

Chapter 13

Ethics in the Mortgage Lending Profession

In This Chapter

Ethics and fair lending are two of the most important issues you will face in your mortgage career. Although ethics, as a philosophical discipline, is a vast topic, in the simplest sense, ethical behavior can be thought of as nothing more than doing the right thing, behaving with integrity, treating people fairly, evaluating a situation and choosing the moral path even if that path is not the easiest one to follow. When considering ethics, it's important to note that unethical behavior may not necessarily be illegal, but once you begin to consider only the legality of your actions, you may have passed the point of giving appropriate consideration to the ethical issues at hand. Still, every person must make choices about how to conduct his or her business and personal life, and while a mortgage professional who always strives to do the right thing is in little danger of violating the law, the law does provide us with a common standard by which to evaluate behavior. Therefore, some important legal points are reviewed in this chapter as we look at conduct that violates anti-discrimination laws, as well as conduct that may be evidence of deception, mortgage fraud, or predatory lending.

At the end of this chapter, you will be able to:

- Define ethics and discuss the 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 the participants and their roles in mortgage fraud schemes.
- Identify predatory lending practices.

Bait and Switch

Blockbusting

Civil Rights

Community Reinvestment Act

**Equal Credit Opportunity Act (ECOA) /
Regulation B**

Fair Housing Act

Familial Status

Flipping

Fraud

Home Mortgage Disclosure Act

Kickback

Material Fact

Negligence

Predatory Lending

Redlining

Steering

Straw Buyer

Ethical and Legal Considerations

Ethics in the mortgage industry may seem like a complex issue, but it really boils down to a few simple points:

- Treat everyone equally.
- Be honest.
- Give full disclosure.
- Don't take advantage of people.
- Keep good documentation.

If you do these things, follow the law, and adhere to a code of ethics put forth by your state or local mortgage board and other industry groups, then you shouldn't have any problems.

In an earlier chapter, you learned about federal laws related to consumer rights, and disclosure obligations. In this chapter, you'll look at laws related to fair lending. The laws are the *minimum* duty required of every mortgage professional. You should always strive to fulfill not only the letter of the law, but also its intent. You will also learn about mortgage fraud, predatory lending, and deceptive advertising practices. There are many sources from which a mortgage professional can obtain ethical guidance. The Better Business Bureau (BBB) and the attorney general's office in your state can provide guidance. Also, it is crucial to respond to consumer complaints filed with those agencies. Many training and educational organizations offer business ethics training for mortgage professionals and their support staff.

Code of Ethics

The **National Association of Mortgage Professionals** (which was known previously as NAMB or the National Association of Mortgage Brokers) has promulgated a **Code of Ethics**.

Honesty and Integrity

Mortgage professionals should conduct business in a manner reflecting honesty, honor, and integrity. Obviously, honesty and integrity are the very heart of ethical behavior. You have a basic obligation to protect consumers, to act in accordance with standard practices, and to follow the law. Not only must you act with integrity, but you should insist that those with whom you do business act with integrity as well. What good is it if you are fair and honest, yet you accept an appraisal from someone who has the reputation for hitting a requested value whether it is there or not? The "Golden Rule" you learned as a child still applies: Treat others as you would like to be treated.

Professional Conduct

Reasonable care and skill must always be used when acting on behalf of a customer. Mortgage professionals should be working to find a fair and workable solution for their customers. Within that framework, you will be viewed as a professional and an expert. A form filled out incorrectly or a misunderstood law could cause problems. If a customer loses money due to your incompetence or carelessness, you may be held liable for **negligence**, which is an unintentional breach of a legal duty.

Also, never take on tasks beyond your ability or claim expertise where you have no special training or skills. If you're not qualified in an area, you must tell a client to seek advice from an accountant, appraiser, attorney, or other expert to protect yourself from liability. For example, during the loan process, customers may raise legal questions. Mortgage professionals need to remember that if they aren't licensed to practice law, they **should never give legal advice** or perform any acts that require a lawyer's expertise. Nor should they perform activities reserved for a real estate licensee in any private party transaction by completing a purchase agreement, lease, land contract, or other occupancy, usage, or transfer agreement, or provide the forms and documents required to create such contracts.

In addition, a mortgage professional should never pressure any provider of services, goods, or facilities to circumvent industry professional standards. Nor should they respond to any pressure placed upon them.

Honesty in Advertising

Often, the primary source of information that a consumer has about a particular mortgage loan originator, lender, or loan product comes from advertising, whether it's in print, on the radio, on television, or on the Internet. Mortgage professionals should strive to be truthful in all advertisements and other solicitations for business that they make. For example, this means that you should:

- Clearly state that loan terms and conditions can change if they can or are likely to.
- Advertise only loan terms and conditions that are likely to be available at the time the loan closes.

Confidentiality

As a mortgage professional, you are privy to your customers' personal information. You know about their jobs, their finances, their bank accounts, their credit scores, etc. To keep from destroying the integrity of the process, such information given by the customer or gained from other sources must be kept confidential.

You can use such information only for the business purpose for which it was intended and you cannot share it with anyone outside of your office—including family and friends—or even with co-workers if they don't need that information to complete tasks related to that transaction.

This ethical responsibility to maintain confidential information also means that you cannot take advantage of confidential information for personal benefit. Furthermore, confidential information learned in the course of a transaction should remain confidential, even after the transaction is closed.

Maintaining confidential information goes beyond simply not talking about customers and clients with those who are not a party to the transaction. The financial industry must put procedures in place that ensure the protection of such confidential information. For example, it's important to have a strategy for safely storing and securing documents; it's also necessary to have a strategy for destroying personal papers or documents that contain confidential information.

Compliance with the Law

It goes without saying that you should obey the law, but it may seem sometimes like the law is a moving target. The mortgage industry is highly regulated, as you know, and has been in a genuine state of transition for a couple of years now. The changes are likely to continue for some time. Not only are you obligated to know and understand the law, you have a duty to stay current with changes to the law. You owe it yourself, your employer, the lenders you deal with, and especially your customers, to make a habit of:

- Staying abreast of local and national news regarding trends and issues that affect the financial and mortgage industries.
- Reading industry publications.
- Attending relevant seminars and workshops.
- Keeping up with your continuing education requirements.
- Reviewing program and guideline change announcements.

Disclosure of Financial Interests

You are expected to avoid all situations that might lead to a real or apparent conflict between your self-interest and your duty as a mortgage professional. This means you are not to use your position for personal gain or benefit, or in any manner that could reflect unfavorably on you or your employer. When you have any equity or financial interest in a property being offered as collateral to secure a loan, you must disclose your professional status and your financial interests. To avoid real and apparent conflicts of interest, a mortgage loan originator should disclose, for example:

- Outside business relationships or employment with any party to a transaction.
- Personal or family relationship with any party to the transaction.
- Any equity or financial interest in the collateral offered to secure a loan.
- Prior employer relations that may have included a non-compete, confidentiality, or other agreement that could restrict you from performing your duties.

Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, designated as the Consumer Financial Protection Act, gives the Consumer Financial Protection Bureau authority in § 1031 to prevent its regulated institutions from engaging in unfair, deceptive, or abusive practices. Section 1412 of Title XIV defines an **abusive act** as one that materially interferes with a consumer's ability to understand the product or service or that takes unreasonable advantage of the consumer's lack of understanding, inability to protect his or her interests, or reasonable reliance on a creditor or mortgage loan originator to act in the interests of the consumer. Every mortgage loan originator is responsible for staying current with the rules and regulations implementing these reforms as they become effective.

Class Activity: Ethical Discussion #1

Joyce walks in to MLO Roger's office and asks to complete a loan application. He takes Joyce's personal information, discusses qualification standards, loan options, rates, etc. Then he asks her if she has a specific property in mind. She says she made an offer of \$210,000 on a house at 123 Oak Street. Roger recognizes that as the house that he has always wanted to own. As soon as Joyce leaves, Roger finds the phone number of the real estate broker listing the house. He tells her that he wants to make an offer of \$215,000 on the house, and that he can guarantee he'll get the loan closed within seven days.

Were Roger's actions ethical? Why or why not? Discuss your responses with the class.

Penalties for Unethical Behavior

When a mortgage loan originator behaves in an unethical manner or otherwise breaches his or her professional obligations, there are a number of possible consequences:

- Action by the state licensing authority,
- Civil lawsuits filed by injured parties,
- Disciplinary action by professional associations, and, in very serious cases,
- The filing of criminal charges.

Ethics in Advertising

In your career, you will spend hours every day dealing with the intricacies of the industry. But most consumers are significantly less informed, and buying or refinancing a home is usually a stressful and confusing undertaking. According to the Better Business Bureau, many consumers begin their search for a mortgage by reviewing printed advertisements in newspapers or magazines. Television and radio commercials—as well as the internet—are also being used more frequently as a means of advertising mortgages and other loan products. According to § 1026.2 of Regulation Z, an advertisement is a **commercial message in any medium that promotes, directly or indirectly, a credit transaction**.

While there are obviously many laws that have been put in place to protect consumers—the Truth in Lending Act and the Wall Street Reform and Consumer Protection Act of 2010 certainly come to mind—consumers generally rely on the honesty and integrity of those mortgage professional with whom they deal.

The **Federal Trade Commission** has the authority to act in the interest of all consumers to prevent deceptive and unfair acts or practices. Section 5 of the Federal Trade Commission Act (Title 15 U.S.C. 41-58) prohibits unfair or deceptive practices of any kind, which would include advertising in any medium. Therefore, advertising must tell the truth and not mislead consumers. A claim can be misleading if relevant information

is left out or if the claim implies something that's not true. For example, an advertisement for a loan that promotes "\$0 Down" may be misleading if significant and undisclosed charges are due at closing.

To comply with the mandate to be truthful and fair, advertising should not:

- Misrepresent **material facts** or make **false promises** likely to influence, persuade, or induce an applicant for a mortgage loan or mortgagor to take a mortgage loan.
- **Conceal** any material factors, terms, or conditions of a transaction to which he is a party, including the receipt of payment from a third party, pertinent to an applicant for a mortgage loan or a mortgagor.

Misrepresentation and Material Facts

Misrepresentation is more than mere "puffing," which is an opinion that is not necessarily intended as a representation of fact, such as "best customer service in town!" When a misrepresentation is made to a consumer with the intent to deceive, it is a form of fraud and can result in prosecution. Note that written disclosures or fine print in an ad may not be sufficient to correct a misleading representation.

Sometimes, a misrepresentation may be made unintentionally or through **negligence**. While not necessarily actionable fraud, obviously a mortgage professional has an obligation to consumers to be factually accurate in all communication. Either way, misrepresentation is serious, especially when it involves material facts.

When claiming fraud or deception, it may not be necessary to prove that the person to which the deliberate misstatement, misrepresentation, or omission was made was harmed financially in the transaction or relied upon such misstatement, misrepresentation, or omission to make a decision in the transaction. This brings us to the next key concept: What is a "material fact"? A material fact is generally defined as one that, if known, might have caused a reasonable consumer to make a different decision. For example, when offering a mortgage loan, material facts may include:

- Annual percentage rate
- Length of loan term
- Fixed or adjustable interest rate
- Origination fees or other closing costs
- Prepayment penalties

From a legal perspective, the misrepresentation of a material fact *could possibly* give a consumer grounds to rescind a contract. Because the terms of a mortgage loan constitute material facts, however, federal law requires significant disclosures that inform and protect the consumer.

Bait and Switch

When discussing advertising, you may hear the term **bait and switch**. This is a tactic of luring consumers in with promises of low rates and specific products, and then **steering** otherwise qualified buyers to other terms so that the mortgage loan originator can earn a higher fee. The Federal Trade Commission Act addresses the practice of bait and switch in Title 16, Part 238. According to § 238.0:

Bait advertising is an alluring but insincere offer to sell a product or service which the advertiser in truth does not intend or want to sell. Its purpose is to switch consumers from buying the advertised merchandise, in order to sell something else, usually at a higher price or on a basis more advantageous to the advertiser. The primary aim of a bait advertisement is to obtain leads as to persons interested in buying merchandise of the type so advertised.

So, for example, mortgage loan originator Jack advertises refinance loans with 0 points and 3.8% APR just to get prospective borrowers in the door. Then, he tells them that such terms are not available to them because of their debt, or their income, or any other such factor. In reality, Jack had no intention of placing any loan on those terms.

Jack baited consumers with his advertisement, which is violation of 16 C.F.R. 238 § 238.1:

No advertisement containing an offer to sell a product should be published when the offer is not a bona fide effort to sell the advertised product.

