7 Hour SAFE CORE CE Top 10 Violations, Cybersecurity, ARMs, BSA/AML, Break Through Industry Updates

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Chapter 1

Top 10 Violations

Learning Objectives for Chapter 1

- ☐ Describe the role of the MMC and State Regulators in outlining continuing education topics
- ☐ Identify the top 10 violations outlined by the MMC in the continuing education topics for 2023
- ☐ Understand how to avoid these violations as a mortgage professional

The MMC and State Regulators

Mortgage professionals are required to take continuing education annually to maintain their NMLS license. **The Multi-State Mortgage Committee** (MMC) identifies the content and outlines what a course provider must include in the CE topics each year. The MMC is composed of 10 appointed State Regulators and one Conference of State Bank Supervisors (CSBS) member. The role of the MMC is to implement cooperative protocol between state agencies and the financial industry.

The State Regulator's role includes the licensing and supervising of mortgage companies. They ensure that financial services operate safely and soundly. State Regulatory auditors complete an examination to determine if a mortgage company is operating in compliance with state and federal laws. A review of mortgage companies' loans and corporate records is conducted to decide whether the entities are effectively meeting the requirement to operate, monitor, and control risks with loan origination activities.

The topics identified by the MMC are the top violations that the State Regulatory auditors found in their compliance examinations. We need to do our best to ensure the violations don't happen so we can get some new topics! Here is a quick list of the violations we will be covering in this chapter:

1. Excessive Charges for Third Party Fees
2. Charging Advanced Fees
3. Unlawful Higher-Priced Mortgage Loans
4. Inaccurate Loan Estimates
5. Violations related to the Notice of Action Taken
6. Inaccurate Closing Disclosures
7. Inaccurate Corrected Closing Disclosures
8. Content of the Closing Disclosure: Prepaids, Title Costs, Initial Escrow Payment, "Other" and Closing Cost Details
9. Content of the Closing Disclosure: Excessive Charges on the Closing Disclosure
10. Adverse Action Notice Violations

For additional information: MMC Mortgage Examination Manual

Violation #1 – TILA – 12 C.F.R. §1026.19(f)(3)(i)

Findings: Excessive Charge for Third-Party Fees

Citation Violation: Regulation Z, 12 C.F.R. § 1026.19(f)(3)(i) states that the amount imposed upon the consumer for any settlement service shall not exceed the amount charged by the settlement service provider for that service.

Examination Findings: Excessive compensation charged or received by a third party for loan-related goods, products, and services.

This is a very straightforward type of violation. Never charge more for a third party than they are charging for the service. For example, if an appraisal is $300, do not charge $320 for no additional service. Another example is if a credit report costs the mortgage company $30, do not charge $38 for no additional services.

Another example of when this might happen is when over-disclosing a fee on the Loan Estimate. In theory, this is an ok practice, but the fee must be fixed on the final Closing Disclosure. For example, a mortgage professional over-discloses the appraisal fee because they think that the appraiser may have to go back out, or it's possible that the loan will switch from Conventional to FHA and that requires a different appraisal, that inflated fee goes out on the Loan Estimate. Then none of those scenarios happen, and it's just a standard conventional appraisal, but you over-disclosed on the Loan Estimate by $300. Now the appraisal fee must be fixed on the Closing Disclosure to reflect the actual cost of the appraisal. The lender cannot charge that excessive appraisal fee.

Mortgage professionals might be asking themselves – the Closing Disclosure is not my problem, the processor or my closing department handles the Closing Disclosure, not me. Neither of those individuals has a license, their license number does not appear on the Closing Disclosure – the mortgage professional's license number does. That means that as a mortgage professional, reviewing the Closing Disclosure should be a priority.

Violation #2 – RESPA - 12 C.F.R. §1024.7(a)(4)

Findings: Charging Advanced Fee

Citation Violation: 12 C.F.R. §1024.7(a)(4) prohibits lenders from charging, as a condition for providing a Good Faith Estimate (GFE), any fee for an appraisal, inspection, or other similar settlement service. The lender may charge a fee for the cost of a credit report but cannot charge additional fees until after the applicant receives the GFE and indicates an intention to proceed with the loan covered by that GFE.

Examination Findings: A fee was collected in advance of the borrower's receipt of the GFE and the borrower's intent to proceed with the loan application.

The Good Faith Estimate, or GFE, is not a disclosure that we have discussed very often since the implementation of the TILA-RESPA-Integrated Disclosure Rule. It's easy for some to forget that the Good Faith Estimate exists but does exist. TRID does not apply to all transactions. It does not apply to:

- Home-equity lines of credit
- Reverse mortgages
- No-interest second mortgages made for down payment assistance, energy efficiency, or foreclosure avoidance
- Loans made by a creditor who makes five or fewer mortgages in a year

The Loan Estimate took the place of the GFE in most transactions, but in others, the GFE still exists.

If a mortgage professional ever plans to originate a HELOC, a reverse mortgage, or any of the TRID-exempt transactions, it's important that mortgage professionals are familiar with the requirements for the GFE. TRID also requires a good faith estimate of the fees and costs associated with the loans. The accuracy of fees and charges on all disclosures regardless of whether the transaction is a TRID or TRID-exempt transaction should be a top priority for mortgage professionals because it is a top priority for examiners.

12 CFR Part 1024.7: Good Faith Estimate

Violation #3– TILA - 12 C.F.R. §1026.35(c)(4)

Findings: Unlawful Higher-Priced Mortgage Loan

Citation Violation: 12 C.F.R. § 1026.35(c)(4)(i)(A) states that a creditor cannot extend a higher-priced mortgage loan to a consumer to finance the acquisition of the consumer's principal dwelling without obtaining, prior to consummation, two written appraisals, if the seller acquired the property 90 or fewer days prior to the date of the consumer's agreement to acquire the property and the price in the consumer's agreement to acquire the property exceeds the seller's acquisition price by more than 10 percent.

Additionally, 12 C.F.R. § 1026.35(c)(4)(iv) states that one of the two required appraisals must include an analysis of: (A) The difference between the price at which the seller acquired the property and the price that the consumer is obligated to pay to acquire the property, as specified in the consumer's agreement to acquire the property from the seller; (B) Changes in market conditions between the date the seller acquired the property and the date of the consumer's agreement to acquire the property; and (C) Any improvements made to the property between the date the seller acquired the property and the date of the consumer's agreement to acquire the property.

Examination Findings: The two required appraisals conducted showed discrepancies and did not comply with the higher-priced mortgage loan requirements.

Higher-priced mortgages (HPML) are like high-cost mortgages. ***TILA Section 35 covers higher-priced mortgages (Remember – Section 32 is high-cost mortgage loans).*** A mortgage loan covered by Section 35 is a **closed-end consumer credit transaction,** secured by a consumer's principal dwelling, with an APR that exceeds the Average Prime Offer Rate (APOR) for a comparable transaction by:

- 1.5% for loans secured by a first-lien loan
- 2.5% for first-lien jumbo loans (with a loan amount over the conventional limit)
- 3.5% for a second-lien loan.

If the APR is higher than the APOR index plus the trigger listed above, it is a higher-priced mortgage.

If a lender extends a higher-priced mortgage, the loan must have an escrow account for the collection and payment of property taxes and premiums for mortgage-related insurance. The escrow account is required for at least five years.

A lender can extend a higher-priced mortgage loan after first obtaining a written appraisal of the property to be mortgaged. The appraisal must be provided to the borrower within three business days before consummation.

When originating higher-priced mortgages, the lender:

- Cannot rely on the collateral alone for repayment of the loan, without considering the borrower's financial ability to make payments.
- Cannot rely on consumer-provided information regarding income and assets without verification.
- Cannot charge a prepayment penalty if the rate can change in the first four years of a loan. Otherwise, they can charge a two percent penalty.
- Must escrow for at least the first 60 months of the loan.

The mortgage company can only charge for one of the appraisals. The mortgage company is prohibited from charging the consumer for the performance of one of the two appraisals required, including by imposing a fee specifically for that appraisal or by marking up the interest rate or any other fees payable by the consumer in connection with the higher-priced mortgage loan.

Real-Life Compliance Scenario

In 2022 MEC instructors received a lot of questions about buydowns and discount points. A 2/1 buydown is a mechanism where the borrower's rate is bought down 2% the first year and 1 % the second year and then is paid at the note rate in the third and subsequent years. Lending companies have started to advertise that when rates go down, the borrower can refinance, assuming they qualify.

More often we are seeing a combination of seller-paid discount points as a seller contribution and borrowers are wanting to pay points to buy down their rate in the same transaction. We've also heard about people wanting to do a 2/1 buydown, with a seller-paid subsidy, but the borrower also wants to permanently buy down their interest rate. As if that is not enough, some of these loans also have lender-paid credits as well.

This can lead to TILA Section 32 or section 35 issues, as well as points and fees issues under the Qualified Mortgage Rule. This can also be a disclosure headache, especially if the points are disclosed as buyer-paid and then swapped to seller-paid prior to closing.

The official commentary to TILA addresses many of these scenarios including Third-party buydowns (Comment 17(c)(1)-3), Consumer buydowns (Comment 4), Lender Buydowns (Comment 4 subpart ii), and Split buydowns (Comment 5).

Let's assume a borrower is receiving both Lender Credit and Seller Credit. Where should those be disclosed?

Closing Cost Details

Loan Costs

A. Origination Charges

% of Loan Amount (Points)

B. Services You Cannot Shop For

C. Services You Can Shop For

D. TOTAL LOAN COSTS (A + B + C)

Other Costs

E. Taxes and Other Government Fees

Recording Fees and Other Taxes
Transfer Taxes

F. Prepaids

Homeowner's Insurance Premium (months)
Mortgage Insurance Premium (months)
Prepaid Interest (per day for days @)
Property Taxes (months)

G. Initial Escrow Payment at Closing

Homeowner's Insurance per month for mo.
Mortgage Insurance per month for mo.
Property Taxes per month for mo.

H. Other

I. TOTAL OTHER COSTS (E + F + G + H)

J. TOTAL CLOSING COSTS

D + I
Lender Credits

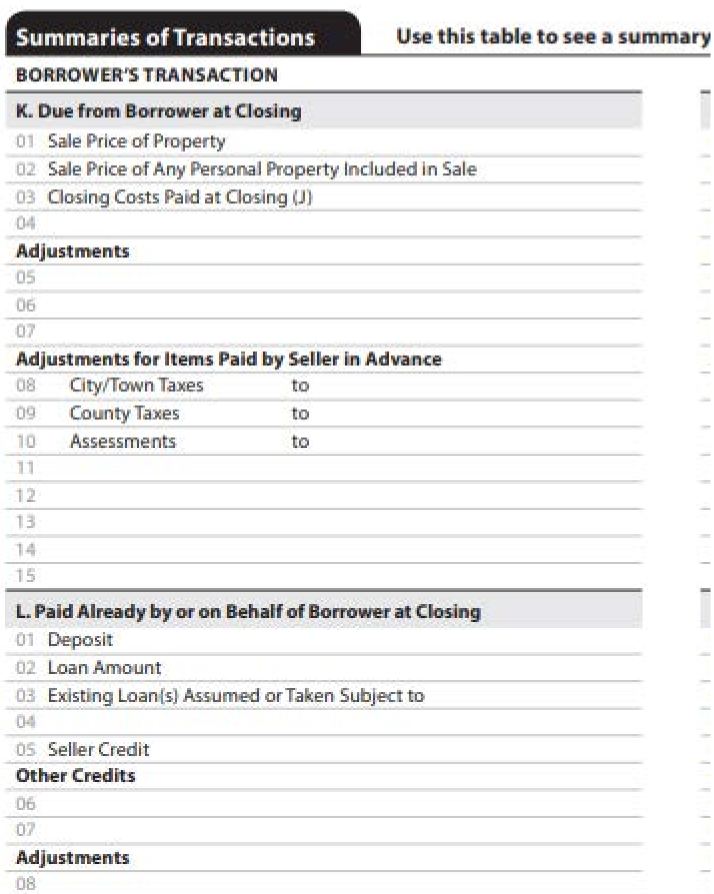
Calculating Cash to Close

Total Closing Costs (J)
Closing Costs Financed (Paid from your Loan Amount)
Down Payment/Funds from Borrower
Deposit
Funds for Borrower
Seller Credits
Adjustments and Other Credits
Estimated Cash to Close

Let's start with the Lender Credit. It could be added to Section A, points, Section A general or Section H. According to the commentary:

ii. The rules regarding consumer buydowns do not apply to transactions known as “lender buydowns.” In lender buydowns, a creditor pays an amount (either into an account or to the party to whom the obligation is sold) to reduce the consumer's payments or interest rate for all or a portion of the credit term. Typically, these transactions are structured as a buydown of the interest rate during an initial period of the transaction with a higher-than-usual rate for the remainder of the term. The disclosure of the finance charge and other disclosures affected by it for lender buydowns should be based on the terms of the legal obligation between the consumer and the creditor. See comment 17(c)(1)-3 for the analogous rules concerning third-party buydowns.

The “Other” section is likely incorrect based on 12 CFR 1026.37(g)(4), which states this section applies to amounts “the consumer is likely to pay or has contracted with a person other than the creditor or loan originator to pay at closing”.



Summaries of Transactions Use this table to see a summary

BORROWER'S TRANSACTION

K. Due from Borrower at Closing	
01	Sale Price of Property
02	Sale Price of Any Personal Property Included in Sale
03	Closing Costs Paid at Closing (J)
04	
Adjustments	
05	
06	
07	
Adjustments for Items Paid by Seller in Advance	
08	City/Town Taxes to
09	County Taxes to
10	Assessments to
11	
12	
13	
14	
15	
L. Paid Already by or on Behalf of Borrower at Closing	
01	Deposit
02	Loan Amount
03	Existing Loan(s) Assumed or Taken Subject to
04	
05	Seller Credit
Other Credits	
06	
07	
Adjustments	
08	

For Seller-paid credits some possible options include:

o **Disclose in Section K and J.** To avoid creating a mathematical problem in the Cash to Close Table disclose as a Buydown Program Fund in Line K04 (just above Adjustments) (which acts as a positive) and then disclose the seller credit in line L05 (which acts as a negative). Disclosing in K and J nets out the value so it has no mathematical impact to the Cash to Close Table.

o **Disclose as POC.** Disclose the seller credit in Line 05 (or other line in L if seller credit cannot accommodate a POC).

o **Disclose as a Specific Credit on Page 2.** Arguably the credit should appear in Category A (lender charge because the money goes to the lender) as a specific credit.

12 CFR 1026.35, 12 CFR 1026.17(c) Official Commentary, TILA-RESPA Integrated Disclosure: Guide to the Loan Estimate and Closing Disclosure Forms Version 2.1

Violation #4– TILA - 12 C.F.R. §1026.37(m)(4)

Findings: Failed to Accurately Complete the Loan Estimate

Citation Violation: Regulation Z, 12 CFR, Section 1026.37(m)(4) requires that the lender provide all borrowers with Loan Estimates that accurately state the late payment charge for the loan program.

