest charges on late loan payments

D. requiring mortgage insurance

Chapter 11 Quiz

13. If an ad mentions the interest rate on a specific loan product, that interest rate must be

A. available for at least 10 business days.

B. given to every applicant.

C. locked in without a lock-in fee.

D. made available to a reasonable number of qualified applicants.

Chapter 11 Quiz

14. An MLO takes an application and suspects that a Social Security number provided by the consumer may not be valid. What should the MLO do?

A. approve the mortgage loan for the consumer if the middle credit score is 680 or above

B. report the fraudulent number to the CFPB

C. stop the application and inform the consumer that he cannot obtain a mortgage loan

D. take the application and verify the validity of the Social Security number