Bona Fide Offer

Furthermore, it is a violation of 16 C.F.R. 238 to *discourage* the purchase of the advertised merchandise as part of a bait scheme to sell other merchandise. When determining whether or not the initial offer was a bona fide offer, these points would be considered:

- The refusal of the advertiser to show, demonstrate, or sell the product offered in accordance with the terms of the offer
- The disparagement by acts or words of the advertised product or the disparagement of the guarantee, credit terms, availability of service, repairs or parts, or in any other respect, in connection with it
- The failure to have available at all outlets listed in the advertisement a sufficient quantity of the advertised product to meet reasonably anticipated demands, unless the advertisement clearly and adequately discloses that supply is limited and/or the merchandise is available only at designated outlets
- The refusal to take orders for the advertised merchandise to be delivered within a reasonable period of time
- The showing or demonstrating of a product which is defective, unusable, or impractical for the purpose represented or implied in the advertisement
- Use of a sales plan or method of compensation for salesmen or penalizing salesmen, designed to prevent or discourage them from selling the advertised product

While some of these points may seem more relevant to personal property such as appliances or automobiles, you should certainly be able to see how they could apply to mortgage products and services as well.

Switch After Sale

Section 238.4 of the FTC Act indicates that no practice should be pursued by an advertiser, in the event of sale of the advertised product, of “unselling” with the intent and purpose of selling other merchandise in its stead. Among acts or practices which will be considered in determining if the initial sale was in good faith, and not a stratagem to sell other merchandise, are these:

- Accepting a deposit for the advertised product, then switching the purchaser to a higher-priced product
- Failure to make delivery of the advertised product within a reasonable time or to make a refund
- Disparagement by acts or words of the advertised product, or the disparagement of the guarantee, credit terms, availability of service, repairs, or in any other respect, in connection with it
- The delivery of the advertised product which is defective, unusable or impractical for the purpose represented or implied in the advertisement

But what if the consumer decided to accept different terms and apply for the loan anyway? According to 16 C.F.R. Part 238, even though the true facts are subsequently made known to the buyer, the law is violated if the first contact or interview is secured by deception.

Class Activity: Mortgage Advertising

You may wonder how bait and switch relates to advertising mortgage loans, but consider these examples and discuss your thoughts with the class.

Scenario 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 comes in and starts the loan process, paying for a credit report, and completing a loan application. But 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?

Scenario 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 extra 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?

Unfair and Deceptive

When determining whether or not an advertisement or practice is likely to be deceptive, the FTC will examine it from the perspective of a consumer acting reasonably in the circumstances, examining the entire advertisement, transaction, or course of dealing in determining how reasonable consumers are likely to respond. Rather than focusing on certain words, the FTC indicates that it looks at the ad in context—including words, phrases, and images—to determine what it conveys to consumers.

If the representation or practice affects or is directed primarily to a particular group, such as the elderly, the FTC examines reasonableness from the perspective of that group.

For example, think about the advertisements you see on television for reverse mortgages, which are marketed for homeowners age 62 or older as a way to take advantage of the equity in their homes. These ads often employ well-known actors telling potential borrowers about the benefits of this particular loan product, but do not necessarily explain all the details. While there are certainly many regulations in place to protect elderly borrowers—such as required counseling—when considering advertisements, the FTC would examine the ad’s message from the perspective of an elderly homeowner.

To assist consumers in determining whether advertisements for mortgage products are fair, the Federal Trade Commission distributed a consumer alert entitled **Deceptive Mortgage Ads: What They Say; What They Leave Out**. The main points are summarized below:

- Consumers should be able to understand all the terms and conditions of a proposed loan. They are advised to learn to read what’s between the lines as well as what’s emphatically stated in the ad.
- Some ads—whether on the internet, on television, in the paper, fax, or mail—may look tempting, but are flawed if they don’t disclose the true terms.
- The annual percentage rate is a critical factor in comparing mortgage offers from different lenders; sometimes the APR is hidden in the fine print or buried deep in a website.

- Important payment information is often excluded from an ad; consumers should be prepared to ask about payments, terms, escrow, penalties, etc.
- Consumers are advised to consider shopping with several lenders to compare all of the fees they charge and encouraged to ask MLOs to see a list of mortgage rates.
- Consumers are reminded that negotiating is acceptable.

(See: <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt023.shtm>)

Evaluating Buzzwords

The FTC consumer alert on mortgage advertising also advises consumers to look for certain buzzwords that often appear in ads. Though these are not deceptive in and of themselves, when preparing an advertisement, you should consider whether or not the use of such words or terms is fair, accurate, and complete within the context of your advertisement. Taking time to evaluate such language will help you remain in compliance with state and federal laws prohibiting deception. Look at these examples:

- **Low “Fixed” Rate.** If an ad indicates availability of a “fixed” rate, it should also indicate how long it will be “fixed.”
- **Very Low Rates.** Is the ad referring to a low “payment” rate or a low interest rate? There’s a big difference, and it should be clear to the consumer. Also, does the rate apply only for an introductory period? Ads with teaser rates don’t often disclose that a rate or payment is for a very short introductory period. Consumers must be informed of all the details in order to avoid payment shock when the rate and payment increase dramatically.
- **Very Low Payment Amounts.** Such ads should tell the whole story. Is it an interest-only loan? Does it cover the interest due? Is it an adjustable rate loan?

The FTC alert also provides examples of solicitation and advertising tactics that are intended to deceive consumers, such as mailers that have information about their mortgage that are not actually from their lender or mailings with official-looking stamps, envelopes, forms, etc., that appear to be from a government agency. Sadly, there are people and organizations out there who are willing to walk a fine line when it comes to deceptive advertising, and consumers must be on their guard.

The Internet

Obviously, the world today is different place today because of the internet. As consumers, we comparison shop, we play games, we socialize, all without leaving our living rooms. As members of the mortgage business community, we advertise, we provide guidance and counseling, we accept loan applications. The internet has become indispensable, and the power of the internet to reach potential consumers for our products and services seems virtually limitless. It’s critical to understand, though, that the same laws that regulate print and broadcast media apply equally to advertising, promotion, and marketing on the internet. In a nutshell:

- Advertising must be truthful and not misleading.
- Advertisers must have evidence to back up their claims.
- Advertisements cannot be unfair.

An unfair or deceptive message will be unfair or deceptive wherever the consumer views or hears it. Additionally, required disclosures are as important online as anywhere else, and you must comply with all laws related to disclosures. The mandate that disclosures be “clear and conspicuous” applies here as well.

When considering the idea of clear and conspicuous disclosures in online ads, placement and proximity are critical. The FTC’s **Dot Com Disclosures: Information about Online Advertising** paper provides some valuable guidance on making disclosures clear and conspicuous:

- Place disclosures **near**, and when possible, on the same screen as the triggering claim.
- Use text or visual **cues** to encourage consumers to scroll down a Web page when it is necessary to view a disclosure.
- If using hyperlinks to lead to disclosures, make the link **obvious**, label the hyperlink appropriately to convey the importance of the information it leads to, and take consumers directly to the disclosure (note that it might not be possible to meet the letter of the law by burying disclosures in a link).

- **Prominently** display disclosures so they are noticeable to consumers, and evaluate the size, color and graphic treatment of the disclosure in relation to other parts of the page.
- Review the entire ad to ensure that other elements—text, graphics, hyperlinks or sound—**do not distract** consumers’ attention from the disclosure.
- **Repeat** disclosures, as needed, on lengthy web sites and in connection with repeated claims.
- Display visual disclosures for a **duration** sufficient for consumers to notice, read, and understand them.
- Use **clear language** and syntax so that consumers understand the disclosures.

(See: <http://www.ftc.gov/opa/2000/05/dotcom.shtml>)

And with the advent of emerging technology of social media, such as Facebook, LinkedIn, and Twitter, the need for clear and conspicuous disclosure to avoid even unintentional deception is an ongoing challenge.

Advertising Guidance

The Better Business Bureau also offers some general guidance related to advertising ethics. When creating advertisements, consider these questions:

- Does your advertising make your customers satisfied that they do business with you? Your advertising is just another outlet through which you can promote good will and customer loyalty.
- Are you avoiding impossible promises and guarantees? When using the term “guarantee,” you should include a statement that explains complete details are available at the store, or, in the case of mail or telephone sales, are available free upon written request.
- Are your advertised merchandise or programs readily available?
- Do you mean to sell what you advertise? Do not participate in **bait and switch** tactics that involve advertising a low-priced item to bring in customers, then persuading them to buy similar, but higher-priced items.
- Do your ads avoid misleading inferences? Misleading advertising is considered a questionable business practice that should be avoided.
- Do your advertised terms agree with the facts? An advertisement as a whole may be misleading even if every sentence separately considered is literally true.
- Is your advertising easy to understand without asterisks and fine print? Asterisks should not be used as a means of contradicting or substantially changing the meaning of an advertising statement.
- Do you believe your own comparatives? You should be able to substantiate all claims made in the ad.
- Would you be attracted by what your ad says? If it is not attractive to you, it most likely will not be attractive to your customers.

Finally, you must, of course, follow all federal and state laws and regulations related to advertising, such as the requirement to include your NMLS unique identifier and Equal Housing Lender logo/slogan as applicable, and the disclosure requirements found in the Truth in Lending Act and Regulation Z (explained in detail in Chapter 4).

Illegal Discrimination

Fair and equitable treatment in housing and real estate transactions is a right by law. The two federal anti-discrimination statutes that have the greatest impact on real estate transactions are the **Civil Rights Act of 1866** and Title VIII of the Civil Rights Act of 1968, commonly referred to as the **Fair Housing Act**. In addition, these laws also affect the granting of credit by real estate lenders:

- The Equal Credit Opportunity Act (ECOA)
- The Community Reinvestment Act (CRA)
- The Home Mortgage Disclosure Act (HMDA)

REAL SUCCESS

All mortgage industry professionals are required to observe these federal laws, as well as the anti-discrimination statutes and laws passed by their state and local governments. If you are accepting a mortgage application and the property is in another state other than where you normally do business, it is your responsibility to research any specific laws and regulations for that state. Also, know the licensing requirements in that state.

Civil Rights Act of 1866

The **Civil Rights Act of 1866**, codified in Title 42, Section 1981(a) of the U.S. Code, prohibits public and private racial discrimination in any property transaction in the United States. The Act states:

“All citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property.”

The 1866 Civil Rights Act applies to all property—real or personal, residential or commercial, improved or unimproved. The Act prohibits any discrimination based on race or ancestry, and was upheld in 1968 by the United States Supreme Court in the landmark case of *Jones v. Mayer*. The court ruled that the 1866 federal law “prohibits all racial discrimination, private or public, in the sale and rental of property” and is constitutional based on the 13th Amendment to the U.S. Constitution, which prohibits slavery.

Enforcement

A person who has been unlawfully discriminated against under the 1866 Act can sue only in federal district court. The court fashions the remedies it finds necessary, which may include **injunctions** (court orders requiring the defendant to do or refrain from doing a particular act), **compensatory damages** (reimbursement for expenses caused by the discrimination and/or for emotional distress), and **punitive damages** (to punish the wrongdoer if the acts are deliberate or egregious). Depending on the circumstances, these remedies may be instead of or in addition to those available to parties under other federal and state statutes.

Fair Housing Act

Title VIII of the Civil Rights Act of 1968 is commonly called the **Fair Housing Act**. The Fair Housing Act expanded on the 1866 Act, making it illegal to discriminate in the sale or lease of residential property, including vacant land intended for residential housing. The Act has been amended several times and now extends protection against discrimination based on:

- Race
- Color
- Religion
- Sex
- National origin
- Disability
- Familial status

Although the federal Fair Housing Act prohibits discrimination in housing against the disabled, Congress further expanded protection with the more comprehensive **Americans with Disabilities Act (ADA)**, which was signed into law in 1990.