Examination Findings: Borrowers received Loan Estimates that contained a late charge of five percent for United States Department of Veterans Affairs and Federal Housing Administration loans. The maximum late charge for these government-backed loan programs is four percent.

Do you know where to find the late payment information? Let's look at the last page of the Loan Estimate.

Other Considerations

Appraisal	We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost.
Assumption	If you sell or transfer this property to another person, we ☐ will allow, under certain conditions, this person to assume this loan on the original terms. ☒ will not allow assumption of this loan on the original terms.
Homeowner's Insurance	This loan requires homeowner's insurance on the property, which you may obtain from a company of your choice that we find acceptable.
Late Payment	If your payment is more than *15* days late, we will charge a late fee of *5% of the monthly principal and interest payment.*
Refinance	Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.
Servicing	We intend ☐ to service your loan. If so, you will make your payments to us. ☒ to transfer servicing of your loan.

This is a violation that you can look out for before you send your borrower their Loan Estimate. If you're working with a VA or FHA customer, always verify that it says 4% of the monthly principal and interest payment instead of 5% on that last page.

Usually, you can rely on your lenders, but it's your responsibility to look at these and make sure that they're compliant. For example, some lenders created a Lock and Shop program that allowed borrowers to lock in their loans before identifying a property to purchase. Depending on how the broker set up the program, it could easily violate disclosure or other laws.

When MEC staff asked various lenders offering these programs about the compliance concerns, not a single lender was willing to state they were compliant and stated it was the broker's responsibility to verify compliance with how they were offering the program.

12 CFR § 1026.37 ; Copy of a Loan Estimate

Violation #5– TILA - 12 C.F.R. §1026.38(f), (g), (p)(3), (r), and (t)(5)(v)

Findings: Failed to Provide an Accurate and Complete Closing Disclosure

Citation Violation: Regulation Z, 12 CFR, Section 1026.38(f), (g) and (t)(5)(v) requires that the lender provide all borrowers with Closing Disclosures (CD) that include charges paid by the seller. Borrowers received CDs that did not include all seller-paid charges. Additionally, Regulation Z, 12 CFR, Section 1026.38(p)(3) requires a statement that discloses whether state law may protect the consumer from liability for the unpaid balance in the "Liability after Foreclosure" section.

Examination Findings: The incorrect box was checked in the "Liability after Foreclosure" section. Additionally, the "Contact Information" table, when provided to the borrower shall be complete. Borrowers received CDs with incomplete contact information.

Do you know where to find all this information on the Closing Disclosure? Let's look for it. All the seller-paid charges appear on page 2 in the seller-paid column.

Closing Cost Details

Loan Costs		Borrower-Paid At Closing	Borrower-Paid Before Closing	Seller-Paid At Closing	Seller-Paid Before Closing	Paid by Others
A. Origination Charges		**$1,802.00**				
01 0.25 % of Loan Amount (Points)		$405.00				
02 Application Fee		$300.00				
03 Underwriting Fee		$1,097.00				
04						
05						
06						
07						
08						
B. Services Borrower Did Not Shop For		**$236.55**				
01 Appraisal Fee	to John Smith Appraisers Inc.					$405.00
02 Credit Report Fee	to Information Inc.		$29.80			
03 Flood Determination Fee	to Info Co.	$20.00				
04 Flood Monitoring Fee	to Info Co.	$31.75				
05 Tax Monitoring Fee	to Info Co.	$75.00				
06 Tax Status Research Fee	to Info Co.	$80.00				
07						
08						
09						
10						
C. Services Borrower Did Shop For		**$2,655.50**				
01 Pest Inspection Fee	to Pests Co.	$120.50				
02 Survey Fee	to Surveys Co.	$85.00				
03 Title – Insurance Binder	to Epsilon Title Co.	$650.00				
04 Title – Lender's Title Insurance	to Epsilon Title Co.	$500.00				
05 Title – Settlement Agent Fee	to Epsilon Title Co.	$500.00				
06 Title – Title Search	to Epsilon Title Co.	$800.00				
07						
08						
D. TOTAL LOAN COSTS (Borrower-Paid)		**$4,694.05**				
Loan Costs Subtotals (A + B + C)		$4,664.25	$29.80			

The liability after foreclosure (also known as the Deficiency Judgement) and contact information appear on the last page of the Closing Disclosure.

Liability after Foreclosure

If your lender forecloses on this property and the foreclosure does not cover the amount of unpaid balance on this loan,

- [X] state law may protect you from liability for the unpaid balance. If you refinance or take on any additional debt on this property, you may lose this protection and have to pay any debt remaining even after foreclosure. You may want to consult a lawyer for more information.
- [ ] state law does not protect you from liability for the unpaid balance.

The contact information is the second to last piece of the Closing Disclosure. It's important that the borrower be able to reach out about any party to the transaction!

from your federal income taxes. You should consult a tax advisor for more information.

Contact Information

	Lender	Mortgage Broker	Real Estate Broker (B)	Real Estate Broker (S)	Settlement Agent
Name	Ficus Bank		Omega Real Estate Broker Inc.	Alpha Real Estate Broker Co.	Epsilon Title Co.
Address	4321 Random Blvd. Somecity, ST 12340		789 Local Lane Sometown, ST 12345	987 Suburb Ct. Someplace, ST 12340	123 Commerce Pl. Somecity, ST 12344
NMLS ID					
ST License ID			Z765416	Z61456	Z61616
Contact	Joe Smith		Samuel Green	Joseph Cain	Sarah Arnold
Contact NMLS ID	12345				
Contact ST License ID			P16415	P51461	PT1234
Email	joesmith@ ficusbank.com		sam@omegare.biz	joe@alphare.biz	sarah@ epsilontitle.com
Phone	123-456-7890		123-555-1717	321-555-7171	987-555-4321

Copy of a Closing Disclosure

Violation #6– TILA- 12 C.F.R. §1026.19(f)(2)(iii)

Findings: Corrected Closing Disclosure

Citation Violation: Regulation Z, 12 C.F.R. §1026.19(f)(2)(iii) specifies that if, during the 30-day period following consummation, an event in connection with the settlement of the transaction occurs that causes the disclosures to become inaccurate, and such inaccuracy results in a change to an amount actually paid by the consumer from that amount disclosed, the creditor shall deliver or place in the mail corrected disclosures not later than 30 days after receiving information sufficient to establish that a corrected closing disclosure is to be provided.

Examination Findings: Loans contained corrected closing disclosure that were delivered after the 30 days. The CDs had excessive compensation charged or received by a third party for loan-related goods, products, and services.

Sometimes, things change even after consummation. If so, the lender is required to provide a corrected CD within 30 days. Lenders are required to provide a corrected CD to correct non-numerical clerical errors and document refunds for tolerance violations within 60 calendar days of consummation. After these time frames, if the lender finds the error before the borrower does and makes the appropriate adjustments and provides notice of this adjustment to the borrower within 60 days of discovering the error, the lender will be acting in good faith to correct the error.

In all circumstances, if any amount paid by the borrower at closing exceeds the amount disclosed by more than the applicable tolerance threshold, the creditor is responsible for refunding the excess to the borrower no later than 60 days after consummation.

Timing requirements for disclosures are often targeted for violations. It is something that most auditors, whether they work for a federal or a state agency, will look for and confirm. TRID added the two disclosures, along with different timing requirements. TRID was passed in 2015, yet we still must cover these violations. This is an easy violation to avoid, but it still appears on our list every single year.

Let's quickly review TRID timing requirements for both the LE and CD.

Initial Loan Estimate

- *Initial Disclosure – 3 days*
    - Lenders must ensure delivery or place in the mail no later than the third business day after receiving the consumer's application.
- *Must be delivered 7 days before consummation*
    - The Loan Estimate must also be delivered or placed in the mail no later than the seventh business day before consummation of the transaction.
        - You can't close in less than seven days from delivery of the Loan Estimate
- LE expires after 10 business days

Loan Estimate Timing Example

The lender is open for business Monday through Friday. The MLO submits an application completed on Thursday. By what date must the lender supply the LE? Friday, Monday, and Tuesday (3 LE business days). So, the lender must supply the LE by electronically or mail by end of day Tuesday.

Revised Loan Estimate

- *4 days*
    - A lender can revise an LE at any time before they provide the CD.
    - However, the lender must ensure that the consumer receives the final revised LE no later than four business days before closing (or consummation).

Final Loan Estimate

- *1 day prior to initial CD*

Closing Disclosure

- *3 days*
  - Lender ensures the consumer receives the Closing Disclosure no later than three business days before consummation of the loan.
- *3 days*
  - Loans may not be consummated less than three business days after the Closing Disclosure is received by the consumer.
- *3 days*
  - Changes made to the Closing Disclosure prior to loan consummation require a new Closing Disclosure form to be issued by the lender and, in a limited number of situations (including APR changes of more than 1/8 of a percent for irregular loans, a change in the loan product, or the addition of a prepayment penalty), a reset of the three-day waiting period.

Here are a few other terms to remember from TRID:

- Business day:
  - LE – Any day the lender is open to the public for substantially all its business functions
  - CD – All calendar days except Sundays and certain federal holidays
- What constitutes an application?
  - Consumer's name
  - Consumer's income
  - Consumer Social Security number
  - A property address
  - An estimated value of the property
  - The mortgage loan amount sought

Violation 7 & 8– TILA - 12 C.F.R. §1026.19(f)(1) and §1026.38; §1026.38(f)(2) and §1026.19(f)(2)(i)

Findings: Closing Disclosure Required Content

Citation Violation: Section 1026.19(f)(1) of Regulation Z states, in part, "Mortgage loans secured by real property—final disclosures— (1) Provision of disclosures—(i) Scope. In a closed-end consumer credit transaction secured by real property, other than a reverse mortgage subject to §1026.33, the creditor shall provide the consumer with the disclosures in §1026.38 reflecting the actual terms of the transaction."

Section 1026.38 of Regulation Z states, in part, "Content of disclosures for certain mortgage transactions (Closing Disclosure). For each transaction, the creditor shall disclose the information required, including closing cost details and other costs.

Examination Findings: Required information on the Closing Disclosure was either incomplete or disclosed incorrectly.

The closing cost details, and other costs must include columns stating whether the charge is borrower paid at or before closing, seller paid at or before closing, or paid by other. All costs must be disclosed. The table must contain the items and amounts listed under five subheadings.

Under the subheading 'Prepaids' and in the applicable column is an itemization of each amount for charges, the name of the person ultimately receiving the payment or government entity assessing the property tax, and the total of all such itemized amounts that are designated borrower-paid at or before closing.

Prepaid items required to be disclosed include the interest due at consummation for the period of time before interest begins to accrue for the first scheduled periodic payment and certain periodic charges that are required by the creditor to be paid at consummation. Each periodic charge listed as a prepaid item indicates, as applicable, the time period that the charge will cover, the daily amount, the percentage rate of interest used to calculate the charge, and the total dollar amount of the charge.

Examples of periodic charges that are disclosed include i. Real estate property taxes due within 60 days after consummation of the transaction: ii. Past-due real estate property taxes; iii. Mortgage insurance premiums; iv. Flood insurance premiums; and v. Homeowner's insurance premiums.

Initial escrow payment at closing must also be disclosed. Under the subheading 'Initial escrow payment at closing' and in the applicable column, an itemization of each amount for charges, the applicable aggregate adjustment along with the label ‘aggregate adjustment,’ and the total of all such itemized amounts that are designated borrower-paid at or before closing should be included. Borrower prepaids should be itemized and totaled, in the aggregate adjustment.

Under the subheading ‘Other’ and in the applicable column, an itemization of each amount for charges in connection with the transaction that is in addition to the charges already disclosed for services that are required or obtained in the real estate closing by the consumer, the seller, or other parties, the name of the person ultimately receiving the payment, and the total of all such itemized amounts that are designated borrower-paid at or before closing.

Real Life Story of “Other”

One of our instructors, David Luna, had a situation on a loan where the appraiser went out and opened the back door to find that there was a really long drop to the ground, no deck, and no steps. The appraiser notes this in the appraisal. The underwriter reviewed the appraisal and determined that the borrower needed to put in two steps. So, David along with the real estate agent went out to the borrower’s house, created a concrete form, and poured two new steps. They wanted the loan to close on time, and it did, but the money for the steps went into “Other”.

Other examples of “Other” costs can include other repairs like, for example, an appraiser notates that there are electrical wires hanging out of the wall. Can you just wire-nut them all together and push them into the wall? Does an electrician need to come out? What are the wires for? Other might be an electrician coming out and assessing and repairing the issue. Those costs would go in “Other”. For any cost that is a component of title insurance services, the introductory description ‘Title —' must appear at the beginning of the label for that actual cost. The parenthetical description ‘(optional)’ should appear at the end of the label for costs designated borrower-paid at or before closing for any premiums paid for separate insurance, warranty, guarantee, or event-coverage products.

Other disclosures belong under the heading ‘Other Disclosures’.

Liability after foreclosure (Deficiency Judgement). A brief statement of whether, and the conditions under which, the consumer may remain responsible for any deficiency after foreclosure under applicable State law, a brief statement that certain protections may be lost if the consumer refinances or incurs additional debt on the property, and a statement that the consumer should consult an attorney for additional information, under the subheading ‘Liability after Foreclosure’.

Comment 38(p)(3)-1 of the Official Interpretations of Regulation Z states:

Liability after foreclosure state law requirements: if the creditor forecloses on the property and the proceeds of the foreclosure sale are less than the unpaid balance on the loan, whether the consumer has continued or additional responsibility for the loan balance after foreclosure, and the conditions under which liability occurs, will vary by state. If the applicable State law affords any type of protection, other than a statute of limitations that only limits the timeframe in which a creditor may seek redress, §1026.38(p)(3) requires a statement that state law may protect the consumer from liability for the unpaid balance.

Findings: Closing Disclosure Content

Citation Violation: 12 C.F.R. § 1026.38(f)(2) states, for mortgage transactions subject to 12 C.F.R. § 1026.19(f), the creditor must utilize the Closing Disclosure (CD) form to disclose an itemization of the services and corresponding costs for each of the settlement services required by the creditor for which the consumer did not shop.

Additionally, 12 C.F.R. § 1026.19(f)(2)(i) states, the amount imposed upon the consumer for any settlement service cannot exceed the amount received by the settlement service provider for that service.

Examination Findings: Failed to provide consumers with CDs that contained accurate information.