Fair Housing Act Exemptions

The Fair Housing Act covers the majority of residential transactions in the U.S., although there are specific exemptions:

- The rental of a room or unit in a dwelling with no more than four independent units provided that 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

Fair Housing Violations

The following discriminatory practices and activities violate the Fair Housing Act (42 U.S.C. §§ 3604-3605) if they are based on a person's membership in a protected class:

Violation	Example
Refusing to rent or sell residential property after receiving a good faith offer	A homeowner decides not to accept the offer after learning that the buyer is Jewish.
Refusing to negotiate for the sale or rental of residential property	A listing agent follows his seller's instructions to not show the house to any Asians.
Taking any action that would otherwise make residential property unavailable or deny it to any person	A minority couple tells an agent what they're looking for in a home. Six listings in the MLS match their criteria, but the agent tells them about only the three that are in neighborhoods with a high population of minorities.
Using discriminatory advertising or any other notice that indicates a limitation or preference or intent to make any limitation, preference, or discrimination	A landlord includes the phrase "no children" in an advertisement for an apartment.
Making any representation that property is not available for inspection, sale, or rent when it is, in fact, available	A landlord tells a potential tenant who has a Hispanic accent that the apartment is already rented, but shows the unit to a white man.
Coercing, intimidating, threatening, or interfering with anyone because of his enjoyment, attempt to enjoy, or encouragement and assistance to others in their enjoyment of the rights granted by the Fair Housing Act	A landlord threatens to evict a tenant who files a fair housing complaint.
Discriminating in the terms or conditions of any sale or rental of residential property or in providing any services or facilities in connection with such property	A landlord requires applicants to include a deposit, but the property manager does not tell male applicants about the requirement, so their applications are not processed.

In addition, it is illegal for anyone to threaten, coerce, intimidate, or interfere with anyone exercising a fair housing right or assisting others who exercise that right.

Discrimination in Mortgage Lending

From the perspective of a mortgage professional, no one may take any of the following actions if they are based on a person's membership in a protected class:

- Refusing to make a mortgage loan
- Refusing to provide information regarding loans
- Imposing different terms or conditions on a loan, such as different interest rates, points, or fees
- Discriminating in the appraisal of property
- Refusing to purchase a loan
- Setting different terms or conditions for purchasing a loan, for example, a bank charging a higher interest rate to a creditworthy borrower who wants to buy a house in a minority neighborhood than is charged for an equally creditworthy borrower in a different neighborhood

Discriminatory Practices

Most discussions on fair housing include these illegal acts:

Blockbusting. Blockbusting is *trying to induce owners to sell their homes by suggesting that the ethnic or racial composition of the neighborhood is changing, with the implication that property values will decline*. This practice is also called **panic selling**. The person making the prediction buys the properties from the owners and then resells them for a profit.

Steering. Steering is *channeling prospective real estate buyers or tenants to particular neighborhoods based on their race, religion, or ethnic background*. This may never be done in order to maintain or change the character of those neighborhoods.

Redlining. Redlining is a refusal to make loans—or making loans on less favorable terms—on property located in a particular neighborhood for discriminatory reasons. In the past, many lenders assumed that an integrated or predominantly minority neighborhood was automatically a place where property values declined. Based on that assumption, they refused to make loans in these neighborhoods. Since it was almost impossible to obtain purchase or renovation loans, it was extremely difficult to market, maintain, or improve homes, which caused neighborhood values to decline even further, a cycle from which few neighborhoods could recover.

Lenders may still deny loans in neighborhoods where property values are declining, but this must be based on objective criteria regarding the condition and value of the property or area. A lender may not simply equate integrated or minority neighborhoods with declining property values.



Advertising Provisions

The Fair Housing Act also prohibits discrimination in advertising, real estate brokerage, lending, and some other services associated with residential transactions. To comply with this Act, lenders are required to:

- Include the “equal housing lender” slogan in any broadcast advertisement,
- Display the Equal Housing Opportunity poster in every branch where mortgage loans are made, and
- Display the Equal Housing Opportunity logo on all printed promotional material.

Enforcement

A person who has been discriminated against in violation of the Fair Housing Act may file a written complaint to the nearest HUD office within **one year** of the alleged violation (42 U.S.C. § 3610). Complaints are investigated by the Office of Fair Housing and Equal Opportunity (FHEO). HUD may refer complaints to the state or local agency that has similar responsibilities (for example, a state Civil Rights Commission), or HUD itself may investigate the incident. HUD tries to obtain voluntary compliance with the Fair Housing Act.

The parties involved in the discrimination may choose to have the dispute decided in a civil lawsuit instead, either in U.S. District Court or another court that has jurisdiction. The court may grant an injunction,

compensatory damages, punitive damages, and attorney's fees. In addition, the U.S. Attorney General may bring a civil suit in federal district court against anyone engaged in an ongoing pattern or practice of discriminatory activities, referred to as "pattern or practice lawsuits."

THE HOUSING FINANCIAL DISCRIMINATION ACT OF 1977 FAIR LENDING NOTICE

DATE: _____ COMPANY: *[INSERT COMPANY NAME]*
APPLICATION NO: _____ *[INSERT ADDRESS]*
PROPERTY ADDRESS: _____

It is illegal to discriminate in the provisions of or in the availability of financial assistance because of the consideration of:

1. Trends, characteristics or conditions in the neighborhood or geographic area surrounding a housing accommodation, unless the financial institution can demonstrate in the particular case that such consideration is required to avoid an unsafe and unsound business practice; or
2. Race, color, religion, sex, marital status, national origin or ancestry.

It is illegal to consider the racial ethnic, religious or national origin composition of a neighborhood or geographic area surrounding a housing accommodation or whether or not such composition is undergoing change, or is expected to undergo change, in appraising a housing accommodation or in determining whether or not, or under what terms and conditions, to provide financial assistance.

These provisions govern financial assistance for the purpose of the purchase, construction, rehabilitation or refinancing of a one-to-four unit family residence occupied by the owner and for the purpose of the home improvement of any one-to-four unit family residence.

If you have any questions about your rights, or if you wish to file a complaint, contact the management of this financial institution or the agency noted below:

[INSERT APPROPRIATE ENFORCEMENT AGENCY NAME/ADDRESS HERE]

I/We received a copy of this notice

(Date)

(Date)

The Equal Credit Opportunity Act

The **Equal Credit Opportunity Act** (15 U.S.C. § 1691) is a federal law that *ensures that all consumers are given an equal chance to obtain credit*. The **Equal Credit Opportunity Act** requires anyone who grants credit or sets the terms of that credit must never discriminate based on the basis of:

- Race,
- Color,
- Religion,
- National origin,
- Age (provided applicant has the capacity to contract, i.e., 18 years old),
- Sex,
- Marital status,
- Receipt of income from public assistance programs, or
- Exercised rights under the Consumer Credit Protection Act.

As a matter of fact, the law indicates that someone cannot even be **discouraged from applying for credit** based on any of these factors.

The law protects a borrower against any creditor who regularly extends credit, including banks, small loan and finance companies, retail and department stores, credit card companies, and credit unions. Anyone involved in granting credit, such as real estate brokers and mortgage brokers who arrange financing, is covered by the law. Businesses applying for credit also are protected by the law. ECOA, implemented by **Regulation B** of the Consumer Financial Protection Bureau, must be followed when:

- Taking loan applications.
- Evaluating an application.
- Approving or denying a loan.

The law was originally passed in 1974 to prohibit lending discrimination on the basis of sex or marital status. This law led to, among other things, the requirement that credit bureaus maintain separate credit files on married spouses, if so requested. The law ensured that women received the same consideration by lenders when applying for credit. The law was expanded in 1976 to include all of the protected classes listed above. Most notable among the law's revisions is prohibiting the discrimination against a potential borrower on public assistance.

Note the provision in this Act that protects a borrower who is on public assistance. As long as the borrower's income from public assistance is stable (or permanent), the lender or mortgage broker must consider this income as valid as any other qualifying income. The adequacy and stability of a borrower's income should be considered and *not* its source. Lenders and mortgage brokers must therefore:

- Consider reliable public assistance income the same way as other income.
- Consider reliable income from part-time employment, Social Security, pensions, and annuities.
- Consider reliable alimony, child support, or separate maintenance payments if the borrower chooses to provide this information (lenders may ask for proof).
- Accept someone other than a spouse as a co-signer, if one is needed.

While the Equal Credit Opportunity Act clearly indicates that a lender or mortgage broker must consider reliable alimony, child support, or separate maintenance payments as income, the applicant is **not required to disclose** such income. Furthermore, a mortgage loan originator may not discriminate against an applicant who exercises his or her good faith rights of nondisclosure of those sources of income.

EQUAL CREDIT OPPORTUNITY ACT

APPLICATION NO:

PROPERTY ADDRESS:

The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal Agency that administers compliance with this law concerning the company is *[INSERT APPROPRIATE FEDERAL AGENCY HERE]*.

We are required to disclose to you that you need not disclose income from alimony, child support or separate maintenance payment if you choose not to do so.

Having made this disclosure to you, we are permitted to inquire of any of the income shown on your application is derived from such a source and to consider the likelihood of consistent payment as we do with any income on which you are relying to qualify for the loan for which you are applying.

(Applicant) (Date)

(Applicant) (Date)

(Applicant) (Date)

(Applicant) (Date)

Sample Equal Credit Opportunity Notice

REAL SUCCESS

To comply with ECOA, you usually may not ask interested borrowers of their marital status. Nor can you ask someone about their spouse unless it is a joint application and the spouse will use the account or be contractually liable, or if the applicant is relying on their spouse's income or alimony, or child support from a former spouse to qualify for the loan. When the loan is secured by property—as with a mortgage—you *may* ask about a spouse, since in many states, certain rights and benefits exist for spouses. If, for example, a lender must foreclose on a property, it may be necessary for the spouse to legally relinquish those rights.

When permitted to ask about marital status, you may not ask the applicant if he or she is widowed or divorced, however. You may use only these terms (12 C.F.R. § 1002.2(u)):

- Married
- Unmarried (which includes single, divorced, or widowed)
- Separated

Additionally, you cannot ask an applicant about any plans for having or raising children, but you can ask questions about expenses related to any dependents.

In states that recognize **dower or curtesy rights** of spouses, it is acceptable to ask about marital status even if only one person is applying for the loan. In such states, the non-borrowing spouse must consent, since the non-borrowing spouse has an interest in the security instrument.

Loan Application

It is permissible to ask someone applying for a loan to purchase or refinance a principal residence for certain information for the use of the federal government in monitoring lender compliance with equal credit and equal housing laws. Section X of the Uniform Residential Loan Application asks the borrower to supply the following data:

- Ethnicity (Hispanic or Latino/Not Hispanic or Latino)
- Race (American Indian or Alaska Native, Native Hawaiian or Other Pacific Islander, Asian, White, Black or African American)
- Sex (Male or Female)

The application clearly states that applicants may refuse to furnish this information, and that a lender cannot discriminate based on either the information supplied or on the applicant's refusal. If the applicant does refuse, the interviewer is required to note the information on the basis of visual observation and surname when the application is made in person.

Considering Income

When evaluating a potential borrower's gross income, a creditor may consider the amount and probability of any income continuing. A creditor may NOT:

- Refuse to consider public assistance income the same way as other income.
- Discount income because of sex or marital status.
- Discount or refuse to consider income because it comes from part-time employment or pension, annuity, or retirement benefits programs.
- Refuse to consider regular alimony, child support, or separate maintenance payments.

While the Equal Credit Opportunity Act clearly indicates a lender must consider reliable alimony, child support, or separate maintenance payments as income, the applicant is **not required to disclose** such income. Furthermore, a mortgage loan originator may not discriminate against applicants who exercise their good faith rights of nondisclosure of those sources of income.

Age of Applicant

Creditors can consider the age of an applicant for credit under these circumstances:

- The applicant is too young to sign contracts, generally under age 18.
- The creditor would favor applicants age 62 and older.
- It is used to determine the 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.

Enforcement

ECOA is enforced by the **Consumer Financial Protection Bureau**; however, each financial institution further falls under the authority of its respective regulatory agency. Consumers who apply for credit and feel that they've been unjustly discriminated against may file a complaint with the same bodies as they would for other types of discrimination claims. Any creditor that fails to comply with a requirement imposed by ECOA is subject to civil liability for actual and punitive damages in individual or class actions. Liability for punitive damages can apply only to nongovernmental entities and is limited to \$10,000 in individual actions and the lesser of \$500,000 or 1% of the creditor's net worth in class actions. A civil action may be brought in the appropriate United States district court within **two years** after the date of the occurrence of the violation.

COMMUNITY REINVESTMENT ACT (CRA)

Congress enacted the **Community Reinvestment Act** (12 U.S.C. § 2901 et seq.) in 1977 to encourage financial institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound lending practices.

The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. That record is taken into account in considering an institution's application for deposit facilities, including mergers and acquisitions. CRA examinations are conducted by the federal agencies that are responsible for supervising depository institutions.

In some states, the requirements of CRA have been extended to mortgage lenders. Make sure you know the laws of the states in which you conduct business.

Home Mortgage Disclosure Act of 1975 (HMDA)

The **Home Mortgage Disclosure Act** (12 U.S.C. § 2801-2810), enacted by Congress in 1975, is enforced by the Consumer Financial Protection Bureau's **Regulation C** and applies to certain financial institutions, including banks, savings associations, credit unions, and other mortgage lending institutions or non-depository institutions with assets in excess of \$10 million or who originate more than 100 mortgage loans per year. HMDA provides loan data that can be used by the public to assist in:

- Determining whether financial institutions are serving the housing needs of their communities.
- Aiding public officials in distribution of public-sector investment in order to attract private investment where needed.
- Identifying possible discriminatory lending patterns through the collection and disclosure of data about applicant and borrower characteristics.

As the name implies, the Home Mortgage Disclosure Act is a disclosure law that relies upon public scrutiny for its effectiveness. It does not prohibit any specific activity of lenders, and it does not establish a quota system of mortgage loans to be made in any metropolitan statistical area (MSA) or other geographic area as defined by the Office of Management and Budget.

Covered Properties

The provisions of HMDA affect applications for residential loans, including:

- Home purchase,
- Home improvement,
- Refinancing, and
- Subordinate financing.

It does *not* apply to loans on vacant land, new construction, or on loans that are sold as part of a pool for servicing.

Data Reporting

Regulation C requires financial institutions to submit a report—called a **Loan/Application Register** or LAR—to their supervisory agencies on a loan-by-loan and application-by-application basis every March (12 C.F.R. § 1026.16). Data for the LAR is collected on loan originations, applications, and loan purchases, as well as requests under a pre-approval program, if the pre-approval request is denied or results in the origination of a home purchase loan.

These reports can be used to discover discriminatory practices, including redlining, by analyzing whether an institution turns down a disproportionate percentage of applications by race, gender, or ethnicity or by certain neighborhoods. The application, lending, and denial data that lending institutions subject to HMDA are required to report for all borrowers includes:

- Loan type, amount, and purpose
- Rate spread (the difference between the annual percentage rate and the rate on Treasury securities of comparable maturity) only if above designated thresholds
- Property type and occupancy
- Ethnicity, race, and sex of applicant and co-applicants
- Applicant gross income
- Loan decision, including denial reason(s)
- Population and the percentage of which is minority (census tract)
- Whether or not the loan is subject to the Home Ownership and Equity Protection Act (HOEPA) controls related to predatory lending
- The type of purchaser for mortgage loans that they sell

The loan application register information must be maintained and made available upon request for **three years**.

Additional Data

Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which is designated the Consumer Financial Protection Act, includes provisions that also require MLOs to collect the following data about mortgage loan applicants in order to comply with HMDA:

- Age
- Credit score
- Total points and fees
- Loan term and pricing
- Prepayment penalty information

- Loan-to-value
- Period of any introductory interest rate
- Interest-only or negative amortization information
- Channel of origination

Role of the FFIEC

Supervisory agencies, through the **Federal Financial Institutions Examination Council (FFIEC)**, compile HMDA data in the form of individual disclosure statements for each institution, and in the form of aggregate reports for all covered institutions within each MSA. In addition, the FFIEC produces other aggregate reports that show lending patterns by median age of homes and by the central city or non-central city location of the property. The analysis of this data is a critical component to determine if there is compliance with ECOA as well as fair lending laws.

Regulation C requires a lending institution to post a general notice about the availability of HMDA data in the lobby of its home office and of each branch office located in a metropolitan area. The suggested, not mandated, wording is as follows:

HOME MORTGAGE DISCLOSURE ACT NOTICE

The HMDA data about our residential mortgage lending are available for review. The data show geographic distribution of loans and applications; ethnicity, race, sex, and income of applicants and borrowers; and information about loan approvals and denials. Inquire at this office regarding the locations where HMDA data may be inspected. To receive a copy of these data send a written request to [INSERT ADDRESS OF LENDER/BROKER].

REAL SUCCESS

ECOA requires you to ask the applicant for the information needed for the Loan/Application Register whether the application is taken in person, by mail or telephone, or on the Internet—but you cannot require the applicant to provide it. If the applicant declines to answer these questions or fails to provide the information on an application taken by mail or telephone or on the Internet, the data need not be provided. If the applicant chooses not to provide the information for an application taken in person, however, you must note this fact on the form and then note the applicant's ethnicity, race, and sex on the basis of visual observation and surname, to the extent possible.

Other Types of Discrimination

Blatant discrimination still exists, but it is less common today. Instead, there are more subtle ways—both intentional and unintentional—that may amount to discrimination. If you are ever in doubt about what qualifies as discrimination, talk with your employer or an experienced mortgage professional.

Discrimination in Municipal Actions

Exclusionary zoning laws are defined as *any laws that have the effect of denying housing to minorities or other protected classes*. The clause “make otherwise unavailable or deny” in anti-discrimination legislation has been interpreted to prohibit such exclusionary zoning. Since it's currently unlikely that a municipality would enact

an openly racist ordinance, these cases usually involve arguments based on the concept of **disparate impact**. A law with disparate impact *may be neutral on its face, but it has a discriminatory effect since it has a greater adverse impact on one group than on others*.

Exclusionary zoning cases usually involve ordinances that prohibit or unreasonably restrict multifamily or low-income housing. Statistics show in comparison to the white population, members of minority groups are more likely to be considered low-income. As a result, it has been successfully argued in a number of cases that ordinances limiting low-cost housing have a disparate impact on minority groups, in effect excluding them from certain communities.

Discrimination in Advertising

Words carry great power. The use of certain words can influence, inform, and sometimes, mislead consumers, and the misuse of words, even if unintentional, can create problems. For example, certain phrases used in residential mortgage advertising could convey either overt or tacit discriminatory preferences or limitations.

In addition to outlawing discrimination in housing, the federal Fair Housing Act restricts the publication of any real estate advertising that indicates a limitation, preference, or intent to discriminate based on race or other protected class. Specifically, §804(c) of the Fair Housing Act states that it is:

“... unlawful to make, print, or publish, or cause to be made, printed, or published, any notice, statement, or advertisement, with respect to the sale or rental of a dwelling, that indicates any preference, limitation, or discrimination because of race, color, religion, sex, handicap, familial status, or national origin, or an intention to make any such preference, limitation, or discrimination. However, the prohibitions of the Act regarding familial status do not apply with respect to housing for older persons...”

These provisions apply to advertisements for residential mortgage loans as well. Under certain circumstances, even the newspapers chosen for advertising may be held to have the effect of racial steering. MLOs should choose their words very carefully and should measure whether advertising content could be construed as being in violation of the federal Fair Housing Act

Discriminatory advertising may be subtle. In today’s world of “politically correct” language, words carry great power, and the misuse of words, even if unintentional, can create problems. Seemingly innocent statements are sometimes intended or interpreted as discriminatory. Certain phrases used in advertising could convey either overt or tacit discriminatory preferences or limitations.

And it’s not just the words. An appendix to the Fair Housing Act indicates that human models in photographs, drawings, or other graphic techniques may not be used to indicate exclusiveness because of race, color, religion, sex, handicap, familial status, or national origin. If models are used in display advertising campaigns, the models should be clearly definable as reasonably representing majority and minority groups in the metropolitan area, both sexes, and, when appropriate, families with children. Models, if used, should portray persons in an equal social setting and indicate to the general public that the housing is open to all without regard to race, color, religion, sex, handicap, familial status, or national origin, and is not for the exclusive use of one such group.

Class Activity: Illegal Discrimination

Read through the following scenarios and consider whether or not they could be examples of illegal discrimination. Discuss your responses with the class.

Scenario 1: Mortgage broker Lou has been extremely busy lately. To add to his hectic situation, one of his employees just quit. Since Lou is too busy to answer the phone, he sets aside time at the end of each day to check the messages on his voice mail, responding only to calls from those who sound like they have the best chance to get approved. He manages his time in the office similarly, asking his secretary to screen out potential borrowers who receive public assistance, since they will be wasting their time and his by applying for a mortgage.

Could Lou be violating laws against illegal discrimination or is he simply practicing good time management?

Scenario 2: A large real estate brokerage in a diverse city advertised its listed properties in two newspapers distributed over the entire metropolitan area, a number of smaller newspapers circulated primarily in certain neighborhoods, and a weekly newspaper circulated mainly in African American neighborhoods. Whenever the brokerage took a listing in one of the “changing areas” of the city (a neighborhood becoming more integrated or becoming predominantly African American), its standard practice was to advertise that home in the African American newspaper and not in the newspapers of general circulation.

Is this an example of illegal discrimination or just smart use of limited marketing dollars?

Kickbacks and Referral Fees

Recall that the **Real Estate Settlement Procedures Act (RESPA)** of 1974 requires mortgage lenders, mortgage brokers, or servicers of home loans to *provide borrowers with pertinent and timely disclosures of the nature and costs of the real estate settlement process*. Its purpose is to regulate settlement and closing procedures and to protect borrowers.

Section 8 of RESPA prohibits anyone from giving *or* accepting a fee, kickback, or anything of value in exchange for referrals of settlement service providers involving a federally-related mortgage loan. RESPA also prohibits fee splitting and receiving unearned fees for settlement services not actually performed.

Key terms related to these provisions include “thing of value” and “referral.” RESPA defines a **thing of value** to include *any payment, advance, funds, loan, service, or other consideration*. A **referral** includes *any oral or written action directed to a person which has the effect of affirmatively influencing the selection of a settlement services provider* (12 C.F.R. § 1024.2). A referral also occurs when a borrower is required to use a particular provider of settlement services.

Allowable Fees

Fees, salaries, compensation, or other payments for services *actually rendered* and that are *not based on a referral* do **not** violate RESPA. This includes:

- A payment to an attorney at law for services actually rendered
- A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance
- A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan
- A payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed
- A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers (this does *not* apply to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers)
- Normal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business
- An employer's payment to its own employees for any referral activities

Multiple Services

When a person in a position to refer settlement service providers—such as an attorney, mortgage loan originator, real estate broker or agent, or developer or builder—receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary, and distinct from the primary services provided by such person.

“Required Use”

According to RESPA definitions, a “required use” occurs when a consumer paying for a settlement service is required to use a particular provider of that settlement service (12 C.F.R. § 1026.16). While RESPA makes clear that the use of both economic incentives and disincentives to improperly influence a consumer's choice of settlement service providers are prohibited, this provision does not prohibit **legitimate** discounts on services to consumers.

RESPA provides that settlement service providers can offer **legitimate discounts** to consumers by offering a **combination of settlement services** at a total price lower than the sum of the individual settlement services. This combination of services will **not** be considered a prohibited “required use” if:

1. The use of any such combination is *optional* to the purchaser, and
2. The lower price for the combination is not made up by higher costs elsewhere in the settlement process.

Violations

Violations of Section 8's anti-kickback, referral fees, and unearned fees provisions of RESPA are subject to criminal and civil penalties. In a criminal case, a person who violates Section 8 may be fined **up to \$10,000** and/or be imprisoned up to **one year**. In a civil lawsuit, a person who violates Section 8 may be liable to the person charged for the settlement service an amount equal to **three times** the amount of the charge paid for the service.

Class Activity: RESPA Violations

Read through these scenarios and consider who—if anyone—is in violation of RESPA. Discuss your responses with the class.

Scenario 1: XYZ Mortgage encourages borrowers who receive federally-related mortgage loans from them 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?

Scenario 2: ABC Credit Reporting Bureau places a computer in the office of TOP Mortgage so that TOP can easily transmit requests for credit reports and ABC can respond. ABC supplies the computer for free to any mortgage office that orders a specific number of credit reports each month.

Is anyone in violation of RESPA?

Mortgage Fraud

Being honest with everyone means you should avoid fraud—intentional or unintentional—at all times. Either may lead to civil, and even criminal, penalties. **Negligence** is *an unintentional breach of a legal duty*. It's a tort if it causes harm, though, and you can be sued for it. **Fraud** is *intentional or negligent misrepresentation or concealment of material facts*. Failing to disclose information you're required to disclose can be a form of fraud. Fraud also includes actively concealing information and making false or misleading statements.

- **Actual Fraud.** Actual fraud is *an intentional misrepresentation or concealment of a material fact*. Actual fraud occurs when a person actively hides information, or makes statements known to be false or misleading. When any of these is done with intent to deceive, they constitute actual fraud. (This is also called deceit or intentional misrepresentation).
- **Constructive Fraud.** Constructive fraud is *a negligent misrepresentation or concealment of a material fact*. When information is not disclosed or false statements are made unintentionally, it may be considered constructive fraud. Here, the false statements or failure to disclose are the result of carelessness or negligence, rather than an intent to deceive. (This is also called negligent misrepresentation.)