There are three fee tolerance buckets under TRID:

1. Zero tolerance fees
2. 10% cumulative tolerance fees
3. No-tolerance fees

Why do we have these zero tolerance fees? Because the borrower can't shop. Well, why can't they shop? Because the lender controls them. The 10% cumulative tolerance fees are a group of fees that cumulatively cannot go up by more than 10%. Most of these fees are disclosed in Section C of the Loan Estimate. If a borrower selects someone who is on the lender's service provider list, that fee now falls into the 10% cumulative-fee tolerance. Suppose any amount paid by the consumer at closing exceeds the amount disclosed by more than the applicable tolerance threshold. In that case, the lender is responsible for refunding the excess to the consumer no later than 60 calendar days after consummation. Although an individual fee in the 10% category may increase significantly, the focus isn't on the individual fee line item, it is on the cumulative effect total. No tolerance equals no worries – this fee can go up as much as it wants because it is not in the control of the mortgage company.

Violation #9 & #10–ECOA - 12 C.F.R. §1002.9(a)(1) and (c)(1)(i)(ii)(2)

Findings: Notice of Action Taken

Citation Violation: 12 C.F.R. § 1002.9(a)(1) requires a creditor to notify the applicant of the action taken within 30 days after receiving a completed application concerning the creditor's approval of, counteroffer to, or adverse action on the application. Additionally, 12 CFR § 1002.9(c)(1)(i)(ii)(2) states, within 30 days after receiving an application that is incomplete regarding matters that an applicant can complete, the creditor will notify the applicant either: Of action taken, in accordance with paragraph (a) of this section; or of the incompleteness, in accordance with paragraph (c)(2) of this section.

Examination Findings: A notice of approval, notice of adverse action, or a notice of incompleteness within 30 days of receiving the application was not provided to consumers. Notice of incompleteness. If additional information is needed from an applicant, the creditor will send a written notice to the applicant specifying the information needed, designating a reasonable period for the applicant to provide the information, and informing the applicant that failure to provide the information requested will result in no further consideration being given to the application. The creditor will have no further obligation under this section if the applicant fails to respond within the designated time. If the applicant supplies the requested information within the designated time, the creditor will take action on the application and notify the applicant in accordance with paragraph (a) of this section.

Findings: Failed to Timely Provide Adverse Action Letter

Citation Violation: Regulation B, 12 CFR, section 1002.9(a)(1) requires that once a creditor has obtained all the information it considers in making a credit decision and the application is complete, the creditor has 30 days to notify applicants of credit decisions in writing. Loan files reviewed contained Notice of Adverse Action letters that were not provided to borrowers within 30 days after receiving a completed application or taking an adverse action on the loan.

Examination Findings: The Notice of Adverse Action was not provided within 30 days of receiving a complete application.

Mortgage companies must notify the applicant of adverse action within:

- 30 days after receiving a complete credit application
- 30 days after receiving an incomplete credit application
- 30 days after taking action on an existing credit account
- 90 days after making a counteroffer to an application for credit if the applicant does not accept the counteroffer

The mortgage company can fail to identify an application as incomplete and, as such, fail to meet notice content and timing requirements. What is an incomplete application and how does a mortgage professional know if they have an incomplete application? ECOA doesn't directly define an incomplete application but defines a complete application as an application where the mortgage company has received all the information that they regularly obtain and consider in evaluating applications for the amount and type of credit requested. Ask the question: do you have enough information to make a credit decision? If the answer is yes, then you have a complete application, if you answer no, then you have an incomplete application.

Do brokers make credit decisions? YES. Let's talk about an example: I am a homeless person, and I come into the office, and I would like you to get a house. Have you ever made a credit decision in your mind? They have no income and no money. They even tell you that their credit is bad. Do you have enough information to make a credit decision? Yes, then you need to send out an adverse action.

Looking at the definition of a complete application, there are generally two types of incomplete applications. The first is when the applicant has not provided all the information that the mortgage company needs to underwrite the loan. The missing information could be information on their application, like the Social Security number to obtain a credit report. Another reason an application could be considered incomplete is if the mortgage company is still waiting on information from the applicant to make a final credit decision.

Once a completed application is received, Regulation B has a "clock" that starts when the mortgage professional must then notify the applicant of a credit decision within 30 days of the completed application. Sometimes a mortgage company will give a conditional approval to the applicant. This satisfies the 30-day clock under Regulation B. The conditional approval, however, requires verification of the information used in the initial approval. If a borrower does not cooperate and provide the mortgage company with the verification information needed to give the final approval, the mortgage company still has an *incomplete* application under Regulation B.

A mortgage company has two options after receiving an incomplete application. It can:

- Take action on the application and notify the applicant according to Regulation B's standard notice requirements
- Refrain from taking action and notify the applicant that the application is incomplete.

If the mortgage company provides a notice of incompleteness, the notice must:

- Be in writing,
- Detail the information needed to complete the application,
- Provide a reasonable deadline, and
- State that the application will not be reviewed if the information is not received.

Regardless of which notice is provided, the notice must be provided within 30 days.

Regulation B adverse action errors involving content typically relate to the statement of specific reasons for the action taken. The regulation requires the statement to be specific and indicate the principal reason(s) for taking adverse action. Creditors should disclose up to four principal reasons; disclosure of more than four reasons is unlikely to be helpful to the applicant. Violations often involve inaccurate, ambiguous, or confusing statements of the principal reasons.

The notice provided should include the following disclosures:

- The creditor's name and address
- An ECOA antidiscrimination notice substantially similar to the one in 12 C.F.R. §1002.9(b) (1)
- The name and address of the creditor's primary regulator
- A statement of the action taken by the creditor
- Either a statement of the specific reasons for the action taken or a disclosure of the applicant's right to a statement of specific reasons and the name, address and telephone number of the person or office from which this information can be obtained.

Consumer Compliance Outlook: Adverse Action Notice Requirements Under the ECOA and the FCRA; ECOA

Chapter 1 Review

Now that you've completed Chapter 1, let's do a short review. In this chapter, we discussed ten violations that the MMC is regularly seeing. This chapter was all about bringing to your attention the violations that are occurring regularly so that you can keep an eye out for them. Here are a few key reminders about what we discussed in this chapter:

- Keep an eye on the late payment percentage on the Loan Estimate for VA and FHA loans!
    - Late payment percentage is 4% versus 5%!
- When reviewing the Closing Disclosure, be sure to verify that everything is disclosed and if you see something strange, speak up!
- Be sure to accurately describe applications as complete or incomplete and be aware of how adverse actions should be taken care of if the application is incomplete!
- Never pad or charge excessive fees; it is a major violation!

Chapter 2

Cybersecurity & Fraud

Learning Objectives for Chapter 2

- ☐ Describe the purpose and requirements under GLBA
- ☐ Understand what is considered Nonpublic Personal Information
- ☐ Relate what mortgage professionals can do to protect their borrower's information
- ☐ Redefine the terms Internet of Things, Deepfakes & Ransomware
- ☐ Identify the pieces of the Bank Secrecy Act / Anti-Money Laundering
- ☐ Evaluate how cryptocurrency and blockchain affects the mortgage industry

Gramm Leach Bliley Act

The Gramm-Leach-Bliley Act (GLB Act or GLBA), also known as the Financial Modernization Act of 1999, is a federal law that controls the way mortgage companies and professionals handle the nonpublic personal information obtained from their borrowers and applicants.

GLBA has three sections:

1. The Financial Privacy Rule: This section regulates the collection and disclosure of private financial information.
2. The Safeguards Rule: This section stipulates that financial institutions must implement security programs to protect such information.
3. The Pretexting provisions: This section prohibits the practice of pretexting.

Pretexting is defined as accessing private information using false pretenses.

GLBA also requires financial institutions to give customers written privacy policy notices that explain their information-sharing practices.

GLBA states that financial institutions, like mortgage companies, have an obligation to respect their customers' privacy and securely protect their sensitive personal information against unauthorized access.

GLBA

Nonpublic Personal Information

In part, GLBA's requirements exist to decrease the likelihood that a mortgage company will have a data breach and face the resulting fallout, including significant financial and legal penalties and damage to its reputation. Before we dive into the Safeguards Rule, let's talk about nonpublic personal information and what is included in that definition. Nonpublic personal information (NPI or NPPI) is defined as any information that is not publicly available and that:

- A consumer provides to a financial institution to obtain a financial product or service from the institution.
- Results from a transaction between the consumer and the institution involving a financial product or service; or
- A financial institution otherwise obtains about a consumer in connection with providing a financial product or service.

Information is publicly available if the mortgage company has a reasonable basis to believe that the information is lawfully made available to the general public from government records, widely distributed media, or legally required disclosures to the general public. Examples include information in a telephone book or a publicly recorded document, such as a mortgage or security interest filing.

Nonpublic personal information may include individual items of information as well as lists of information. For example, nonpublic personal information may include names, addresses, phone numbers, Social Security numbers, income, credit score, and information obtained through Internet collection devices (i.e., cookies).

GLBA

Biometric Data

According to the Department of Homeland Security, biometrics are “unique physical characteristics, such as fingerprints, that can be used for automated recognition.” Biometric data is not expressly called nonpublic personal information under GLBA, but because the definition is so expansive, it would generally include biometric data. For some states, that’s not enough. In 2022, many states have tried to or have passed privacy laws specific to biometric data. Most of these laws were based on the Illinois Biometric Information Privacy Act or BIPA. A few other states already have biometric privacy laws. Still, BIPA is different because it provides a private right of action where the information was involved in unauthorized exposure. The business failed to implement and maintain reasonable security procedures, they also failed to take specific steps after receiving a consumer complaint. Keep an eye out in your state!

How does biometric data even fit into the mortgage industry? Remote Online Notarization is just the first step. What is Remote Online Notarization, or RON? With remote notarization, a signer (your borrower!) personally appears before the Notary at the time of the notarization using audio-visual technology (think Google Meet or Zoom) instead of being physically present in the same room. Remote online notarization is also called webcam notarization, online notarization, or virtual notarization. Each state has its own RON requirements, so be aware of that the process we will describe might be different depending upon the state; currently, 43 states have passed remote notarization laws:

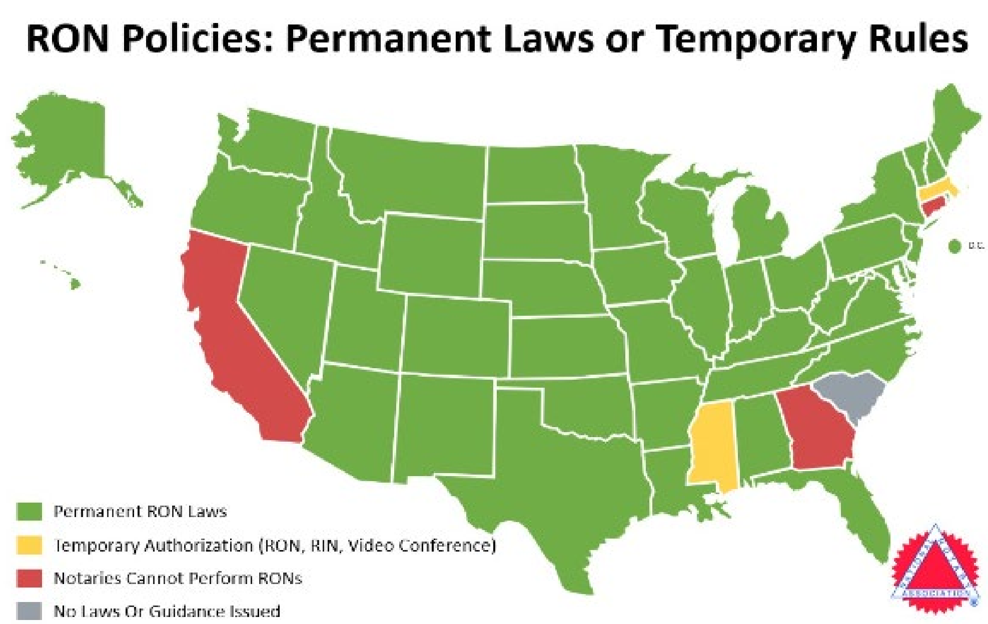


Figure credit: [National Notary Association: Remote Notarization: What You Need to Know]

So how does a RON work? Our friends at the National Notary Association provide a great step by step on how a RON works.

1. The signer contacts the Notary or a RON service provider to request a remote online notarization.
2. The signer's document is sent to the Notary so it can be signed and notarized. Typically, the document is uploaded in an electronic format such as PDF to the online technology platform used to perform the notarization.
3. The signer's identity is screened according to the requirements of the Notary's commissioning state. This may include answering questions based on the signer's personal and credit history (KBA), verifying the signer's identification documents online (credential analysis), the Notary remotely viewing the signer's ID during the notarization, or other RON identification methods set by statute.
4. During the remote online notarization, the Notary and the signer communicate online using audiovisual technology — for example, via webcam. The Notary and signer do not meet face to face.
5. Once the signer's identity has been verified and all other requirements for the notarization have been completed, both the signer and the Notary must sign the document and the Notary's seal attached. For electronic documents, this requires electronic signatures and an electronic version of the Notary's seal.
6. The Notary records any required information for the Notary's journal records. The Notary must typically also retain an audio and video recording of the notarization session.
7. The remotely notarized document is returned to the signer.

So, what does all of this have to do with biometrics? Things like knowledge-based authentication (KBA) can be easily faked or guessed. Identifications can also be forged or faked. Biometrics are much harder to steal and forge, though not impossible. Since KBAs and other forms of identification can be faked – that can open the door to fraudulent transactions.

From our friends at HousingWire:

Solving for Fraud, Biometrics are the Future of Mortgages

"Mission Impossible aside, there are aspects of each person that simply cannot be duplicated, at least not well enough to fool today's modern authentication technologies. Facial recognition technology, for instance, has now advanced to the point that not only can the system determine whether the face on the screen belongs to the person who must electronically sign the document, but it can actually tell if the image on the screen is alive or a photograph.

This is an order of magnitude more effective than the best KBA process currently available. In fact, trying to stay ahead of fraudsters using public information will never work. Frankly, it's a wonder it was ever adopted in the first place.

With modern biometric technology, anyone with a smartphone, tablet or desktop computer can look into a webcam and a lender on the other side of the country can know in an instant whether the person on screen is the actual person they intend to do business with.

This changes everything and makes it possible for the industry to move as quickly as we want without the fear of falling. Anything less will trip us up, cost us more money and alienate everyone we hope to partner with or serve."

Department of Homeland Security: Biometrics; BIPA; HousingWire: Solving for fraud, biometrics are the future of mortgage (used with permission). National Notary Association: Remote Notarization vs. Traditional Notarization; National Notary Association: Remote Notarization: What You Need to Know; National Notary Association: How to Perform a RON

Safeguards Rule

The Federal Trade Commissions (FTC) Standards for Safeguarding Customer Information, also known as the Safeguards Rule, is in place to ensure that mortgage companies, and other financial institutions, maintain safeguards to protect the security of customer information. This Rule was originally passed in 2003, but after public comment, the FTC amended the Safeguards Rule in 2021 to make sure that the Rule "keeps pace with current technology."