Mortgage fraud involves any misrepresentation or concealment used in an attempt to obtain a mortgage loan. It can generally be divided into two main categories: Fraud for **profit**, which is usually perpetrated by industry insiders, and fraud for **property**, which is usually perpetrated by borrowers. This is a serious federal crime when done for any federally related loan (which includes most loans, since HUD, Fannie Mae, or a federally chartered bank are involved at some point in the process).

Common ways in which fraud may be committed include:

- **Material misrepresentations**, such as altered paycheck stubs and tax returns.
- **Material misstatements**, such as the intent to occupy a home as a primary residence when it really is intended to be used as a rental.
- **Omission**, such as failing to mention the borrower is taking an early retirement in six weeks.

The fraud can be perpetrated by borrowers who lie on applications, by an appraiser who provides an inflated property value, or by a mortgage broker who ignores derogatory information to get a loan approved. This also includes not reporting all items on the HUD closing statement accurately, creating phantom documents for verification, or concealing the true nature of a borrower's down payment.

Fraud Participants

Since many people are involved in the process of making loans for property, the opportunity for fraud exists on several levels. A fraud scheme could be simply the initiative of a desperate borrower, or it could involve the participation of multiple industry insiders, such as an appraiser who provides an inflated property value or by a mortgage broker who ignores derogatory information to get a loan approved. This also includes not reporting all items on the HUD closing statement accurately, creating phantom documents for verification, or concealing the true nature of a borrower's down payment.

Borrowers

Borrowers who knowingly supply false documents, such as verifications of employment (VOEs) or forged W-2s, or false information on the loan application, commit mortgage fraud, whether or not they're working in partnership with any mortgage professionals. Borrowers who commit fraud typically do so in order to obtain ownership of property. The borrower usually plans to make regular payments and has no plans to default. The purpose of the fraud is to make the mortgage loan happen at desirable terms for the borrower, not to enter into foreclosure or flip a property for profit.

A borrower might also act as a **straw buyer**, which is *someone who allows his name and personal details to be used to obtain a mortgage loan for a property he has no intention of inhabiting*. Sometimes straw buyers are paid for their participation in the scheme, and sometimes a straw buyer has no idea that his personal information was used.

Borrowers can also get involved in **credit enhancement** schemes. In an effort to show the necessary assets or credit to qualify for a loan, borrowers may look for fraudulent ways to enhance their financial situation. For example, they may add their names to the bank accounts of friends or family to show that they have sufficient assets on deposit. Another scheme is where friends, family—or even builders or mortgage loan originators—temporarily park assets into a borrower's account until the underwriter qualifies the borrower and the loan closes. This type of fraud can be very sophisticated, even to the point of borrowers “buying” seasoned credit account lines and creating fraudulent retailer relationships in an effort to improve the borrower's credit history and credit scores.

As home values continue to fall, many homeowners find themselves underwater with their mortgage—owing more than the property is worth. This has led to record foreclosures, of course, as well as homeowners with little or no equity in the property just walking away from the house and the loan. The current mortgage market has led to some “creative” schemes by borrowers to get out from under an unsustainable mortgage payment:

- **Buy and Bail.** Homeowners apply for a mortgage to purchase a similar home that, because of the market, sells for less money. The homeowner may claim that they are renting out the original property, perhaps engaging a family member or friend to claim to be the renter and even supplying a fake lease. Then after getting the new property, the borrower simply walks away from the first home and bails on that mortgage.
- **Short Sale Fraud.** A borrower who is facing default may offer to short sell the property so that the lender will not have to foreclose. With a short sale, the lender agrees to allow the sale of the property to a third party for less than the balance owed and release its lien on the collateral property. A short sale will not bring a sufficient amount to pay off the lender in full, but the lender would not have to foreclose and title to or market the property, and will get the nonperforming loan off its books. Some lenders even agree to forgive any deficiency between the sale and the balance owed. A short sale is not necessarily fraudulent. However, if a borrower intentionally stopped making mortgage payments to force default, then enlists the assistance of someone else—a straw buyer—to purchase the property at a reduced price, fraud has most likely occurred.
- **Arson.** In order to avoid foreclosure, some homeowners may actually resort to the crime of arson in order to file fraudulent insurance claims.

Lenders and Brokers

Lenders and mortgage brokers commit mortgage fraud by falsifying loan documents, making loans to straw buyers, illegally flipping properties, and through other schemes. Lenders benefit by making loans that should probably never have been made and selling them to the secondary market as quickly as possible. Mortgage brokers benefit by collecting fees and yield spread premiums for putting together fraudulent mortgage packages. Dishonest lenders and mortgage brokers see the opportunity to make a loan resulting in a commission with high profitability. Often, these loans are knowingly made to unqualified buyers, or even straw buyers who will never make a payment on the loan, resulting in foreclosure.

APPRAISAL PRACTICES PROHIBITED BY REGULATION Z

Regulation Z (12 C.F.R. § 1026.36 (b)) was amended effective in 2009 to specifically address perceived abuses in the mortgage industry. Lenders, mortgage brokers, and their affiliates are prohibited from coercing, influencing, or encouraging an appraiser to misstate the value of the dwelling. For example, the law specifically prohibits these practices:

- 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

In addition, a lender cannot extend credit if the lender knows, at or before closing, that improper coercion has occurred by anyone unless the lender can document that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the dwelling's value. It is not a violation to ask an appraiser to consider additional information about the dwelling or comparable properties or to ask an appraiser to correct factual errors. In addition, the following practices are *not* prohibited:

- Obtaining multiple appraisals of a consumer's principal dwelling, unless 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

Appraisers

Appraisals are a critical aspect of mortgage lending. An appraisal with inaccurate information—whether completed because of fraud or negligence—can have a serious impact. An **inflated appraisal** scheme occurs when a property is intentionally appraised with a higher-than-market value by an appraiser acting in collusion with a real estate agent, mortgage broker, or lender. Lenders hiring these appraisers use only those who agree to “hit the number,” “push the value,” or “work with us on the number” regardless of its relationship to actual market value. If the mortgages are part of sales transactions, continued inflation of values in the same neighborhood (with inflated sale prices) can result in continued appraisals at higher-than-market values that appear justified. Even unsuspecting appraisers are caught in this when they unknowingly use the inflated sale prices as comparables.

While inflated appraisals may be the more common type of appraisal fraud, deliberately **understating** the value of a property is also fraud. An appraiser may do this, for example, to allow someone to purchase a foreclosed home or short sale at a lower price. Understated appraisals may also be used to get more favorable terms from a lender with a loan modification.

Other Industry Insiders

- **Attorneys** may prepare bogus deeds and get them duly recorded on public records with the participation of government workers.
- **Accountants** may falsify tax returns, profit and loss statements, and other documentation required by lenders to qualify loans.
- **Title companies** may charge borrowers fees for services never provided at the closing or may complete incorrect title reports that omit valid liens or that create false chains of title.
- **Government workers** may falsify deeds and other records.
- **Real estate agents** may assist in the preparation of false documentation, such as sales contracts or property inspections, and even finding straw buyers for the property. Real estate brokers and agents collude in flipping schemes by finding borrowers for scams and by raising listing prices of homes after a deal is put together to make the over-inflated appraisal value appear valid. Unscrupulous real estate agents may also steer borrowers to a specific lender in exchange for a kickback or other consideration.
- **Rehabbers** and **FSBO (For Sale By Owner) flippers** may use sub-par material, removing materials or fixtures after an appraisal, providing straw buyers, and improperly influencing appraisers, loan officers, and title companies.
- **Investment Property Owners** may falsify occupancy rates on their rent rolls or otherwise misrepresent the condition of rental units or incomplete renovations.

Class Activity: Appraisal Concerns

Read through the following situation and consider the questions about the MLO's options and the potential consequences. Discuss your thoughts with the class.

MLO Marge has worked with Bill for many years, putting together loans for him on a number of properties. Now they are working on cash-out refinance for Bill's vacation home. Since Marge is planning on submitting the loan to a private investor for funding, she goes ahead and orders an appraisal from Hannah, who she's worked with before. When Marge gets Hannah's appraisal report, she's happy to see that the value range is what she expected based on her discussions with Bill. As Marge looks through the appraisal, however, she gets to the last page, where Hannah has included a number of photographs of the property. Marge had not asked for photographs when she ordered the appraisal. While the property seems to be in excellent condition, the photographs show rooms emptied of furniture, window coverings, and anything else that might indicate the property is occupied.

1. What do the photographs most likely indicate?
2. Did appraiser Hannah do anything wrong? What should Marge do with the appraisal report?
3. Bill is one of her best customers. Should Marge go through with the loan?

Flipping

One of the most common and well-known mortgage fraud schemes is **property flipping**. Many people are confused by the term “flipping,” as it has long been understood to mean that an investor has remodeled a property and quickly sold it for a profit. If the investor bought the property below market, and remodeling has brought it up to true market value, this is the good side of flipping, and is completely legal. It also serves the public well, as it increases property values, improves neighborhoods, and provides housing that otherwise might not be available.

Illegal flipping is something else entirely. Illegal property flipping generally requires collusion between the seller, buyer, appraiser, and lender/broker. An illegal property flipping scheme occurs when a property is purchased at a low price, appraised at an inflated value without any valid reason for the increase, and then resold at a much higher price. It may involve a series of sales and quick re-sales, with one property and a group of sellers and buyers changing ownership among them.

The home in a flipping scheme is typically resold at a new, higher price fairly soon after its initial purchase at the lower price. Statistics show that the criminals involved in these schemes do not wait long time periods, often only weeks, or perhaps a few months at most.

Attributes of Flipping Schemes

Typically, flipping schemes are more prevalent in mixed value areas where higher-priced homes are located near lower-priced homes in poor repair, and home values fluctuate extremely. These neighborhoods often include rental properties and tend to have a higher rate of crime, which can adversely affect property values.

The distressed nature of the properties can include broken pipes, no electrical wiring, or other items in poor condition. Homes involved in flipping schemes are often purchased at low prices because they are in poor condition. If repairs are made after the purchase, they are generally cosmetic or exterior-only repairs.

Another common attribute of illegal flipping is that perpetrators rarely use local entities to handle the loan. If local lenders are not used for the mortgage loan, underwriters who review the loans are not based locally and are unfamiliar with the property and neighborhood.

FHA Response to Flipping Schemes

FHA has responded to the increase in property flipping schemes by requiring sellers to own a property for at least **three months** prior to the new sale. And for resales ranging from 91-180 days, FHA may impose additional requirements, assuming that criminals interested in quick resales are not willing to wait. FHA rules include:

- FHA will not insure any resale properties unless the owner of record is the seller. This prevents thieves from flipping property without ever having legally owned it.
- Resales that take place 91–180 days after the initial sale can be FHA-insured only if there is a **second appraisal** that matches a resale threshold percentage established by HUD.

FHA does occasionally waive this rule. For example, in February of 2010, HUD placed a moratorium on this anti-flipping rule—extended through December 31, 2011—which would allow the sale of homes that have been held for less than 90 days under certain circumstances, such as:

- It must be an arm's length transaction.
- Any seller profit is limited to 20% above the purchase cost unless an independent appraiser confirms that repairs and renovations justify the sale price.

This step was taken in an effort to facilitate the return of repaired and habitable properties to the market in a timely fashion, particularly foreclosed/real estate owned (REO) properties.

Other Types of Mortgage Fraud

Sadly, someone determined to act illegally can dream up any number of schemes. We'll look at a few of them next.

Air Loan

An **air loan** scam involves a loan made on non-existent properties. For example, a broker enlists or creates a straw buyer, identifies fictional properties, opens accounts for payments, and maintains custodial accounts for escrow payments. A bank of telephones in an office may even be set up, with one phone line used for the employer, one for the appraiser, etc., for verification purposes.

Deed Scam

In a **deed scam**, the seller's signature on the deed is forged, meaning the real homeowner is not even aware the property is being fraudulently transferred. The deed is recorded; the thief mortgages the property with cash-out refinancing, then walks away with the money, and walks away from the mortgage without making a payment. And, again, the owner has no idea the property has even been transferred! Often this scheme takes place when an owner owns the property free and clear, the property is vacant, or the owners are having trouble making their mortgage payments.

Double Sold Loans

Double sold loans are instigated in various ways. One method involves the primary mortgage holder who sells the loan on the secondary market. In this instance, the loan is sold to a fraudulent company that, supposedly, will service the loan (and receive the mortgage payments). However, when a payment is received, the fraudulent company simply steals the money. The property will eventually go to foreclosure because the loan payments are never actually applied to the mortgage loan.

Another method of devising a double sold loan is when a borrower signs multiple copies of the same documents and the mortgage loan originator submits each "set" of the loan papers to different lenders. When the loan is approved by more than one lender, the mortgage loan originator forges a duplicate set of closing documents, delivers them to a second lender, and keeps the proceeds.

Unrecorded or Silent Second

In a down market, it's not that unusual for a seller to make concessions in order to entice a buyer. These concessions could even include financing some of the purchase price for the buyer. For example, let's say that the buyer applies for a 75% first mortgage, agrees to pay 5% down, and gives the seller a second mortgage at 20% of the sale price. This second mortgage will not be recorded so that the lender will think that the buyer is actually putting 25% down.

The buyer may have every intention of paying the seller, but this **unrecorded second**—also called a **silent second**—is actually a type of mortgage fraud. And it could be quite a risk for the seller. If the buyer does not pay the loan, the seller would not be able to foreclose to get the property back. And even if the seller does at some point record the mortgage, there may be other liens against the property or the property owner by that time that would have priority over the second mortgage.

Disappearing Second

A more common variation on this scheme is when the buyer has *no intention of paying* the second mortgage. For example, schemers will find uninformed buyers willing to sign a sales contract beyond market prices with such enticements as "seller will help finance." In these cases, the seller holds a second mortgage that they present to the lender as if it were an actual mortgage to induce the bank to loan a higher amount. Once the transaction closes, the seller destroys the mortgage, sometimes even giving it back to the buyer immediately. This is called a **disappearing second**. The lender thinks it has a 80% LTV loan, for example, when it may actually be 100% LTV.

Email/Mail Scams

In these scams, e-mail messages or letters promise to eliminate mortgage loans or get rid of credit card debt in return for paying a fee. The consumer pays the money but gets nothing in return. Consumers desperate to eliminate their crushing debt are most vulnerable to these schemes. The e-mail messages or letters often offer credit counseling or are sent under a name like "American Credit Counseling," implying a legitimate business performing a public service.

Identity Theft

A false identity *is when someone uses another person's identity on a loan application without the knowledge of the rightful property owner*; this is also known as identity theft. An identity can be stolen in a variety of ways, including such common scenarios as applying for a job or from discarded documents.

Many times, a thief needs only one piece of information—a Social Security number—to steal an identity. Today, counterfeit Social Security numbers are relatively easy to obtain. Thieves use retired numbers (due to death), numbers issued to someone else, stolen numbers, or numbers issued before the borrower's birth year. Thieves also use altered employment records, bank statements, and pay stubs to commit identity theft. With this information, they are able to impersonate homebuyers and sellers using actual, verifiable identities that give the mortgage transactions the appearance of legitimacy.

Class Activity: Identity Theft

Read through the following incident of identity theft.

A university student database, which includes Social Security numbers and other personal identifying information, is compromised by a computer hacker. The investigation reveals that the hacker subsequently sold the personal identification information to a third party, who then proceeded to submit falsified mortgage loan applications to numerous financial institutions. Law enforcement stated that the third party, in collusion with a notary, appraiser, and other industry insiders, used the student information to purchase homes owned by the third party and other collaborators at highly inflated prices. In addition to identity theft, the loan files also include misrepresentations of employment, falsified down payments, and inflated appraisals. The end result was approximately \$5 million in losses to the financial institutions.

What are some "best practices" that would have helped avoid such mortgage fraud from this incident? Discuss your ideas with the class.

Red Flags of Mortgage Fraud

A red flag is a situation that requires additional scrutiny. According to the **Federal Financial Institutions Examination Council** (FFIEC), one red flag by itself may not be significant; however, multiple red flags may indicate an operating environment that is conducive to fraud. The following are some red flags that could signal mortgage fraud:

- **Steering Buyers to a Specific Lender.** Buyers may choose any lender they want for a purchase transaction. However, it is not unusual for real estate agents to recommend the use of a certain lending institution. Lenders often solicit loans through these real estate agents by forming alliances with them. If a transaction will close only if a certain lender is used, ask questions because it is unlikely that only one lender would offer a buyer certain favorable terms. Unfortunately, in many mortgage fraud scams, the buyer is unsophisticated in seeking financing, and may have credit issues that make lending more challenging. The buyer may be told this is the only chance for a home purchase when, in fact, it is a scam.
- **Stated Income.** Since the inception of no-doc or low-doc loans, the documentation required for the loan may be limited. These loans—rare in today's market—allow the borrower to indicate, without verification, employment history, income, and debt. Be suspicious if a borrower only had to produce minimal documentation to qualify for the loan.
- **No Money Due at Closing.** If a buyer is not required to pay anything at closing, questions should be asked. What this means is the buyer has been able to get around down payment requirements, and the seller is paying all the points and closing costs involved with the buyer's loan. In theory, the sales price may have been inflated to cover these costs. Even with less stringent lending guidelines and requirements, it is unusual for a buyer to need no money for a closing.

- **Sale Subject to the Seller Acquiring Title.** A huge red flag in a transaction is when the seller on the purchase contract is not the owner of record. There could be legitimate reasons for this, like the seller could be the buyer of the property via land contract or the seller could have recently purchased the property at a sheriff's sale and will not gain title until confirmation of the sale. Participants in the sale should ask why the seller is not the owner of record and verify that the reason is legitimate.
- **Difference in Sale Price.** The sales contract is supposed to guide the title agency or closing agent to the terms of the HUD-1 settlement statement, and there should be no discrepancies. Buyers have the right to review their closing statements one business day before closing. They should compare this document to the purchase contract and to the Good Faith Estimate received from the lender.
- **Sale Price Changes to Fit Appraisal.** To carry out this scheme, an appraisal is ordered and completed. The appraiser is then contacted regarding alterations or addendums to the purchase contract, typically made after the lender is told the appraised amount. The new, altered contract now matches the appraisal value. These schemes enable the lender to profit more from the transaction, because more money was available through a higher-than-expected appraisal.
- **Related Parties Involved.** Certainly, there is no law against a mother selling her property to her son or daughter, even at a discounted price. However, mortgage fraud scams often involve family members. So, when the transaction is not an arm's length transaction, full disclosure is imperative. Cases of mortgage fraud involving entire families have been reported. Many times, the straw buyer in a scam is a family member. Purchase contracts between family members should specifically state their relationships so it does not appear intentionally hidden.
- **Funds Paid to Undisclosed Third Parties.** In certain mortgage fraud schemes, unknown third parties who appear to have no relevance to the transaction are paid out of the funds received at the closing. The implication, of course, is there may be debt not revealed in the closing statements. Once again, a closing statement that is not followed to the letter is a red flag to the borrower. It may be prudent to have legal representation to review all the closing paperwork before signing any of the documents.
- **Cash Paid to Seller Outside of Escrow.** The seller receives cash from the sale of the property; however, it is not stated in closing statements or in the purchase contract. The motive, of course, is unstated profits. No paper trail exists to show the payment.
- **Cash Paid to Borrower.** The borrower receives cash when purchasing the property. Usually, in these cases, the borrower does not have a down payment and the purchase contract calls for the seller to pay all loan costs. Although seller-paid costs are becoming more typical in today's economy, schemes in which the borrower receives money from the transaction are not.

Fraud Enforcement

The **Fraud Enforcement and Recovery Act** of 2009 (Pub.L. 111-21), or **FERA**, is a public law in the United States enacted in 2009 that takes a number of steps to enhance criminal enforcement of federal fraud laws, especially regarding financial institutions, mortgage fraud, and securities or commodities fraud. One provision of the Act is that it amends the definition of a *financial institution* for the purposes of federal criminal law to include **mortgage lending businesses**, which are defined as “organizations which finance or refinance 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.” This, in effect, makes it a felony to falsify loan documents submitted to a broad range of financial institutions, including mortgage lending businesses. It also includes any other person “that makes in whole or in part a federally related mortgage loan.” The amendments assure that private mortgage brokers and companies are held accountable under federal fraud laws. Without the amendments, for example, the financial institution bribery statute would not extend beyond traditional banks and financial institutions

FBI and Suspicious Activity Reports

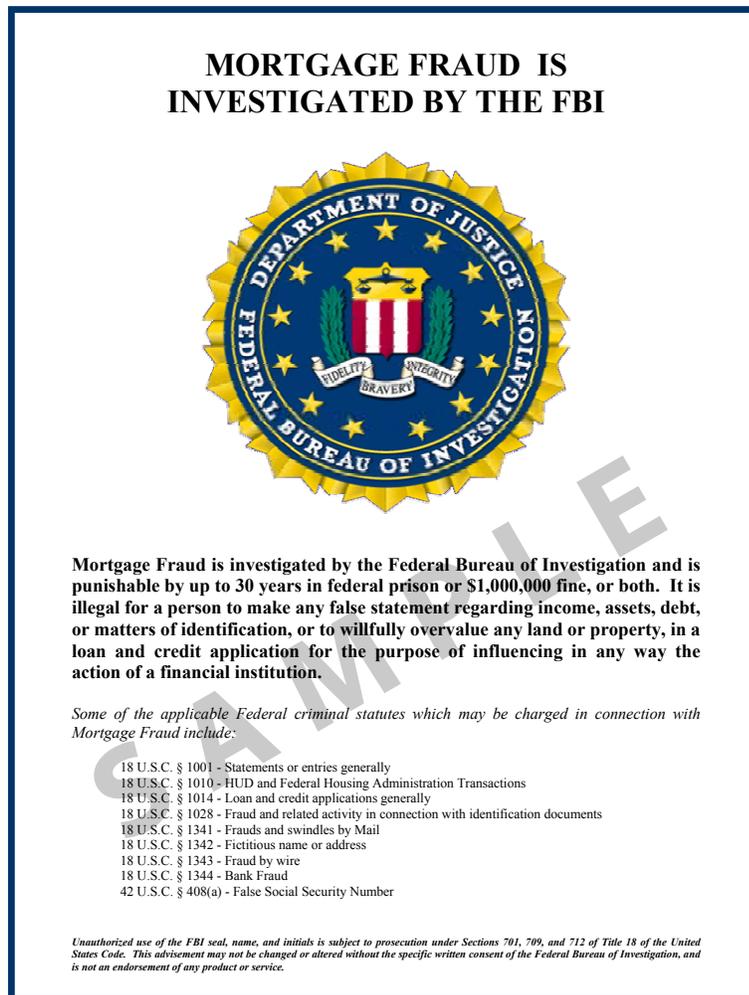
The Federal Bureau of Investigation (FBI) tracks mortgage fraud through **Suspicious Activity Reports** (SARs) filed by federally insured financial institutions and others, and from reports from the Department of Housing and Urban Development's Office of the Inspector General. The FBI also receives complaints from the mortgage industry at large. The FBI's website indicated that as of 7/31/11, they had received 80,549 Suspicious Activity Reports with more than \$3.2 billion in losses! Due to the huge financial losses faced by consumers and lenders on a national scale, the FBI has committed itself to dedicating unprecedented levels of manpower and funding to the investigation of mortgage fraud. Its investigations involve all levels and aspects of the schemes, from undercover work on the “inside” to prosecution of those accused of participating

in mortgage fraud. And they continue to be very busy. As of 7/31/11, the FBI indicated 2,872 pending investigations (with 72% involving losses of more than \$1 million). Compare this to 3,129 investigations (with 71% involving losses of more than \$1 million) in *all of 2010*. (See: http://www.fbi.gov/about-us/investigate/white_collar/mortgage-fraud/mortgage_fraud)

An eye-opening statement in the 2010 Mortgage Fraud Report is that mortgage fraud continued at elevated levels and that fraud schemes are “**particularly resilient, and they readily adapt to economic changes and modifications in lending practices.**” (See: <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2010/2010-mortgage-fraud-report>) Unfortunately, it seems as quickly as enforcement agencies identify fraud schemes and put regulations into place, unethical people will hit on new schemes.

One way you can participate in combating fraud and protecting your reputation is by staying current with what’s going on in the industry. For example, **Mortgage Asset Research Institute (MARI)** is a private subscription service that gives members access to a database of all fraud and suspected fraud as reported by its members and state and federal regulatory agencies, as well as the actions taken. The service allows those in the industry to check credentials of companies and individuals with whom they work.

✓ **Note:** There are also many free websites that document various mortgage fraud scams and the consequences to the participants. It would be a good practice to bookmark some of those sites and make a point of visiting them regularly.