The key changes to the Safeguards Rule were:

- Risk assessment and safeguards. The final rule requires a risk assessment to be in writing and adds specific criteria that must be included in an assessment. It also adds:
    - Requirements for what must be addressed by the safeguards an institution must design and implement to control the risks identified through a risk assessment, and
    - Mechanisms intended to ensure the effectiveness of employee training and service provider oversight.

- The final rule requires the designation of a single "Qualified Individual" who is responsible for overseeing and implementing an institution's information security program and enforcing the program.
    - It also requires the Qualified Individual to provide written reports on the information security program at least annually to the institution's board of directors or equivalent governing body.
- Small Business Exemption. The final rule exempts financial institutions that collect information on fewer than 5,000 consumers from the requirements of a written risk assessment, incident response plan, and annual reporting to the board of directors.
- Expanded Definition of "Financial Institution." The final rule amends the definition of "financial institution" to include entities that are "significantly engaged in activities that are incidental to financial activities." This change means that lenders will be considered financial institutions covered by the Safeguards Rule.

In addition to these changes in 2021, the Federal Trade Commission is seeking comment

> "on whether to make an additional change to the Safeguards Rule to require financial institutions to report certain data breaches and other security events to the Commission"

The Federal Trade Commission also issued a proposal at the same time as they implemented the updated Safeguards Rule that would require covered financial institutions to notify the FTC within 30 days after discovering a data breach affecting or reasonably likely to affect at least 1,000 consumers.

FTC Safeguards Rule: What Your Business Needs to Know

Security Breach Disclosure Requirements

In 2022, many new federal cybersecurity incident reporting requirements and proposals that impact privacy entities in the financial sector were implemented. These reporting requirements are in addition to new standards under the Safeguards Rule for their compliance plans.

In March of 2022, the new Cyber Incident Reporting for Critical Infrastructure Act (CIRCIA), requires entities in a critical infrastructure sector (which can include financial institutions) to report to the Cybersecurity and Infrastructure Security Agency (CISA) certain cyber incidents within 72 hours and ransomware payments within 24 hours of the payment. Whether mortgage companies will be required to follow CIRCIA will be determined through the rulemaking authority given to CISA by the CIRCIA, so stay tuned.

The Securities and Exchange Commission (SEC) also recently published several proposed rules that would require various regulated entities to disclose certain cybersecurity related incidents.

Consumer Finance Monitor: Financial Institutions Face Increasingly Stringent Federal Breach Reporting Requirements (used with permission); U.S. Cybersecurity and Infrastructure Security Agency (CISA)

Financial Privacy or Opt-Out Rule

The Financial Privacy or Opt-Out Rule is the second arm of GLBA and requires that:

“Financial institutions give their customers - and in some cases their consumers - a "clear and conspicuous" written notice describing their privacy policies and practices. When you provide the notice and what you say depend on what you do with the information.”

Each company must put their borrowers in a box; are they a consumer or are they a customer? Depending on which box they are in, the mortgage company may or may not have to give them a privacy notice.

Under the Rule, a "consumer" is someone who obtains or has obtained a financial product or service from a financial institution that is to be used primarily for personal, family, or household purposes, or that person's legal representative. The term "consumer" does not apply to commercial clients, like sole proprietorships. Therefore, if your client is not an individual, or is an individual seeking your product or service for a business purpose, the Privacy Rule does not apply to you.

Examples of "consumer" relationships:

- Cashing a check with a check-cashing company
- Making a wire transfer
- Applying for a loan, whether or not the loan is actually obtained

"Customers" are a subclass of consumers who have a continuing relationship with a financial institution. It's the nature of the relationship - not how long it lasts - that defines customers. Even if an individual repeatedly uses your services for unrelated transactions, she may not be your "customer." For example, if an individual uses the ATM at a bank where she does not have an account, those isolated transactions, no matter how frequent, do not make her that bank's customer. She would still be a "consumer" of that bank, however.

A former customer "has obtained" a financial product or service from a financial institution but no longer has a continuing relationship with it. For purposes of your obligations under the Privacy Rule, a former customer is considered to be a consumer.

Examples of "customer" relationships:

- Opening a credit card account with a financial institution
- Leasing an automobile from an auto dealer
- Using the services of a mortgage broker to secure financing
- Obtaining the services of a tax preparer or investment adviser
- Getting a loan from a mortgage lender or payday lender

Regardless of whether your company shares customer NPI, they must give all their customers a privacy notice. They must provide an "initial notice" by the time the customer relationship is established. If this would substantially delay the customer's transaction, the mortgage company may provide the notice within a reasonable time after the customer relationship is established, but only if the customer agrees.

If the mortgage company shares NPI with **nonaffiliated third parties** outside of the exceptions, the mortgage company also must give their customers:

- An "opt-out" notice explaining the individual's right to direct the mortgage company not to share their NPI with a nonaffiliated third party
- A reasonable way to opt out
- A reasonable amount of time to opt out before the company discloses their NPI.

The mortgage company must also give their customers an "annual notice" - a copy of their full privacy notice - for as long as the customer relationship lasts.

Before a mortgage company shares NPI with nonaffiliated third parties, they must give their non-customer consumers a privacy notice, including an opt-out notice. If they don't share information with nonaffiliated third parties, or if the mortgage company only shares within the exceptions, they do not have to give a privacy notice to their consumers.

If the mortgage company is required to provide a privacy notice to their consumers, they may choose to give them a "short-form notice" instead of a full privacy notice. The short-form notice must:

- Explain that the mortgage companies' full privacy notice is available on request
- Describe a reasonable way consumers may get the full privacy notice
- Include an opt-out notice.

Type of Notice	To Whom	When	Contents
Initial	Customers	Not later than when you establish the customer relationship, unless it would substantially delay the transaction and the customer agrees	Description of information-collection and sharing practices, and opt-out notice (if you share NPI with nonaffiliated third parties outside of certain exceptions)
	Consumers who are not customers (including former customers)	Before you disclose their NPI to a nonaffiliated third party outside of certain exceptions	Full description of information-collection and sharing practices or "short-form" notice, along with opt-out notice
Annual	Customers	Delivery on a consistent basis at least once in any period of 12 consecutive months for the duration of the customer relationship	Description of information-collection and sharing practices, and opt-out notice (if you share NPI with nonaffiliated third parties outside of certain exceptions)

There is some information sharing that is exempt from the privacy notice requirements. If your company shares information only under these sets of exceptions, they don't need to give their consumers a privacy notice, but they will need to give their customers a simplified initial and, if applicable, an annual privacy notice. Customers and consumers have no right to opt out of these disclosures of NPI.

"The section 14 exceptions apply to various types of information-sharing that are necessary for processing or administering a financial transaction requested or authorized by a consumer. This includes, for example, disclosing NPI to service providers who help mail account statements and perform other administrative activities for a consumer's account. It also includes disclosures to and by creditors listed by a consumer on a credit application to perform a credit check.

The section 15 exceptions apply to certain types of information-sharing, including disclosures for purposes of preventing fraud, responding to judicial process or a subpoena, or complying with federal, state, or local laws. Examples of appropriate information disclosures under this exception include those made to technical service providers who maintain the security of your records; your attorneys or auditors; a purchaser of a portfolio of consumer loans you own; and a consumer reporting agency, consistent with the Fair Credit Reporting Act

If you share information under this exception, you must give your customers - and your consumers if you share their information - a privacy notice that describes this disclosure. However, your consumers and customers do not have a right to opt out of this information sharing.

The section 13 exception covers disclosures for certain service providers and for certain marketing activities. The section 13 exception covers disclosures to third party service providers whose services for you do not fall within the section 14 exceptions. For example, if you hire a nonaffiliated third party to provide services in connection with marketing your products or to market financial products jointly for you and another financial institution, or to do a general analysis of your customer transactions, your disclosure of NPI for these purposes does not fall under the section 14 exceptions. Therefore, you can use the section 13 exception for these types of service providers.

The section 13 exception also applies to marketing financial products or services offered through a "joint agreement" with one or more other financial institutions. The "joint agreement" requirement means that you have entered into a written contract with one or more financial institutions about your joint offering, endorsement, or sponsorship of a financial product or service. This does not apply to any kind of joint marketing you do, but only joint marketing with other financial institutions and only the marketing of financial products or services."

[FTC: How To Comply with the Privacy of Consumer Financial Information Rule of the Gramm-Leach Bliley Act]

The Pretexting Rule

The last arm of GLBA is often called the pretexting rule. It is prohibited under GLBA for any person to obtain or attempt to obtain, or cause to be disclosed or attempt to cause to be disclosed to any person, customer information of a financial institution relating to another person:

1. By making a false, fictitious, or fraudulent statement or representation to an officer, employee, or agent of a financial institution.
2. By making a false, fictitious, or fraudulent statement or representation to a customer of a financial institution.
3. By providing any document to an officer, employee, or agent of a financial institution, knowing that the document is forged, counterfeit, lost, or stolen, was fraudulently obtained or contains a false, fictitious, or fraudulent statement or representation.

15 U.S. Code Section 6281

Cybersecurity Threats & Trends in The Mortgage Industry

Cybersecurity threats are always changing. It's the nature of the beast as technology gets more complex and financial technology companies (fintech) bring new technologies to the market to improve efficiencies and processes for the mortgage industry. With these increases in the use of technology in the mortgage industry, there is an increase of potential threats to borrowers' nonpublic personal information. While this section is not an exhaustive list of the things that could impact your business, it will shed light into some of the more prevalent concerns. It is worth your time to research more and make sure that you are doing everything in your power to protect your borrower's information from potential cyberthreats.

Per the Cybersecurity & Infrastructure Security Agency (CISA):

> **Cybersecurity** is the art of protecting networks, devices, and data from unauthorized access or criminal use and the practice of ensuring confidentiality, integrity, and availability of information.

We all rely tremendously on computers and the internet; communication via e-mail, smartphones, tablets, providing disclosures, moving files through the loan process, and transferring information to third parties, and so much more.

How much of our daily lives revolve around technology? How much of your borrower's personal information is stored either on a computer, smartphone, tablet or on someone else's system?

Per CISA:

> There are huge risks to having poor cybersecurity; some are more serious than others. Among these dangers are malware erasing your entire system, an attacker breaking into your system and altering files, using your computer to attack others, or stealing your credit card information and making unauthorized purchases. Even with the best precautions, there is no guarantee that some of these things won't happen to you, but there are steps you can take to minimize the chances.

CISA Security Tip (ST04-001)

Internet of Things (IoT)

The Internet of Things refers to any object or device that sends and receives data automatically through the Internet. This rapidly expanding set of "things" includes tags (also known as labels or chips that automatically track objects), sensors, and devices that interact with people and share information machine to machine.

Examples devices included in the term Internet of Things:

- Smartphones
- Computers
- Printers
- Cameras
- Tablet
- Smart doorbells
- Routers
- Smartwatches
- Smart lights
- Smart locks
- Alarms
- Water Sensors
- Smart Thermostats
- Servers

Though many security and resilience risks are not new, the scale of interconnectedness created by the Internet of Things increases the consequences of known risks and creates new ones. Attackers take advantage of this scale to infect large segments of devices at a time, allowing them access to the data on those devices or to, as part of a botnet, attack other computers or devices for malicious intent.

Many of the cyberattacks happening are taking advantage of the IoT by using things like denial-of-service attacks (DoS), ransomware and malware to bring down the IoT and obtain sensitive information. The mortgage industry has not been spared from these types of attacks.

How Do I Improve the Security of Internet-Enabled Devices?

CISA published a list of things that can help protect your IoT devices from being vulnerable to cyberattack. Let's take a look at that article:

> Without a doubt, the Internet of Things makes our lives easier and has many benefits; but we can only reap these benefits if our Internet-enabled devices are secure and trusted. The following are important steps you should consider to make your Internet of Things more secure.
>
> Evaluate your security settings. Most devices offer a variety of features that you can tailor to meet your needs and requirements. Enabling certain features to increase convenience or functionality may leave you more vulnerable to being attacked. It is important to examine the settings, particularly security settings, and select options that meet your needs without putting you at increased risk. If you install a patch or a new version of software, or if you become aware of something that might affect your device, reevaluate your settings to make sure they are still appropriate.
>
> Ensure you have up-to-date software. When manufacturers become aware of vulnerabilities in their products, they often issue patches to fix the problem. Patches are software updates that fix a particular issue or vulnerability within your device's software. Make sure to apply relevant patches as soon as possible to protect your devices.
>
> Connect carefully. Once your device is connected to the Internet, it's also connected to millions of other computers, which could allow attackers access to your device. Consider whether continuous connectivity to the Internet is needed.
>
> Use strong passwords. Passwords are a common form of authentication and are often the only barrier between you and your personal information. Some Internet-enabled devices are configured with default

passwords to simplify setup. These default passwords are easily found online, so they don't provide any protection. Choose strong passwords to help secure your device.

Per the Federal Bureau of Investigation (FBI), Cyber actors are using compromised IoT devices as proxies to:

- Send spam e-mails
- Maintain anonymity
- Obfuscate network traffic
- Mask Internet browsing
- Generate click-fraud activities
- Buy, sell, and trade illegal images and goods
- Conduct credential stuffing attacks, which occurs when cyber actors use an automated script to test stolen passwords from other data breach incidents on unrelated web-sites
- Sell or lease IoT botnets to other cyber actors for financial gain.

Cyber actors typically compromise devices with weak authentication, unpatched firmware or other software vulnerabilities, or employ brute force attacks on devices with default usernames and passwords,

CISA Security Tip (ST17-001); Department of Homeland Security: Strategic Principles for Securing the Internet of Things; FBI: Cyber Actors Use Internet of Things Devices as Proxies for Anonymity and Pursuit of Malicious Cyber Activities

Ransomware

Ransomware attacks are on the rise. There are often reports on the nightly news highlighting a new attack that has brought down some system. Along with everything from airports to hospitals, financial institutions like mortgage companies are not immune from being targets for cyberattacks.

What is ransomware? Per CISA: Ransomware is an ever-evolving form of malware designed to encrypt files on a device, rendering any files and the systems that rely on them unusable. Malicious actors then demand ransom in exchange for decryption. Ransomware actors often target and threaten to sell or leak exfiltrated data or authentication information if the ransom is not paid. In recent years, ransomware incidents have become increasingly prevalent among the Nation’s state, local, tribal, and territorial (SLTT) government entities and critical infrastructure organizations.

According to CISA, cybercriminals use a variety of techniques to infect victims with ransomware, the most common means of infection are:

- Email phishing campaigns
- Remote Desktop Protocol (RDP)
- Software vulnerabilities

> Ransomware can be devastating to an individual or an organization. Some victims pay to recover their files, but there is no guarantee that they will recover their files if they do. Recovery can be a difficult process that may require the services of a reputable data recovery specialist.
>
> Ransomware incidents can severely impact business processes and leave organizations without the data they need to operate and deliver mission-critical services. The monetary value of ransom demands has increased, with some demands exceeding $1 million. Ransomware incidents have become more destructive and impactful in nature and scope. The economic and reputational impacts of ransomware incidents, throughout the initial disruption and, at times, extended recovery, have also proven challenging for organizations large and small.