Mortgage Fraud Warning Poster. Source: Federal Bureau of Investigation
 (http://www.fbi.gov/about-us/investigate/white_collar/mortgage-fraud/)

Class Activity: Fraud Schemes

Read through the following scenarios and decide what sort of scheme is being perpetrated. Discuss your thoughts with the class.

Scenario 1: Young couple June and Bud really wanted to buy a home, but their debt ratio was too high and they didn't have much for a down payment. June's dad, Jack, decided to help them by applying for a FHA loan himself, with the understanding that June and Bud would make the mortgage payments. Within a year of moving in, they were well behind in their monthly payments, and the lender called Jack. Jack said he had no intention of making the payments, so the lender started foreclosure procedures, and June and Bud moved into Jack's basement.

Scenario 2: MLO Stu is working with Emily, who is planning on buying her cousin Doug's house. Emily is putting 10% down and Doug is willing to hold a 10% purchase money mortgage so that Emily can avoid paying private mortgage insurance. As he's consulting with Doug and Emily to put the deal together, Doug asks Stu if he can just tear the mortgage up after closing, since he doesn't really expect Emily to pay him back.

Scenario 3: Patrick is behind on his mortgage payments and has been threatened with foreclosure. He has his house on the market, and a few people are showing interest in purchasing the property. Patrick contacts his lender and asks whether or not they would consider agreeing to a short sale. Patrick has a number of offers, but does not submit the highest offer to the lender, instead, convincing his friend Joe to purchase the property. The lender agrees to the sale, and once the lien is released, Joe sells the property at market value to the other prospective buyer, and he and Patrick split the \$30,000 profit.

Predatory Lending

Along with the advantages of subprime lending, which extends credit to people who might not otherwise qualify for a home mortgage, come some of the inevitable negative by-products—lenders taking advantage of borrowers. **Predatory lending** involves loans that *take advantage of ill-informed consumers through excessively high fees, misrepresented loan terms, frequent refinancing that does not benefit the borrower, and other prohibited acts*. Predatory lending targets borrowers with little knowledge of, or defense against, these practices. New regulations require that complete and clear disclosures be made to borrowers and specifically prohibits certain practices, including:

- Packing a loan with credit insurance and other extra fees.
- Extending credit to people with little or no income and who have little chance of repaying the loan (the lender forecloses on the property and keeps the excess equity to cover costs).
- Refinancing the lender's own high-cost loan with another fee-rich loan in less than a year's time (unless a lender can show that the new loan benefits the borrower).

The motive for predatory lending is profit. The goal of a predatory lender is to take the property or strip its equity, or to profit from the exorbitant fees charged. Undoubtedly, the lender claims to help borrowers achieve

the dream of homeownership. Predatory loans are approved without regard for the borrower's ability to repay. Interest rates are higher than the level of risk justifies. And, lenders may bundle unrelated products—such as a life insurance policy—into the mortgage loan to further their profit.

Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, designated as the **Mortgage Reform and Anti-Predatory Lending Act**, prohibits mortgage loan originators from steering 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 (§1403). Final rules on these steering provisions amend Regulation Z (§ 1026.36 (e)) and became effective as of April 2011. For more on this, see the topic on the **Federal Reserve Mortgage Loan Originator Compensation Rule** in Chapter 4.

SUBPRIME LENDERS AND PREDATORY LENDING

Legitimate subprime lenders offer loans to low-income and risky borrowers, and must charge higher interest rates to accommodate the risk. The higher-than-typical closing and processing fees allow them to take on that risk. Without these lenders, riskier borrowers could not tap into their home equity or even own a home. Subprime lenders may be mainstream lenders who also offer conventional loans to borrowers or mortgage brokers specializing in working with the “credit impaired” or with borrowers who are unable or unwilling to meet other criteria—such as verification of income or assets—required for a conventional loan. These lenders usually do not make government-backed loans and, therefore, often operate outside of some federally-related loan guidelines.

While many instances of predatory lending involve subprime loans, it's certainly not reasonable to say that all subprime lenders are predatory lenders. Still, it may be difficult for potential borrowers to discern who is legitimate and who is not.

Excessive Fees

Predatory lending costs the borrower in many ways. Although it is understandable a higher-risk borrower would pay higher interest rates than someone with good credit, it still forces borrowers to pay more than they would for a typical transaction. If the terms are difficult to understand, the borrower may be paying exorbitant loan origination, settlement, and servicing fees.

Total fees greater than 4-5% of the loan amount may be considered higher than normal and may be a red flag to look for **junk fees**—multiple fees under a variety of names alleging services done on the borrower's behalf.

Exorbitant **prepayment penalties** may lock borrowers into abusive loans that cannot be easily refinanced when credit scores improve. Prepayment penalties may be tens of thousands of dollars and be enforced for many years into the loan. The reason? To discourage payoff of the highly profitable loan. In reality, the majority of lenders do not charge prepayment penalties or, if they do, only in the first years of the loan.

Documentation

For many borrowers, but particularly those not well informed, loan documents may be difficult to understand. Legal jargon, small print, and page after page of confusing documentation may be presented for immediate signature. Often, the pressure is on finishing the closing with no time allowed to read the documents carefully. What is the solution for the borrower? Borrowers should be advised to have an attorney review all documents before signing or get a credit counselor or other expert to review them.

Equity Skimming

Equity skimming involves lenders making various types of loans knowing the borrowers will not be able to make the monthly payments and thus setting them up for foreclosure. The borrower loses everything—the home and the equity in it. Some common types of equity skimming schemes include:

Loans Exceeding Ability to Repay. Borrowers typically rely on a lender's advice regarding debt-to-income ratio, believing there are reasonable limits in place on what they can borrow. Equity skimming schemes may falsify loan documents so the borrower does not realize the amount being borrowed is too much, with a monthly payment amount that is too high. The lender makes the loan, knowing the borrower will not be able to make those monthly payments, setting them up for foreclosure. The borrower loses everything—the home and the equity in it.

Home Improvement Scams. In these instances, a contractor working in conjunction with a predatory lender recommends repairs to the home, driveway, basement, etc. (Work may or may not actually need to be done.) The quote for the work is typically extremely high, and the contractor indicates arrangements for financing are available. Enter the lender—offering a loan that will strip the equity out of the home, again resulting in possible foreclosure.

Loan Flipping. This involves refinancing over and over again, usually with minimal to no net tangible benefit to the borrower in terms of lowering the interest rate or saving fees. The borrower is promised benefits that never materialize. Since the lender profits every time a loan is made, there is no incentive for the lender to recommend otherwise. Often, the refinancing actually raises the interest rate to the borrower. With higher monthly payments, the borrower may wind up defaulting on the loan, undergoing foreclosure, or being forced to refinance into even more unfavorable terms. Once again, the high-risk borrower takes a hit financially—a price he can ill afford to pay!

Extreme Lending. Some borrowers fall victim to extreme lending. Borrowers with extremely high debt in relationship to income are targets. With typical lending guidelines restricting borrowers to around 30% of income toward the mortgage payment, this extreme lending—often as much as 50% of income going toward the mortgage payment or more—puts borrowers at risk. If this borrower is laid off, loses a job, or experiences unanticipated expenses due to injury or illness, the risk for foreclosure is great because of the high percentage of income going to the mortgage loan.

FORECLOSURE RESCUE SCAMS

In the current housing market, the number of foreclosures is staggering. Honest homeowners are desperate to save their homes, and unscrupulous schemers are eager to take advantage of their vulnerability. The **Federal Trade Commission** warns borrowers about certain schemes, including:

- **Phony Counseling or Phantom Help.** A scam artist tells homeowners that he can negotiate a deal with their lender to save their homes for an upfront fee. Homeowners may be told not to contact their lenders, lawyers, or credit counselors, and to let the scam artist handle all the details. Once they pay the fee, the scam artist takes off with their money. Sometimes, the scam artist insists that homeowners make all mortgage payments directly to him while he negotiates with the lender. In this instance, the scammer may collect a few months of payments before disappearing.
- **Rent-to-Buy Scheme.** A homeowner is told to surrender the title as part of a deal that allows him to remain in the home as a renter with the intention of buying it back during the next few years. The schemer may tell the homeowner that surrendering the title will permit a different borrower with a better credit rating to secure new financing and prevent the loss of the home. But the terms of these deals usually are so burdensome that buying back the home becomes impossible. The homeowner loses the home, and the scam artist walks off with all or most of the home's equity. Worse yet, when the new borrower defaults on the loan, the original homeowner is evicted. In a variation, the scam artist raises the rent over time to the point that the former homeowner can't afford it. After missing several rent payments, the renter—the former homeowner—is evicted, leaving the "rescuer" free to sell the house.

FORECLOSURE RESCUE SCAMS (CONTINUED)

- **Bait and Switch Scheme.** Recall that the term “bait and switch” usually refers to an advertising tactic where a consumer is enticed with what sounds like a great deal, and then is sold something else, either more expensive or somehow less advantageous to the consumer. Similarly, a rescue scam artist will provide borrowers with loan documents they need to sign to make their mortgage current, but buried in the stack of documents is one that surrenders title to the scammers.

See: <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre42.shtm>

Indicators of Predatory Lending

Changing loan terms at closing was historically one of the most common predatory lending schemes. Borrowers discovered closing documents do not reflect the loan terms and fees originally stated in the Good Faith Estimate, and often feel as though they had no choice but to go through with the loan. A difference between the sale price on the HUD-1 Settlement Statement and the price on the sales contract is a red flag. Of course, it could be an honest mistake, but as the sales contract is supposed to guide the title agency or closing agent to the terms of the HUD-1, and there should be no discrepancies. The 3/7/3 Rule introduced with the Mortgage Disclosure Improvement Act amendments to TILA that requires an additional waiting period of three business days after disclosing changed loan terms helps to address this situation (12 C.F.R. § 1026.19 (a)(2)(ii)).

The Department of Housing and Urban Development (HUD) identifies several other predatory schemes used by unscrupulous mortgage loan originators, including the following:

- Encouraging borrowers to lie about their income, expenses, or cash available for down payments in order to get a loan.
- Knowingly lending more money than a borrower can afford to repay.
- Charging high interest rates to borrowers based on their race or national origin and not on their credit history.
- Charging fees for unnecessary or nonexistent products and services.
- Pressuring borrowers to accept higher-risk loans such as balloon loans, interest only payments, and steep prepayment penalties.
- Targeting vulnerable borrowers to cash-out refinances offers when they know borrowers are in need of cash due to medical, unemployment or debt problems.
- Stripping homeowners’ equity from their homes by convincing them to refinance again and again when there is no benefit to the borrower.

HUD also indicates that borrowers should be aware of the following red flags that could indicate predatory tactics:

- Lenders tell borrowers that they are the borrower’s only chance of getting a loan or owning a home. Borrowers should be able to take their time to shop around and compare prices and houses.
- The house the borrower is buying costs a lot more than other homes in the neighborhood, but isn’t any bigger or better.
- Borrowers are asked to sign a sales contract or loan documents that are blank or that contain information which is not true.
- Borrowers are told that the Federal Housing Administration insurance protects them against property defects or loan fraud when it does not.
- The cost or loan terms at closing are not what the borrower agreed to.
- Borrowers are told that refinancing can solve their credit or money problems.

See: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/buying/loanfraud

Class Activity: Predatory Lending

Read through the following scenarios and decide if they are examples of predatory lending. Discuss the rationale for your conclusions with the class.

Scenario 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.

Scenario 2: Bill takes an application for a cash-out loan from a woman on a fixed income so that she can pay her real estate taxes. Bill does not tell her that she can 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.

Scenario 3: Kara has some credit issues, 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 will pay 20% down and consent to an interest rate that is higher than that offered to consumers with perfect credit.

Scenario 4: Pamela has applied for a loan with XYZ Mortgage Company. The mortgage loan originator tells her that since 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.

Mortgage Assistance Relief Services (MARS) Rule

In October of 2010, a final rule was issued with the intention of addressing many mortgage relief scams that have sprung up recently that take advantages of distressed homeowners. The following are among the provisions of the final rule (12 C.F.R. § 1015):

- A ban on those who provide mortgage foreclosure rescue and loan modification services from collecting fees until homeowners have a written offer from their lender or servicer that they decide is acceptable.
- A requirement that mortgage relief companies disclose key information to consumers to protect them from being misled and to help them make better informed purchasing decisions, for example, the company's fee, the fact that the company is not associated with the government, and that the consumer has the right to discontinue doing business with the company at any time.
- A prohibition against making any false or misleading claims about their services, for example, any guarantees or the amount of money the consumer will save.
- A prohibition barring mortgage relief companies from advising consumers to discontinue communication with their lenders.

See: <http://www.ftc.gov/opa/2010/11/mars.shtm>

Class Activity: Ethical Discussion #2

Read through the following scenario and think about how you might handle the situation. What are some issues to consider? Discuss your thoughts with the class.

Velma, a 59-year-old minority woman who works as a teacher, contacts you about getting a loan to purchase a condominium. As you're chatting, she indicates that she's hoping to retire from teaching in three years. You take her financial and personal information and see that you should be able to get her the amount she needs to purchase the home, and now you need to discuss terms. You share some loan options with her, and she insists that she's only interested in an adjustable rate mortgage, since she wants the lower monthly payments to start and she's convinced the interest rates will stay low or go down even further.

What should you share with Velma about the ARM loan given her situation? Are you obligated to help her apply for the loan she wants?

Let's say you decide that you will not submit an application for an ARM due to Velma's intention to retire in three years, about the time the monthly payments on the loan could jump beyond her ability to pay on a fixed income. You don't want to seem as though you're pushing through an inappropriate loan. Velma is very unhappy and accuses you of refusing to help her because she's a woman and a minority.

It seems as though your choice is between risking accusations of discrimination or accusations of predatory lending. Now what do you do?

Class Case Study and Discussion

To conclude this chapter, read the following consumer complaint letter, review the mortgage loan originator's notes, and then discuss the scenario with your class. *See the Appendix for some additional discussion.*

January 18, 2012

State Commissioner, Division of Banks

Anytown, USA 10001

Dear Commissioner,

On December 1, 2011, I telephoned the ABCDFG Mortgage Company of Anytown, USA. I spoke to John Doe. On that day, Mr. Doe advised me that his company was one of the most competitive and respected in the state. He informed me that he could refinance my present mortgage for 15 years at 6.625% with 0 points. He also told me that, based upon the information I had given him and my credit report, this would be an easy loan and I would have no problem at all.

A sudden death in my family made it impossible for me to meet with Mr. Doe until December 14. On that morning, I called Mr. Doe to confirm our appointment for later in the day and also to confirm that the rate of 6.625% with no points was still in place. He confirmed this. That evening when Mr. Doe arrived at my home, he informed me that the market changed and the rate would now be 6.75%. We proceeded to complete the application at the 6.75% rate.

Mr. Doe completed the mortgage application, had me sign some documents and disclosures, and assured me that copies would be made for my records of the signed disclosures. He also told me that his processor would mail back my original documents along with some other mortgage papers I would need to sign.

On December 28, I called and emailed John Doe for a status of my mortgage application. He returned my call and said everything was "fine." I had read that interest rates had increased but did not worry because my rate had been locked in for 30 days. I asked Mr. Doe when I would be hearing from the appraiser, and he told me that the appraisal had been ordered but the appraisers were busy. He told me not to worry; he would take care of everything.

On January 15, John Doe called me to let me know my interest rate would be 7.375%. I told him that this was not the rate we had agreed to and wanted my money back. He said that my application fee was already "spent," my interest rate was "floating," and he would forward me a copy of my appraisal. He told me I was not entitled to any refund.

I am enclosing copies of the papers given to me at application. I am disappointed over how my mortgage application was handled—the increase in the interest rate and the loss of my application fee. Because of current interest rates, I have lost the ability to refinance and lower my current interest rate. Is there anything you can do to assist me?

Sincerely,

Jane Consumer

Loan Application Log	
ABCDFG Mortgage Company of Anytown	
Borrower: Jane Consumer	Loan #: 123456-78
Address: 123 Elm St.	LO/Proc.: John Doe / Sue Smith
Anytown, USA 10001	
12-14-11	Notes to Processor: Copy attached original documents and return to borrower. Open file and send GFE, TIL and mortgage disclosures. Lock loan at Investor A at 6.625% with 0 points. (JD)
12-15-11	Opened file, ordered appraisal, sent originals back to borrower. (SS)
12-18-11	Sue – lock in fax confirmation to Investor A shows busy, called Stan in secondary marketing dept., he shows NO LOCK!!!! Rates have moved... will have to float. Notice we didn't send the GFE/TIL/ disclosures ... backdate disclosures but do not send lock conf. (JD)
12-28-11	Sue – borrower called on appraisal. What is the status? (JD)
12-28-11	John – called appraiser. They let their clerical person go because of mistakes, couldn't find order. Will send out appraiser ASAP and will RUSH. Rates are rising and loan is still not locked. (SS)
1-5-12	Loan submitted to investor. (SS)
1-7-12	Loan approved by investor – rate is floating, need to send commitment letter. (SS)
1-7-12	Send approval out dated January 8 at original rate with 0 points. Will advise borrower that we are unable to close... don't see rate lock in file. (JD)
1-12-12	Advised borrower that investor needed 48 hours notice to close, also that loan had to fund within three-day rescission period. Told the borrower the only option is to wait until original "lock" expires, then get best market price. Will call borrower on 1-15-10. (JD)

1. If you were the Commissioner of Banks who received that letter from Jane Consumer, what would be your impression of the ABCDFG Mortgage Company?

2. Were the mortgage loan originator's actions:

ETHICAL

UNETHICAL

DEBATABLE

3. Discuss what bothers you about the actions taken by the mortgage loan originator.

REAL SUCCESS

As a mortgage professional, you are deemed to be in a superior position because of your knowledge of the mortgage loan process. This is an advantage that should not be used for personal gain or the gain of your employer at the expense of the general public. The government takes all complaints seriously, especially when consumers feel victimized.

It's important to understand that many borrowers are working with you to complete the single largest transaction they will make in their lives. Most people will be happy and excited, but when people have less experience or knowledge than you, there's always a chance for some to feel they did not come out ahead in the transaction. You may not make everyone happy all the time, but if you follow the same guidelines and procedures for everyone (whether given to you by your employer or created on your own), you should avoid many of the potential pitfalls you could face in your mortgage career—or have the records, reputation, and other tools to help get yourself out of a bad situation if the need arises. And, by treating others ethically, honestly, and with respect, you can strive to earn their respect and repeat business and referrals.

While you may not be legally obligated to keep notes of every substantive conversation you have, it can be your strongest defense to establish that you gave equal professional service. Keep good records of all meetings, phone calls, appointments, and missed appointments. If you find yourself being questioned—or even end up in court—at least you can demonstrate a conscious effort to be fair, open, and honest with everyone. Some organizations require their employees to use a preprinted contact form to document whom they spoke with, what they discussed, etc., as part of their compliance procedures to show that they provided equal service to all and met all disclosure obligations.

Chapter 13 Summary

1. The laws outlined are the minimum duty required of a mortgage loan originator. MLOs, however, should strive to fulfill not only the letter of the law, but also its intent. There are many sources from which a MLO can obtain ethical guidance. The Better Business Bureau (BBB) and your state attorney general's office can provide guidance. The National Association of Mortgage Brokers (NAMB) has promulgated a Code of Ethics.
2. **Bait and switch** advertising is an alluring but insincere offer to sell a product or service which the advertiser in truth does not intend or want to sell in order to switch consumers from buying the advertised merchandise. Every advertisement should be a bona fide offer to sell. **Misrepresentation** is simply false or misleading information that could include documents, misstatements, or omission. A **material fact** is one that, if known, might have caused a reasonable consumer to make a different decision. **The Federal Trade Commission Act** states that advertisements must be truthful and non-deceptive, that advertisers must have evidence to back up their claims, and that advertisements cannot be unfair. An ad is **unfair** if it causes or is likely to cause substantial consumer injury which a consumer could not reasonably avoid and it is not outweighed by the benefit to consumers. An ad is **deceptive** if it contains a statement—or omits information—that is likely to mislead consumers acting reasonably under the circumstances and is material to a consumer's decision to buy or use the product. The same laws that regulate print and broadcast media apply equally to advertising, promotion, and marketing on the internet.
3. Treating everyone equally helps avoid violations of the **Civil Rights Act of 1866** and the federal **Fair Housing Act of 1968** (Title VIII). It is illegal to discriminate based on race, color, religion, sex, national origin, disability, or familial status. **Redlining** is illegally refusing to make loans on property located in a particular neighborhood for discriminatory reasons. The **Home Mortgage Disclosure Act** (HMDA) helps enforce compliance of this by requiring certain lenders and mortgage brokers to file an annual report categorizing the location of loans they made so cases of redlining can be spotted. Exclusionary zoning laws are also discriminatory, especially if they have a disparate impact on a minority group. The courts can step in to remedy these situations. Advertising must also be fair and neutral in its language. The **Equal Credit Opportunity Act** prohibits discrimination in granting credit to people based on sex, age (if at least 18), marital status, race, color, religion, national origin, receipt of public assistance, or exercised rights under the Consumer Credit Protection Act.
4. The **Real Estate Settlement Procedures Act** (RESPA) regulates settlement and closing procedures and requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures. Among RESPA requirements is Section 8, which prohibits kickbacks and unearned fees.
5. Being honest with everyone involves avoiding **fraud**—intentional misrepresentation or concealment of a material fact. Mortgage professionals must also steer clear of any situation that can be construed as mortgage fraud because it is a serious crime. The fraud can be perpetrated by borrowers who lie on applications, by an appraiser who provides an inflated property value, or by a mortgage loan originator who ignores derogatory information to get a loan approved. Mortgage fraud also includes not reporting all items on the HUD closing statement accurately, creating phantom documents for verification, or concealing the true nature of the borrower's down payment.
6. **Predatory lending** involves loans that take advantage of ill-informed consumers through excessively high fees, misrepresented loan terms, frequent refinancing that does not benefit the borrower, and other prohibited acts. Predatory lending targets borrowers with little knowledge of, or defense against, these practices. Laws such as the **Home Ownership and Equity Protection Act** (HOEPA) the **Mortgage Disclosure Improvement Act** (MDIA), and the **Mortgage Reform and Anti-Predatory Lending Act** (Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010), establish disclosure requirements and prohibit equity stripping and other abusive practices.

Chapter 13 Quiz

1. ***The Civil Rights Act of 1866 prohibits what type of discrimination in property transactions?***
 - A. race
 - B. religion
 - C. sex
 - D. all of the above
2. ***The federal Fair Housing Act prohibits discrimination based on race, color, religion, sex, and***
 - A. age, national origin, disability/handicap, or familial status.
 - B. disability, national origin, or sexual orientation.
 - C. marital status, national origin, disability/handicap, or familial status.
 - D. national origin, disability/handicap, or familial status.
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
4. ***Which act specifically prohibits redlining?***
 - A. Civil Rights Act of 1866
 - B. Equal Credit Opportunity Act
 - C. Fair Housing Act
 - D. Home Mortgage Disclosure Act
5. ***As mortgage loan originator Sam puts together an ad to attract some new customers, what law should he be most concerned about?***
 - A. FACT Act
 - B. GLBA
 - C. RESPA
 - D. TILA
6. ***Mortgage loan originator Dave knows that his customer is losing his job at the end of the month because the plant where he works is closing, but in his eagerness to close the deal, he decided to ignore that fact. This might be considered an example of***
 - A. actual fraud.
 - B. constructive fraud.
 - C. good business.
 - D. negligent misrepresentation.
7. ***Mortgage fraud can be committed by***
 - A. appraisers only.
 - B. borrowers only.
 - C. lenders and brokers only.
 - D. any party to a mortgage loan.
8. ***Which law prohibits kickbacks?***
 - A. Fair Credit Reporting Act
 - B. Gramm-Leach-Bliley Act
 - C. Regulation Z
 - D. RESPA
9. ***Predatory lending involves***
 - 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. all of the above
10. ***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.
11. ***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 uses his twin brother's Social Security number and credit information to apply for a loan.
 - C. Dave agrees to secure a loan under his name even though only his sister with bad credit will live in the house.
 - D. Tina tells Rob, who is facing foreclosure, that if he deeds the property to her, she will refinance on good terms and let him stay in the house.

12. ***MLO Cindy's customer 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 pre-approves him for a larger mortgage than he really should have. Do you think Cindy did anything wrong?***
- A. No, she can't be held responsible if a client withholds information that does not show on his credit report.
 - B. Yes, she colluded with the customer 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 the customer's debts.
13. ***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
14. ***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.
15. ***Which statement about a bait and switch advertising strategy is FALSE?***
- A. The advertiser does not intend to sell the offered product.
 - B. The consumer is lured in by attractive terms or promises.
 - C. The goal is to get interested consumers in the door.
 - D. There is no bait and switch if the consumer accepts the new terms.