Since most of you are not IT professionals, we are going to talk specifically about phishing campaigns, because you, as a mortgage professional can be targeted by these malicious actors, and you could unknowingly put your company and your borrower's information at risk simply by clicking on the wrong e-mail.

Phishing is a type of social engineering attack. Social engineers use human interaction to obtain or compromise information about an organization or its computer systems. Pretexting, which we talked about earlier, is also a form of social engineering attack.

Per CISA:

> Phishing is a form of social engineering. Phishing attacks use email or malicious websites to solicit personal information by posing as a trustworthy organization. For example, an attacker may send email seemingly from a reputable credit card company or financial institution that requests account information, often suggesting that there is a problem. When users respond with the requested information, attackers can use it to gain access to the accounts.

Phishing attacks may also appear to come from other types of organizations, such as charities. Attackers often take advantage of current events and certain times of the year, such as

- Natural disasters (e.g., Hurricane Katrina, Indonesian tsunami)
- Epidemics and health scares (e.g., H1N1, COVID-19)
- Economic concerns (e.g., IRS scams)
- Major political elections
- Holidays

Like we said, as technology advances and our reliance on different types of technology occurs, cyber criminals, change their tactics. They also may use vishing and smishing. CISA states:

> Vishing is the social engineering approach that leverages voice communication. This technique can be combined with other forms of social engineering that entice a victim to call a certain number and divulge sensitive information. Advanced vishing attacks can take place completely over voice communications by exploiting Voice over Internet Protocol (VoIP) solutions and broadcasting services. VoIP easily allows caller identity (ID) to be spoofed, which can take advantage of the public's misplaced trust in the security of phone services, especially landline services. Landline communication cannot be intercepted without physical access to the line; however, this trait is not beneficial when communicating directly with a malicious actor.
>
> Smishing is a form of social engineering that exploits SMS, or text, messages. Text messages can contain links to such things as webpages, email addresses or phone numbers that when clicked may automatically open a browser window or email message or dial a number.
>
> This integration of email, voice, text message, and web browser functionality increases the likelihood that users will fall victim to engineered malicious activity.

What are Common Indicators of Phishing Attempts?

- Suspicious sender's address. The sender's address may imitate a legitimate business. Cybercriminals often use an email address that closely resembles one from a reputable company by altering or omitting a few characters.
- Generic greetings and signature. Both a generic greeting—such as "Dear Valued Customer" or "Sir/Ma'am"—and a lack of contact information in the signature block are strong indicators of a phishing email. A trusted organization will normally address you by name and provide their contact information.
- Spoofed hyperlinks and websites. If you hover your cursor over any links in the body of the email, and the links do not match the text that appears when hovering over them, the link may be spoofed. Malicious websites may look identical to a legitimate site, but the URL may use a variation in spelling or a different domain (e.g., .com vs. .net). Additionally, cybercriminals may use a URL shortening service to hide the true destination of the link.
- Spelling and layout. Poor grammar and sentence structure, misspellings, and inconsistent formatting are other indicators of a possible phishing attempt. Reputable institutions have dedicated personnel that produce, verify, and proofread customer correspondence.
- Suspicious attachments. An unsolicited email requesting a user download and open an attachment is a common delivery mechanism for malware. A cybercriminal may use a false sense of urgency or importance to help persuade a user to download or open an attachment without examining it first.

How Do You Avoid Being a Victim?

- Be suspicious of unsolicited phone calls, visits, or email messages from individuals asking about employees or other internal information. If an unknown individual claims to be from a legitimate organization, try to verify his or her identity directly with the company.
- Do not provide personal information or information about your organization, including its structure or networks, unless you are certain of a person's authority to have the information.
- Do not reveal personal or financial information in email, and do not respond to email solicitations for this information. This includes following links sent in email.
- Don't send sensitive information over the internet before checking a website's security.
    - Pay attention to the Uniform Resource Locator (URL) of a website. Look for URLs that begin with "https"—an indication that sites are secure—rather than "http."
    - Look for a closed padlock icon—a sign your information will be encrypted.

- If you are unsure whether an email request is legitimate, try to verify it by contacting the company directly. Do not use contact information provided on a website connected to the request; instead, check previous statements for contact information. Information about known phishing attacks is also available online from groups such as the Anti-Phishing Working Group.
- Install and maintain anti-virus software, firewalls, and email filters to reduce some of this traffic.
- Take advantage of any anti-phishing features offered by your email client and web browser.
- Enforce multi-factor authentication (MFA).

CISA: Ransomware 101; Ransomware: What It is & What To Do About It; CISA: Ransomware FAQs; CISA Security Tip (ST04-14)

Field Trip: Deepfakes

Deepfakes, what are they? According to the Merriam-Webster dictionary, a deepfake is an image or recording that has been convincingly altered and manipulated to misrepresent someone as doing or saying something that was not actually done or said

Deepfakes are being used around the world to literally put words in someone else's mouth. Take a few moments and follow this link and read this article: https://www.forbes.com/sites/jessedamiani/2019/09/03/a-voice-deepfake-was-used-to-scam-a-ceo-out-of-243000/?sh=5e03ef3b2241

Discussion Questions:

- How is this a threat in the mortgage industry?
- What are some examples of ways this technology could be used to harm your borrower?

Deepfake Definition

Bank Secrecy Act and Anti-Money Laundering

The Bank Secrecy Act passed Congress in 1970 and established requirements for recordkeeping and reporting by private individuals, banks, and other financial institutions. The BSA was originally designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the US or deposited in financial institutions. The statute sought to achieve that objective by requiring individuals, banks, and other financial institutions to file currency reports with the U.S. Department of the Treasury (U.S. Treasury), properly identify persons conducting transactions, and maintain a paper trail by keeping appropriate records of financial transactions.

Since then BSA/AML has evolved through multiple new laws being passed, the most significant of which is the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act). According to the FFIEC BSA/AML Examination Manual:

> Title III of the USA PATRIOT Act is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. The USA PATRIOT Act is arguably the single most significant AML law that Congress has enacted since the BSA itself. Among other things, the USA PATRIOT Act criminalized the financing of terrorism and augmented the existing BSA framework by strengthening customer identification procedures; prohibiting financial institutions from engaging in business with foreign shell banks; requiring financial institutions to have due diligence procedures and, in some cases, enhanced due diligence (EDD) procedures for foreign correspondent and private banking accounts; and improving information sharing between financial institutions and the U.S. government.

The USA PATRIOT Act and its implementing regulations also:

- Expanded the AML program requirements to all financial institutions.
- Increased the civil and criminal penalties for money laundering.
- Provided the Secretary of the Treasury with the authority to impose "special measures" on jurisdictions, institutions, or transactions that are of "primary money-laundering concern."
- Facilitated records access and required banks to respond to regulatory requests for information within 120 hours.
- Required federal banking agencies to consider a bank's AML record when reviewing bank mergers, acquisitions, and other applications for business combinations.

Certain government agencies play a critical role in implementing BSA regulations, developing examination guidance, ensuring compliance with the BSA, and enforcing the BSA. These agencies include the U.S. Treasury, FinCEN, and the federal banking agencies (Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), and Office of the Comptroller of the Currency(OCC)). Internationally there are various multilateral government bodies that support the fight against money laundering and terrorist financing.

Let's talk more about what money laundering is. FFIEC states that: **Money laundering** is the criminal practice of processing ill-gotten gains, or "dirty" money, through a series of transactions; in this way the funds are "cleaned" so that they appear to be proceeds from legal activities. Money laundering generally does not involve currency at every stage of the laundering process. Although money laundering is a diverse and often complex process, it basically involves three independent steps that can occur simultaneously:

- Placement. The first and most vulnerable stage of laundering money is placement. The goal is to introduce the unlawful proceeds into the financial system without attracting the attention of financial institutions or law enforcement. Placement techniques include structuring currency deposits in amounts to evade reporting requirements or commingling currency deposits of legal and illegal enterprises. Some examples are dividing large amounts of currency into less-conspicuous smaller sums that are deposited directly into a bank account, depositing a refund check from a canceled vacation package or insurance policy, or purchasing a series of monetary instruments (e.g., cashier's checks or money orders) that are then collected and deposited into accounts at another location or financial institution.
- Layering. The second stage of the money laundering process is layering, which involves moving funds around the financial system, often in a complex series of transactions to create confusion and complicate the paper trail. Examples of layering include exchanging monetary instruments for larger or smaller amounts, or wiring or transferring funds to and through numerous accounts in one or more financial institutions.
- Integration. The ultimate goal of the money laundering process is integration. Once the funds are in the financial system and insulated through the layering stage, the integration stage is used to create the appearance of legality through additional transactions. These transactions further shield the criminal from a recorded connection to the funds by providing a plausible explanation for the source of the funds. Examples include the purchase and resale of real estate, investment securities, foreign trusts, or other assets.

Penalties for money laundering are severe; someone convicted of money laundering can face up to 20 years in prior and a fine up to $500,000. Moreover, there are criminal penalties for willful violations of the BSA and for structuring transactions to evade BSA reporting requirements. For example, a person, including a bank employee, willfully violating the BSA or its implementing regulations is subject to a criminal fine of up to $250,000, five years in prison, or both. A person who commits such a violation while violating another U.S. law, or engaging in a pattern of criminal activity, is subject to a fine of up to $500,000, ten years in prison, or both. A bank that violates certain BSA provisions faces criminal money penalties up to the greater of $1 million or twice the value of the transaction. The federal banking agencies and FinCEN, respectively, can bring civil money penalty actions for violations of the BSA.

Institutions Required to Comply with BSA/AML

Institutions that are required to comply with the BSA/AML include:

- Casinos
- Depository Institutions
- Insurance Industry
- Money Services Businesses
- **Mortgage Companies**
- **Mortgage Brokers**
- Precious Metals/Jewelry Industry
- Securities and Futures

Policies and Procedures Minimum Standards BSA/AML

According to the MMC Mortgage Examination Manual BSA/AML Program Examination Procedures, the BSA/AML policies and procedures must, at a minimum, include the following four "pillars:"

1. Policies, procedures, and internal controls based on an assessment of risks associated with products, services, customer types and geographic locations.
2. Designation of a qualified compliance officer responsible for ensuring day-to-day compliance.
3. Ongoing training of appropriate persons concerning their responsibilities under the program.
4. Independent testing and audit functionality to monitor and maintain an adequate program.

31 CFR § 1029.210

Reporting Requirements BSA/AML

BSA/AML requires reporting activities with specific currency limitations.

- **CTR- Currency Transaction Report** is required when funds are in excess of $10,000 in one business day by a company or individual.
- **MIL-Monetary Instrument Log** is required when case purchases of monetary instruments, money orders, cashier's checks, and traveler's checks are valued between $3,000 to $10,000.

- **SAR-Suspicious Activity Report** is required for any cash transaction in which the consumer is trying to avoid the limits set forth by the CTR. It is also required when the activities seem suspicious and may be money laundering. It also must be filed for an aggregate of more than $5,000.
- **FBAR-Foreign Bank Account Report** is required when a US citizen or resident has a foreign bank account with an aggregate value of $10,000.

SAR Reporting Requirements

Based on the guidance from the MMC examination manual, the mortgage company is required to file a SAR if it knows, suspects, or has reason to suspect a transaction conducted or attempted at the mortgage company:

- Involves funds derived from illegal activity.
- Attempts to disguise funds derived from illegal activity.
- Is designed to evade regulations promulgated under the BSA.
- Lacks a business or apparent lawful purpose.
- Involves the use of the mortgage company to facilitate criminal activity.

The mortgage company must file a SAR if it receives any cash payment of $5,000 or more and suspects illegal activity. For example, if the borrower is unable to verify the source of the cash down payment, the mortgage company is not required to file a CMT because, technically, the company is not a financial institution. However, if the mortgage company received $10,000 or more in cash payments, the mortgage company must file an IRS Form 8300 with both the IRS and FinCEN.

FinCEN has established a BSA Electronic Filing System (E-File). The mortgage company should already be registered in the event that they need to file a SAR. This will be a compliance audit violation, because the mortgage company needs to be able to file a SAR anytime there is any suspicious activity. Make sure to do this now:

- Register with FinCEN through the BSA E-Filing System.
- Identify a Point of Contact that represents the mortgage company and will file reports.

The SAR must be electronically filed through the BSA E-Filing System no later than 30 calendar days from the date of the initial incident when a SAR report was triggered.

When filing a SAR report, no one is permitted to inform the consumer of the filing of the report. All reports and supporting documentation must be kept for five years from the date of the report.

Blockchain & Cryptocurrency

In our 2018 continuing education course, we talked about virtual currency. At the time, FinCEN had issued a Geographic Target Order (GT0) that directly applied to Title Companies for real estate transactions that are conducted in cash, check, funds transfer, virtual currency or other forms of direct payment. At the time, we predicted more would come of this and we were right. In 2018, virtual currency was something new and now it's become mainstream. Before we talk about how this applies to the mortgage industry and money laundering, let's go over some quick definitions.

What is cryptocurrency?

- A cryptocurrency is a form of digital asset based on a network that is distributed across a large number of computers. This decentralized structure allows them to exist outside the control of governments and central authorities.
- Some experts believe that blockchain and related technology will disrupt many industries, including finance and law.
- The advantages of cryptocurrencies include cheaper and faster money transfers and decentralized systems that do not collapse at a single point of failure.
- The disadvantages of cryptocurrencies include their price volatility, high energy consumption for mining activities, and use in criminal activities.

Cryptocurrency can be used for money laundering. Stolen cryptocurrency can also be laundered and cashed out into actual currency. In February 2022, two individuals were arrested for laundering $4.5 billion in stolen cryptocurrency. Per the Department of Justice's press release:

> According to court documents, Lichtenstein and Morgan allegedly conspired to launder the proceeds of 119,754 bitcoin that were stolen from Bitfinex's platform after a hacker breached Bitfinex's systems and initiated more than 2,000 unauthorized transactions. Those unauthorized transactions sent the stolen bitcoin to a digital wallet under Lichtenstein's control. Over the last five years, approximately 25,000 of those stolen bitcoin were transferred out of Lichtenstein's wallet via a complicated money laundering process that ended with some of the stolen funds being deposited into financial accounts controlled by Lichtenstein and Morgan. The remainder of the stolen funds, comprising more than 94,000 bitcoin, remained in the wallet used to receive and store the illegal proceeds from the hack. After the execution of court-authorized search warrants of online accounts controlled by Lichtenstein and Morgan, special agents obtained access to files within an online account controlled by Lichtenstein. Those files contained the private keys required to access the digital wallet that directly

> received the funds stolen from Bitfinex, and allowed special agents to lawfully seize and recover more than 94,000 bitcoin that had been stolen from Bitfinex. The recovered bitcoin was valued at over $3.6 billion at the time of seizure.

These individuals stole cryptocurrency with the intent of swapping it into cold hard cash. You might be wondering what this have to do with the mortgage industry. Can your borrower use cryptocurrency to purchase a home? The short answer: Maybe. The subject of cryptocurrency is still a tangled mess of complicated and contradictory guidance.

On July 18, 2022, the Federal Housing Finance Agency (FHFA) launched a new Office of Financial Technology with the goal of "advancing effective risk management as it evaluates fintech developments in the housing finance space." The FHFA also published a request for information seeking public input on "how to facilitate responsible innovation, identify barriers, or changing to implementing fintech into housing finance, support equity for homeowners and renters and increase efficiency and effectiveness in the compliance and regulatory processes."

In the introduction to the RFI, the FHFA noted President Biden's March 2022 executive order. While the executive order focused on cryptocurrency and digital assets, it also more broadly directed agencies to take concrete steps to study and support technological advances and promote equitable access to safe and affordable financial services.

This points to the possibility that the FHFA is going to get more heavily involved with whether your borrower can use their cryptocurrency to purchase their next home. What about Fannie and Freddie? They have two differing opinions.

In Bulletin 2021-36, Freddie Mac addressed cryptocurrency in the mortgage qualification process. They indicated that they were providing guidance "due to the high level of uncertainty associated with cryptocurrency." In the Bulletin, Freddie Mac outlined updates to their Seller/Servicer Guide, which now includes the following guidance:

- Income paid to the borrower in cryptocurrency may not be used to qualify for the mortgage.
- For income types that require evidence of sufficient remaining assets to establish likely continuance (e.g., retirement account distributions, trust income and dividend and interest income, etc.), those assets may not be in the form of cryptocurrency.
- Cryptocurrency may not be included in the calculation of assets as a basis for repayment of obligations.

- Monthly payments on debts secured by cryptocurrency must be included in the borrower's debt payment-to-income ratio and are not subject to the guide provisions regarding installment debts secured by financial assets.
- Cryptocurrency must be exchanged for U.S. dollars if it will be needed for the mortgage transaction (i.e., any funds required to be paid by the borrower and borrower reserves).

On the other hand, Fannie Mae's Selling Guide states that virtual currency that has been exchanged into U.S. Dollars is acceptable for the down payment, closing costs, and financial reserves provided the following requirements are met:

- There is documented evidence that the virtual currency has been exchanged into U.S. dollars and is held in a U.S. or state regulated financial institution, and
- The funds are verified in U.S. dollars prior to the loan closing.

A large deposit may be from virtual currency that was exchanged into U.S. dollars. The lender must obtain sufficient documentation to verify the funds originated from the borrower's virtual currency account. Virtual currency may not be used for the deposit on the sales contract (earnest money) for the purchase of the subject property.

So, what does this mean for you and your company? This is a new compliance risk! Fannie and Freddie allow it, but do your investors? Do you want to deal with confirming the money was legitimate before it was invested into cryptocurrency and then cashed out? Stay tuned, because we guarantee this will continue to be a hot topic.

DOP: Two Arrested for Alleged Conspiracy to Launder $4.5 Billion in Stolen Cryptocurrency; FHFA Announces Office of Financial Technology; Fintech Request for Information; Investopedia: Cryptocurrency Explained; B3-4.1-04: Virtual Currency; Bulletin 2021-36

Chapter 2 Review

Now that you've completed Chapter 2, let's do a quick review. In this chapter, we discussed cybersecurity including conversation on Gramm Leach Bliley Act and Bank Secrecy Act and Anti-Money Laundering. We also discussed ethical conversation on protecting borrower's information, avoiding and being aware of fraudulent practices in the mortgage industry.

- Mortgage professionals deal with a borrower's nonpublic personal information every day and it is their responsibility to protect that information by:
  - Following their company's compliance policy; and
  - Following federal law related to the protection of a borrower's nonpublic personal information
- Be sure to understand pretexting, ransomware, and other cybersecurity threats.
- Always remember the purpose of Anti-Money Laundering and the Bank Secrecy Act, mortgage professionals are required to take this training every year for a reason!

Chapter 3

Social Media & Advertising Compliance

Learning Objectives for Chapter 3

- ☐ Describe the requirements for advertising under TILA, MAP, and RESPA Section 8
- ☐ Create compliant social media advertising
- ☐ Understand how to reach out to a state or federal regulatory authority to report a non-compliant advertisement

Federal Advertising Laws

Advertising is a productive conduit for mortgage professionals to obtain new borrowers. Social media advertising is nothing new, many mortgage professionals and companies use a variety of social media platforms to drum up new business. Social Media is also where mortgage professionals and companies can run into compliance errors in their advertising. In this chapter, we are going to talk about many of the federal laws surrounding advertising. Then we will take that knowledge and apply it to how mortgage professionals and companies can successfully create compliant social media advertising.

TILA

Let's start with the Truth in Lending Act (TILA). It was the first of the federal advertising laws to be passed and has significant implications for how mortgage professionals can advertise.

One of the most drastic compliance rules added to advertising came from TILA. TILA requires the APR to be included in all advertising if a triggering term exists. A lot of people believe that if you advertise the APR, then the interest rate does not need to be included, while accurate, we suggest that if you only have room for one rate, it must be the APR.

The APR must also be disclosed if a trigger term appears in the advertisement. **A trigger term** is a phrase that represents the features of the loan scenario.

Some trigger terms are:

- 10% down payment
- $1,000 down
- 80% financing
- Monthly payments less than $500 on all loan plans
- Pay $32.11 per $1,000 borrowed
- $850 per month

If any trigger term exists in the advertisement, the ad must also disclose:

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

Some examples of terms that do not require the disclosure of the APR include:

- Easy monthly payments
- Low down payments
- Pay bi-weekly
- Terms to fit any budget
- Financing available
- FHA or VA loans available

If a mortgage company or professional advertises directly to a borrower, they are required to:

- Advertise only the specific terms the lender can truly offer.
- State the finance charge rate using the term Annual Percentage Rate or APR.
- Specify that the APR might increase after consummation of the loan; the ad must be specific on this detail, for example, on an adjustable-rate mortgage.
- Advertise the APR in conjunction with the simple annual or periodic rate. The APR must be advertised clearly and conspicuously as the other rate.

TILA "clear and conspicuous rule"

Regulation Z requires advertisements relating to credit present certain information clearly and conspicuously. It includes requirements regarding the proper disclosure of the annual percentage rate and other loan features. If an advertisement for credit states specific credit terms, it must state only those terms that are or will be arranged or offered by the creditor.

Disclaimers can be used to avoid allegations of misrepresentation, but ~~any~~ disclaimers must be "clear and conspicuous" and in close proximity to the applicable statement. Fine print at the bottom of a page is not a valid disclaimer. Accurate information in the text of an advertisement does not provide a remedy to a misleading headline, for instance.

Also included in TILA is the requirement that anything advertised must **actually be available**. If you are advertising a specific interest rate or program, that interest rate and the program must be available to a reasonable number of qualified borrowers.

Regulation Z states that if the advertiser provides information on a table or schedule located on a different page from the main advertisement, the main advertisement must refer to the page the table or schedule is on.

🌐 12 CFR 1026.24; Regulation Z

MAP Rule

The Mortgage Acts and Practice Rule, or MAP Rule, was created in 2009 to prohibit misrepresentation in commercial communication about any term(s) of a mortgage credit product. The FTC used to control the MAP Rule, but control was swapped to the CFPB. It's good to note here that the CFPB can enforce the MAP Rule based on **individual violations.**

Commercial communication refers to any written or oral statement, illustration, or depiction, whether in English or any other language, designed to affect a sale or create interest in purchasing goods or services. Social media advertisements are indeed commercial communications. **A quick way to remember the MAP Rule is no material misrepresentations are allowed in advertisements.**

According to the Rule, you must avoid misrepresenting:

- Fees
- Costs
- Obligations
- Loan Conditions
- Product Availability
- The amount of cash the consumer will receive or the out-of-pocket payment that will be required at closing
- The existence, number, amount, or timing of any minimum or required payments

- Whether the loan is a reverse mortgage or non-recourse loan, and any amount that must be paid to retain the home when the borrower moves or dies
- Specific info on taxes and insurance, like:
  - Amounts, payments, or other requirements related to taxes or insurance
  - Escrow requirements – including the amount needed to fund the escrow, cushions, monthly escrow payments
  - Any taxes and insurance premiums that must be paid at or before closing
  - Types of insurance that must be obtained
- A false association
  - Associated with the borrower's current servicer
  - Government association/affiliation
- Debt Consolidation
  - Effectiveness of the loan to help the consumer resolve difficulties in paying debts
  - Misrepresentations that any loan can reduce, eliminate, or restructure debt
  - Misrepresentations that the loan m y result in a waiver or forgiveness in whole or in part of the consumer's existing obligation
  - Misrepresentations concerning debts or costs that are incorporated into the loan amount
- Whether there are any government benefits (tax benefits!)
- That the loan is
  - Endorsed
  - Sponsored by or
  - Affiliated with any government or other program

The MAP Rule also has extensive record keeping requirements. Copies of all advertisements are required to be kept for two years after the last use.

RESPA Section 8

RESPA Section 8 states that:

No person shall give, and no person shall accept any fee, kickback, or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. Any referral to a settlement service is not a compensable service.

RESPA does allow for "normal promotional and educational activities" that are NOT conditional upon referral of business and does not defray the cost. Whether a particular item or activity meets the conditions in Regulation X for "normal promotional and educational activities" depends on the facts and circumstances.

For example, you host a one-time-only drawing for a mini basketball set (backboard, rim, net, and ball). You include an announcement of the drawing in an email or on social media to all previous customers and all real estate agents in the city, summarizing your services and providing your contact information. The entries to the drawing are automatically made for every previous customer and realtor in the city, regardless of whether the prior customer or realtor has made or will make a referral to you. You also include a drawing entry submission form on your website.

The drawing is more likely to meet the conditions for a “normal promotional and educational activity” under Regulation X because 1) the drawing entry is not conditioned on referrals and 2) the prize would not defray expenses, as the basketball set is not an expense that a person ~~in~~ would otherwise incur.

Conversely, if you are having a drawing in which the announcement and promotion emails or social media posts are sent **only** to select borrowers or real estate agents who are given drawing entries for each referral they gave, this is not a “normal promotional or educational activity.” This would be a violation of Regulation X.

The facts and circumstances indicate the opportunity to win the mini basketball set is conditioned on the referral of business, given that the persons in the drawing pool are only those persons who made referrals and that the number of entries is based on the number of referrals. As a reminder, this may implicate a RESPA Section 8(a) violation.

What about co-advertising with another service provider? Yep, co-advertising is addressed under RESPA Section 8. If you want to advertise jointly with another company or individual – you must pay proportionally. For example, in open house fliers, the front side is the house, and the back side is the loan, it’s very clearly 50/50. If the open house flier is 75% about the house and you have a banner at the bottom, you’re only getting 25%, you should be paying 25%, not 50%.

If you pay more than your portion, there could be an assumption that you are giving that service provider something for a referral, especially if they have referred business to you before or you’re expecting something in return.

Another potential RESPA section 8 issue is using the term preferred Lender on builder signage. It is prohibited for a builder to require a borrower to use a specific lender or loan officer. They are allowed to have a preferred lender or preferred loan officer, but they cannot force their borrowers to use them.

If the builder has a lender that they trust, and they give them preferred lender status and no money exchanged, that’s acceptable. If they’re paying you or someone else to be the preferred lender and it’s part of a Marketing Service Agreement (MSA) then that would be unacceptable.

Marketing services agreements, or “MSAs,” are agreements that commonly involve an arrangement where one person (or entity) agrees to market or promote the services of another and receives compensation in return

12 CFR § 1024.14(a)(b)

Other Laws that Govern Advertising

ECOA prohibits discrimination and discouragement, and as you can imagine, both can occur in advertisements. Be sure to send out advertisements to everyone in the city or county that you work in – failing to advertise in lower-income areas or areas that are primarily of one race over another can be considered discrimination and discouragement. For example, when using direct mailers, please send them to everyone in your city or county, and do not leave out an area because they are lower income, that’s discrimination Be sure to be inclusive in the faces that appear in the advertisements that are sent. Failing to include diversity in advertising could also be construed as discriminatory and discouraging.

The Unfair Deceptive Abusive Acts and Practices Rule (UDAAP), also prohibits the use of deceptive, unfair, or abusive language in advertising.

The SAFE Act plays a small part in advertising. It requires that a mortgage processional’s NMLS ID# appears in all marketing material!

These three laws need to be considered when drafting and creating advertising.

It is also essential to consider how advertisements sometimes elude government affiliation. Advertisements cannot look as though the mortgage professionals or the company they work for is affiliated with, or endorsed by a government agency~~.~~ While government programs insure or guarantee certain mortgages, the private lenders that make these loans are not government entities and are not affiliated with the U.S. government.

For example, one mailer sent to nearly 200,000 consumers advertising a mortgage company’s reverse mortgages had an eagle resembling the Great Seal of the United States. Furthermore, the header read, “GOVERNMENT LENDING DIVISION” and “Housing and Recovery Act of 2008 Eligibility Notice.” This type of advertising is problematic for ECOA and UDAAP.

Federal Communications Commission: Ringless Voicemails Update

While not directly related to social media, we felt it was important to make students aware of this change by the Federal Communications Commission (FCC) in 2022. In 2022, the Federal Communications Commission issued a declaration clarifying that delivering "ringless voicemails" to someone's cell phone requires the consent of the consumer.

The Telephone Consumer Protection Act (TCPA), which protects consumers from unwanted robocalls, prohibits making any non-emergency call using an automatic telephone dialing system or an artificial or prerecorded voice to a wireless telephone number without the prior express consent of the called party. The Commission today has clarified that ringless voicemail is a form of robocall and is illegal if the caller did not have the consumer's prior express consent.

FCC Press Release

State Laws & Additional Notes

Federal advertisement requirements set the basis for what is required, but state laws may add another layer of regulations. A mortgage professional could be 100% compliant under TILA, MAP, and RESPA but still have a violation under a state statute.

Additional State regulations may also apply to recordkeeping requirements. We mentioned that the MAP Rule requires records to be kept for two years, but many states have longer recordkeeping requirements for advertisements. So, whether you're keeping records for print material, or social media, following your state's rules for recordkeeping, you may keep your social media posts for longer than the two-year requirement.

It is also easy to think that if an advertisement complies with TILA, it follows federal advertising law, but this is false. An advertisement can be compliant with TILA and still break MAP or UDAAP or RESPA, or ECOA!

Case Study: CFPB fines company $1million and Bans them from the Industry for Misleading & Deceptive Advertising

In February 2023, the CFPB issued an enforcement action against a mortgage company penalizing them $1 million dollars and banning them from the industry for illegal advertising practices.

Per the CFPB, this company tricked military families about the government ’ s role in sending the advertisements or providing the loans; deceived borrowers about interest rates and key terms; and falsely misrepresented loan requirements and lied about projected savings from refinancing. It did not help either that this company was a repeat offender – having committed similar violations in 2015.

Specifically, the CFPB states that this company sent advertisements that misrepresented that they were, or was affiliated with, the VA or the FHA, that the VA or FHA sent the notices, or that the advertised loans were provided by the VA or FHA.

Military families or others who view such advertisements may decide to purchase the advertised mortgage based on the trust they have in the government agencies. The company's advertisements illegally disclosed a simple annual interest rate more conspicuously than the annual percentage rate, illegally advertised unavailable credit terms, and used the name of the homeowner’s current lender in a misleading way. Consumers who view such advertisements may be misled about the terms being offered or mistakenly believe their current lender is sending the advertisement; and

The company’s advertisements misrepresented that the benefits available to those who qualified for VA or FHA loans were time limited.

Additionally, the company’s advertisements misrepresented that military families could obtain VA cash-out refinancing loans without an appraisal and without incurring the cost of an appraisal, that an appraisal was not a condition of qualifying for VA cash-out refinancing loans, and that no minimum credit score and no income verification were required to qualify for VA cash-out refinancing loans.

Finally, the company’s advertisements misrepresented the amount of monthly payments, the annual savings under the advertised loans, and the cash available in connection with the advertised loans.

This plays into what we are talking about in this chapter – be aware of what you’re putting out there in your advertising! It can get you into big trouble and this recent enforcement definitely lets us know that the CFPB is serious about protecting consumers from misleading and deceptive advertising practices.

CFPB Press Release

Creating Compliant Social Media Posts

Social media is a powerful tool, but as we've alluded to, compliance violations in social media advertising can be problematic for some mortgage professionals and mortgage companies. According to the CFPB, most compliance violations fall into four categories:

- Misrepresentations about government affiliation, like ads containing official-looking seals or logos.
- Inaccurate information about interest rates, like ads promoting low rates that may mislead consumers about the terms of the product actually offered, or advertising rates that are not generally available.
- Misleading statements concerning the costs of reverse mortgages, like ads claiming that a consumer will have no payments in connection with the product, even though they are generally required to pay tax and insurance payments.
- Misrepresentations regarding the amount of cash or credit available to a consumer, like ads suggesting that a consumer has been pre-approved to receive a certain amount of money when refinancing.

Here is a list of additional examples of deceptive ads:

- Suggesting with a VA loan, that the rate being offered was part of an "economic stimulus plan" that will expire shortly
- Ads offering a very low "fixed" rate, without discussing significant loan terms
- Ads guaranteeing approval and offering very low monthly payments, without discussing significant conditions of these offers

What if someone puts non-compliant information into a comment or says you improperly denied them a loan? You can start with social media accounts that allow you to control comments on your posts. You can maintain control on Facebook by turning off comments for your posts. This allows you to post your messages and allows others to share them, while controlling content seen on your page.

If the mortgage processional or company has a large enough team, that team can monitor Facebook and hide or delete non-compliant comments. Be careful with this approach- if people think you're deleting all negative feedback they may just post more. You may want to post something like, "We reserve the right to hide comments that may violate mortgage lending advertising laws," plus a short description of what that means.

LinkedIn also allows you to disable comments on your posts. You can also set up more than one page on LinkedIn. This is helpful if you run campaigns for different types of borrowers.

Ensure all your pictures look professional, and the backgrounds align with your brand guidelines. You might think a picture of your dog water-skiing is great, but a professional headshot or your logo is probably a better choice.

Instagram also allows you to disable comments on your posts and is the preference for Millennials and Gen Z over Facebook. Many lenders don't choose to use Twitter because you can't prevent or delete comments. Their business model of free speech is a great fit for other consumer product companies but may not be suitable for lenders who must comply with strict communication guidelines.

Websites catering to communities are growing, especially in urban areas. A good example is Nextdoor.com. Nextdoor.com is like Facebook for over 235,000 neighborhoods in the U.S. It includes a real estate section similar to Realtor.com or Zillow; users can look at homes for sale and see ads for service providers, including mortgage lenders. Mortgage professionals can control their content, showcase specific information, and add content. Mortgage professionals can use this social media platform to start participating with the community in their neck of the woods.

What are some other dos and don'ts when you post on Social Media?

Do:

- Post happy client testimonials, with permission
- Post client closing announcements, with permission
- Post new mortgage product announcements
- Explain mortgage glossary terms
- Share charity events
- Share market stats
- Share inspirational or funny quotes
- Share holiday messages
- Share remodeling projects
- Provide tools like rent payment vs mortgage payment calculators
- Post consistently- (example: 1-2 X/day on most social media platforms is sufficient. Too often is annoying, not often enough is not going to give you traction)
- Share realtor listings but remind people to see the house or make an offer
- Talk to your manager, compliance department or attorney if you have questions

But Don't

- Forget to ask your client's permission
- Forget to tag clients and realtors in your post
- Quote interest rates, APR, or other specific mortgage terms
- Include payment amounts
- Make claims of reducing debt
- Comment on likelihood of approval
- Use superlatives, like: "best", "lowest", "most competitive" or "unbeatable"
- Use "fixed"
- Use "no costs" or "no fees"

- Include number of payments or down payment amounts without including all terms required by TILA
- Include the amount of any finance charge without including the terms required TILA
- Quote facts, figures, graphs, or statistics without sourcing them

We have provided a quick advertising marketing review checklist for you to review, this can be helpful when developing advertisements to ensure that all the boxes are checked. As a disclaimer, this is not protection from a violation and does not include state statutes requirements.

ADVERTISING/MARKETING REVIEW CHECKLIST				
GENERAL REQUIREMENTS	N/A	YES	NO	COMMENTS
Company Name*				Required all advertisements
Corporate Address				Required some states, see second tab
Corporate Phone Number				Required some states, see second tab
Corporate NMLS ID*				Required all advertisements
Corporate Website Address				
Branch Address				Not required
Branch Phone Number				Not required
Branch NMLS ID				Not required
Loan Originator Title (BM, MLO or LO)				Not required
Loan Originator NMLS ID				Required if name is listed.
Loan Originator Email Address				Not required
Equal Housing Opportunity logo*				Required
Are the advertisements distributed to the general public, such as publicly-facing, broadly-reaching websites?				If no, do they target specific consumers or groups? If yes, discuss with Compliance.
Joint Marketing: Expenses must be split on a pro rata basis and tracked (see below)				
FEDERAL REQUIREMENTS/PROHIBITIONS	N/A	YES	NO	COMMENTS
Ecoa and Regulation B (15 USC Section 1691; 12 CFR Part 202) prohibit credit discrimination on the basis of race, color, religion, national origin, sex marital tatus, age or the fact that an individual receives public assistance. Does the advertisment distinguish between borrowers based upon any of these catergories?				Note: Answer MUST be NO.
Does the advertisment have any of the following "Triggering Terms" •The $ or % of down payment; •The				

# of payments or period of repayment; •The amount of any payment; and •The amount of any finance charge.				
If yes to any of the above, does the advertisement state all of the following terms? •The $ or % of downpayment; •The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment; •The "APR," using that term, and, if the rate may be increaased after consummation, that fact. •Disclaimer- "Based on terms available as of {Insert Date} subject to change without notice. Contact_____ Representative for additional information regarding terms shown above."				Maintain records of how APR was calculated
If a rate of finance charge was stated, was it stated as an APR?				Note: Answer MUST be YES.
Is the APR stated more conspicuously than any rate?				Note: Answer MUST be YES.
If an APR will increase after consummation, is a statement to that fact made?				Note: Answer MUST be YES.
Does the advertisement clearly disclose all material limitations or conditions on the terms or availability of products or services, such as: 1. special rates for a limited time period (teaser rates); 2. expiration date for terms that apply only during an introductory period; 3. rate resets that could cause significant increases in payments (ARM); 4. material prerequisites for obtaining particular products, services, or benefits (e.g., discounts, refunds or rebates); 5. non-amortizing or less-than-fully amortizing loan terms (I/O); 6. balloon payments; or 7. pre-payment penalties?				
Does advertisement avoid using fine print, separate statements, or inconspicuous disclosures to correct potentially misleading headlines?				Note: Answer MUST be NO.
Must contain the verbiage "This is to NOT be construed mortgage loan approval"				Note: Answer MUST be YES.
STATE REQUIREMENTS/PROHIBITIONS	**N/A**	**YES**	**NO**	**COMMENTS**
Is any statement known, or should be known, to be untrue or misleading?				Note: Answer MUST be NO.
Does the advertisement contain a seal, emblem, insignia, trade or brand name that could interpreted or construed as implying any federal, state or government connection, approval or endorsement?				Note: Answer MUST be NO.
If the advertisement includes the name, trade name, logo or tagline of the consumer's current lender, does the advertisment clearly and conspicuously state that the person is not sponsored by or affiliated with the lender and the solicitation is not authorized by the lender, in close proximity to and in the same or larger				Note: Answer MUST be YES.

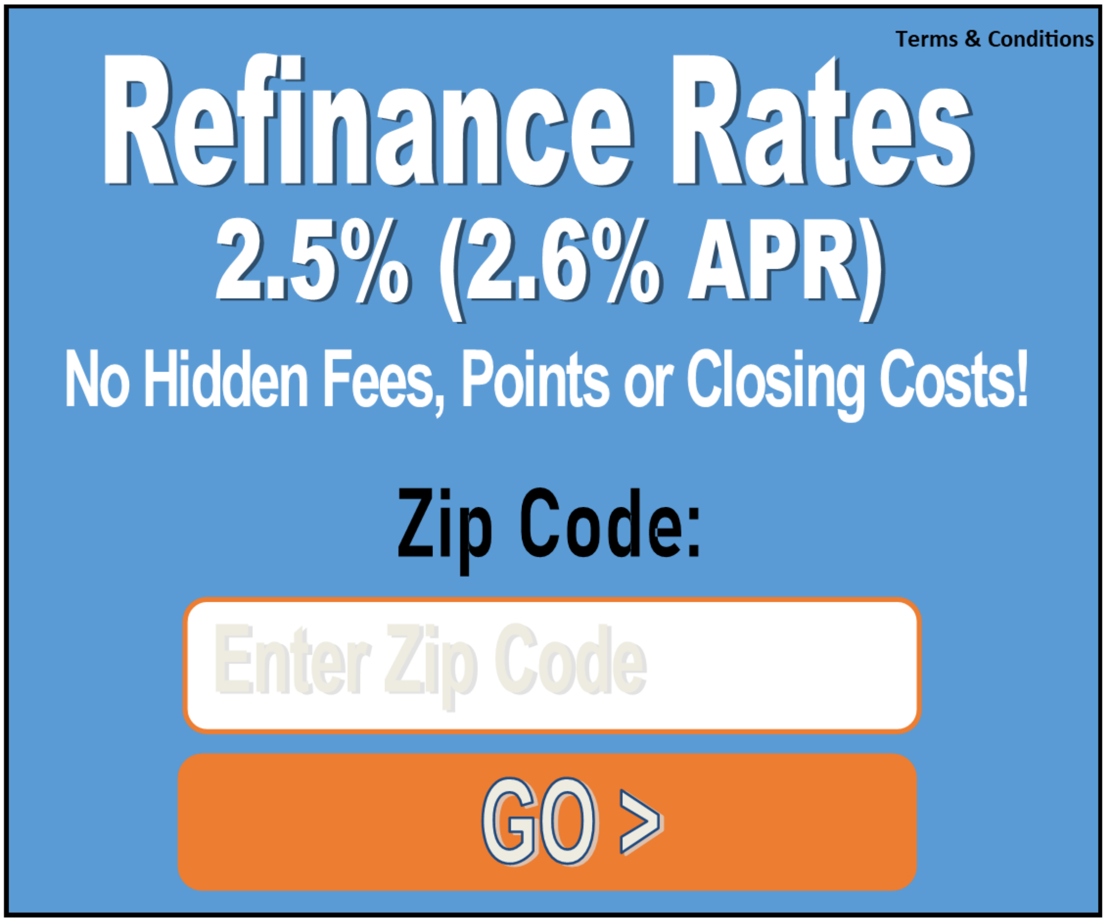
font size as the first and most prominent use of the name, including on an envelope?				
If an advertisement includes the consumers loan number or loan amount, does the advertisement clearly and conspicuously state that the person is not sponsored by or affiliated with the lender, the solicitation is not authorized, and the loan information was not provided by the lender, in close proximity to, and in the same or larger font as the first and the most prominent use of the consumer's loan information, including on an envelope?				Note: Answer MUST be YES.
If the loan is subject to the Guidance on Non-traditional Mortgage Product Risks, are all the applicable terms included in the advertisement?				Note: Answer MUST be YES.
If rates, charges, or costs of a loan are advertised, is the information stated fully and clearly, so as to prevent misunderstanding?				Note: Answer MUST be YES.
Are the loan terms actually available at the time of advertising?				Note: Answer MUST be YES.
Is the advertisement a 'blind' advertisement? (For example, contains only a phone number, PO box, or fictitious name?)				Note: Answer MUST be NO.
Does the ad include any representation that an individual who is solely a loan processor or underwriter can or will perform any activities of a loan originator?				Note: Answer MUST be NO.
RESPA CO-MARKETING RULES (Only use this when you are marketing with another party ie. Real Estate Agent)				
What percent of the space is used by the Mortgage Company?				
Did the Mortgage company pay only their proportionate amount of the fair market cost?				Note: Answer MUST be YES.
Are you giving the other party a thing of value beyond your proportionate share of the advertisement?				Note: Answer MUST be NO.
Are you defraying the expense that would otherwise be incurred by someone who is in the position to refer borrowers to you?				Note: Answer MUST be NO.
Do you adjust the compensation paid under an arrangement based on caputre rate or the percentage of referrals that convert to actual clients?				Note: Answer MUST be NO.
Is the co-marketing general in nature or only to those with whom the other party already has a relationship?				Should be general, for exceptions contact Compliance.
Does the co-marketing party provide you with warm or hot leads or just the contact information?				Must only be contact information

If you're beginning your social media journey, it's a good idea to engage with your compliance department early, understand each website's control features, and think about emerging sites to complement your marketing strategy.

Compliant v. Noncompliant Advertisements

We've learned a lot about advertising and federal laws~~,~~ now we need to apply what we learned by looking at some advertisements.

Can you point out what they did wrong?



Disclosures

The example loan rate of 2.5% for a 30-year $150,000 5-year Adjustable Rate Mortgage (ARM) for purchase and re-finance loans is generally based on the following criteria; a borrower with good to excellent credit and average income seeking a loan for a single family, owner occupied one unit dwelling with 30% down payment (or 70% loan to value ratio). The Annual Percentage Rate (APR) is 2.6%

*****$150,000, $225,000, $300,000 mortgage with payments as low as $592, $889, $1185.** Example assumes a 30-year adjustable rate mortgage (ARM) with a rate of 2.5%. Annual Percentage Rate (APR) of 2.6% and up to 2% loan origination/discount points due at closing. Rates and APRs may vary depending on loan details, such as points, loan amount, loan-to-value, your credit, property type, and occupancy. The example assumes a credit score of 780 or greater with a loan to value (LTV) of 70% or less on a primary residence. After 5 years, the interest rate and paymen will adjust every year. The potential interest on the example loan after 5 years could be about 4.11% based on an ARM index of 1.184% (LIBOR index) and an ARM margin of 2.25%. The corresponding monthly payment at 4.11% would be $150,000, $225,000, $300,000 mortgage with payments as low as $726, $1088, $1451.

DID YOU KNOW?

You can refinance your home with ***NO*** closing costs.

Read how we can help

Other Costs Associated with the No-Closing-Cost Refinance

You can choose between two different options with a no-closing-cost refinance; either an increased interest percentage or a higher loan balance. Not every lender offers both types of no-closing-cost refinances, so make sure your lender can offer you the option you want.

MLO Marcus · Follow
Salt Lake City, UT

356 likes

MLO Marcus There is so much to fear in the housing market right now due to misinformation & miseducation. I'm here to help!
"I can't afford to buy right now because of interest rates." I hear you, I really do. Rising rates are scary and can make home-buying seem like it's not worth it.
Here's the real deal. Rising rates don't make it impossible to buy. Rising rates simply limit how much you can afford.
Want an example? 2 years ago we purchased a home for $250,000 at a 3.1% rate. Our mortgage payment was $1,300. Today a $200,000 home will cost you $1,300 or more.
How can you be smart in this housing market? If you have any money saved up for a down payment + closing costs, buy the home! Your first home doesn't have to be your dream home. In a few years, when your needs change, you can sell that home & profit the equity you've earned.
A bonus bit of goodness about this housing market = sellers are more flexible than they have been in years. Less buyers are out there making the housing market less competitive & sellers more wiling to provide financial assistance to buyers.
... more

View all 16 comments

Add a comment...

6 days ago

NO Down Payment

Up to 100% financing available! No down payment required to purchase a home with a VA home loan– as long as the home appraises for more than the cost of the home.

NO Mortgage Insurance

Private Mortgage Insurance is normally required on any loan that isn't purchased with a down payment of 20% or more. One of the best features of a VA loan is that you won't make mortgage insurance payments even if you finance 100% of the loan.

Lower Monthly Payments

Since 1944 VA loans have been insured by the federal government, which can mean lower risk for lenders and lower interest rates for borrowers. VA home loans are also assumable which means when you sell your home it can be an attractive selling point.

U.S. Department of Veterans Affairs

SUMMIT MORTGAGE

Smiley Mortgage Inc.

Date the rate, marry the home! Don't let the current rates keep you from buying your dream home. Reach out to one of our trusted loan officers today to learn more about how you can save on future closing costs through our Loyalty Refinance Program.

Like · Comment · 9 minutes ago ·

4 people like this.

Loyalty Refinance
PROGRAM

Purchase your dream home today and receive a Smiley Mortgage Loyalty Refinance Discount when rates drop again.

*up to $2,000 off refinance closing costs

If a client locks their rate on a purchase loan that closes in 2022, they are deemed eligible for the Loyalty Refinance Program. The Loyalty Refinance must be claimed by locking a new rate between 120 days and 36 months from the purchase closing date. Refinance loan must be on the same subject property as the initial loan. The Loyalty Refinance Program is eligible on conventional, FHA, VA, and USDA purchase loans. Renovation, construction, and non-conforming purchase loans are ineligible. Smiley Mortgage will cover the following fees through a $2,500 lender credit; underwriting fee, tax transcript fee, fraud check fee, commitment fee (only applicable on FHA), and first appraisal fee. Offer may not be redeemed for cash or credit and is nontransferable. Offer cannot be retroactively applied to any loans. Offer may not be used with any other discounts. This offer is subject to changes or cancellation at any time at the sole discretion of Smiley Mortgage. Additional restrictions and conditions may apply. This is not a commitment to lend and is contingent on qualification per full underwriting guidelines. Refinancing may cause finance charges to be higher over the life of the loan. Smiley Mortgage Company, Inc. Is a corporation licensed by the Indiana Department of Financial Institutions (DFI). For complete licensing information visit http://www.nmisconsumeraccess.org/EntityDetails.aspx/ COMPANY 12345. Equal Housing Lender NMLS # 123456

CFPB Source: NMP: Walking the Line: Compliance and Social Media in Today's Mortgage Marketplace (used with permission)

Chapter 3 Review

Now that you've completed Chapter 3, in this chapter, we discussed advertising, specifically compliance with federal laws related to advertising. We also provided some best practices and a checklist to assist you with making your own compliant advertisements.

- Mortgage professionals need to be careful not to violate RESPA or any other advertising laws when they advertise.
- Be sure to keep trigger terms away from all advertisements.

Chapter 4

Fair Lending

Learning Objectives for Chapter 4

- ☐ Explain requirements when using complex algorithms in lending decisions
- ☐ Examine how using algorithms can lead to digital redlining in both lending decisions and advertising/marketing
- ☐ Forecast how new rulemaking by the CFPB may impact small lenders with the new AVM requirements
- ☐ Discuss the new Uniform Appraisal Dataset (UAD) Aggregate Statistics Data File published by FHFA
- ☐ Interpret Limited English Proficiency (LEP) requirements

Fair Lending and Important Terms

Before we dive into what's going on right now with fair lending, let's refresh our memories about what fair lending means and discuss some important terms that we will be using throughout this chapter.

> **Fair lending** is unbiased treatment and granting equal access to credit to anyone who wishes to apply for and obtain a loan. If you have a conversation with someone or have a belief that they probably won't qualify, you can't discourage them from applying; this would be discriminatory. There are specific laws designed to prevent discrimination against protected groups of individuals.

As a reminder, our three laws that pertain to Fair Lending in play here are:

1. **ECOA (Reg B -1974)** - This Act deals with fair lending and discrimination. It protects nine classes from discrimination: Race, color, religion, sex, national origin, marital status, age, public assistance, and the exercise of rights under the Consumer Credit Protection Act.

2. **Fair Housing Act (1968)** – This Act also deals with fair housing and discrimination. It protects seven classes from discrimination: Race, color, religion, sex, disability, familial status, and national origin or ancestry. It also deals with disparate treatment and impact.

3. **HMDA (Reg C -1975)**– This Act gathers data to serve the housing needs of the community, assists in distributing public investments, and identifies discriminatory lending practices such as redlining, reverse redlining, blockbusting, and disparate treatment and impact.

Two terms we frequently discuss when we talk about fair lending are disparate impact and disparate treatment.

Disparate Treatment occurs when one protected group is treated differently from another similarly situated group, and non-discriminatory factors can't fully explain the inconsistencies in treatment. It is either overt discrimination, or there is comparative evidence of discrimination.

Overt Evidence of Disparate Treatment occurs when a mortgage professional **openly discriminates on a prohibited basis**. It is a blatant statement of discrimination. This typically occurs through verbal statements by mortgage professionals but could also occur through written advertisements and other materials published by the mortgage professional. For example, if an advertisement makes a statement that discourages applications from a specific protected class, the advertisement could be considered disparate treatment.

An example of overt discrimination is a mortgage company that has a written policy stating anyone aged 21-27 can only have a loan under $150,000, while anyone over 30 automatically qualify for $200,000.

Comparative Evidence of Disparate Treatment occurs when a protected class applicant is treated **less favorably than other applicants**. It is often **not intentional** (though it could be). The differences in treatment are not fully explained by legitimate non-discriminatory factors, and no evidence is required to show that the treatment was motivated by prejudice or that the creditor intended to discriminate against a person.

This form of disparate treatment often occurs when a lender allows discretion in the underwriting process that leads to inconsistencies. When all underwriting discretion is eliminated (such as is the case with some automated underwriting models), fair lending risk from comparative evidence of disparate treatment is significantly reduced.

An example of comparative evidence is if two borrowers have the same credit file, yet one is White, and the other is Hispanic, and the Hispanic applicant receives a higher interest rate.

Disparate Impact occurs when what seems like a neutral policy or practice is applied equally to all applicants, but the policy or practice adversely affects a protected group.

An example is a lender who will only take applications for loan amounts above $300,000. Upon review of files, it is determined that several protected groups were adversely impacted by this policy, which was not necessarily intended to be discriminatory, but the result is that the company assists less minority borrowers.

Comparative Analysis is a method used by examiners to compare protected class applicants with control group applicants.

For example, a comparative analysis might compare the best denials versus the worst approvals. In comparing the denials that were borderline, but were not approved, with the files that barely got approved, auditors can determine whether inconsistencies occurred and whether those inconsistencies adversely affected a protected group. Auditors may also compare fees or credit terms in similarly situated borrowers.

Part of HMDA's purpose is to identify potential discriminatory lending patterns while attempting to determine whether a financial institution's policies are creating disparate treatment or disparate impact.

HMDA was implemented to identify when **redlining or blockbusting** was occurring. With HMDA's data, **redlining and reverse redlining** can be identified in lending institutions' data.

Redlining is an unethical practice in which financial institutions, or even individual loan officers, make it extremely difficult or impossible for residents of a particular neighborhood to borrow money, gain approval for a mortgage, take out insurance, or gain access to other financial services because of a history of high default rates. Redlining typically occurs in poor inner-city neighborhoods. In the case of redlining, an individual's qualifications and creditworthiness are not considered as they should be; only the location of the property is considered.

Reverse Redlining is the opposite; it occurs when a financial institution lends specifically in poor inner-city neighborhoods to charge them more than a comparable White consumer.

If you were to draw a circle around a specific area on a map, and then refuse to lend there, that would be redlining. Reverse redlining occurs when a lender targets minority consumers in a specific area; not to deny them loans, but to take advantage of a particular group, such as charging them more than would be charged to a similarly situated White consumer.

Social Media Advertising & Fair Lending

In Chapter 3, we discussed compliance pertaining to advertising laws and how to create compliant social media advertisements. In addition to the types of violations mentioned in Chapter 3 regarding the content of advertisements, there are many questions about how social media companies, like Meta (formerly Facebook) show advertisements to their audience and the potential fair lending issues associated with their methods.

This Fair Lending issue with Facebook has been ongoing for years:

- 2018 – HUD alleged FHA violations by Facebook.
- 2019 - Facebook settled a lawsuit stemming from the 2018 complaint made by the National Fair Housing Alliance and several other consumer advocacy groups.
    - In the resolution of one of those complaints against Facebook, they agreed to remove age, gender, and zip code targeting for housing, employment, and credit-related advertisements.
- In 2022, the Department of Justice announced a settlement with Facebook to resolve alleged Fair Housing Act violations arising from their targeted advertising system.

We'll get to the "settlement" outcome shortly, but let's dive a little deeper into the DOJ's complaint.

In their 2022 complaint, the DOJ alleges that the changes Facebook made in response to earlier complaints and lawsuits were **simply not enough** – the complaint alleges that Facebook continues to engage in discrimination in violation of the Fair Housing Act in three ways:

1. Trait-based targeting
2. Look-alike targeting
3. Delivery determination

Let's look at each one.

1. **Trait-based targeting** involves encouraging advertisers to target ads by including or excluding Facebook users based on Fair Housing Act protected characteristics that Facebook, through its data collection and analysis, attributed to those users.

> By enabling advertisers (or the technology companies they rely on) to curate information for consumers based on detailed data about them, including habits, preferences, financial patterns, and where they live, there is a risk that this curation may result in digital redlining or steering. Likewise, when Internet-based marketing relies on artificial intelligence (AI) and machine learning (ML) technologies, the potential for discrimination **may increase**.
>
> Facebook's advertising practices initially drew attention when it was revealed that the company permitted advertisers to exclude groups of Facebook users with selected personal characteristics from viewing particular advertisements on the social media site. Facebook's technology effectively allowed advertisers to show advertisements to certain users while excluding others based on sex or age, or on interests, behaviors, demographics, or geography that related to or were associated with race, national origin, sex, age, or family status.
>
> The Federal Reserve: Consumer Compliance Outlook

Let's say you're putting together an advertising campaign on Facebook, and you decide to tailor that advertisement to:

- Anyone older than 18 (age)
- People who have enough income to qualify, (income) and
- You want people in a specific part of town or neighborhoods to receive your FB ad (location).

You are tailoring your advertisement to specific traits, and you're redlining at the same time. The new term for this type of advertising, is ***digital redlining.***

2. Another aspect of the DOJ's complaint is **look-alike targeting**. This practice involves a ***machine learning algorithm*** that advertisers could use to find Facebook users who "look like" a specific advertiser's audience, based in part on Fair Housing Act-protected characteristics.
   a. For example, if you like dogs, you might choose to post pictures of you and your dog. Facebook's algorithms could then target you as a person who likes dogs and would therefore be targeted to see more ads related to dog toys and dog treats.

Per Meta's own Business Help Center:

> A lookalike audience is a way your ads can reach new people who are likely to be interested in your business because they share similar characteristics to your existing customers.
>
> A lookalike audience uses an existing Custom Audience you select for its primary source audience for your advertising campaign. To create a lookalike audience, the system leverages information such as demographics, interests, and behaviors from your **source audience** to find new people who share similar qualities. When you use a lookalike audience, your ad is delivered to that audience of people who are similar to (or already "look like") your existing customers.

3. The last piece of this puzzle is delivery determinations. According to the DOJ, this practice also involves applying a machine learning algorithm to help determine which subset of an advertiser's target audience would receive a particular ad.

> Facebook's advertisement delivery practices determine which users will see a particular advertisement, regardless of the advertisers' own preferences, and using user data that include sex and close proxies for other protected characteristics which has the effect of classifying users by protected characteristics.

In layman's terms, HUD alleged that Facebook used their users' sex and race to determine whether or not they should see an advertisement.

> As a result, these algorithms may potentially raise fair lending risks and render some advertisements invisible to certain users, disproportionately impacting users based on protected characteristics, such as race and sex. Indeed, an academic study of Facebook's advertisement delivery practices demonstrated just that, finding "previously unknown mechanisms that can lead to potentially discriminatory advertisement delivery, even when advertisers set their targeting parameters to be highly inclusive."
>
> The study's authors published groups of advertisements on Facebook, where advertisement features were varied to observe how changing a feature would affect the demographics of the audience of a particular advertisement. They found that the delivery of a particular advertisement may be skewed for many reasons including the content of the advertisement itself, the images contained in the advertisement, and how advertisement images are classified by Facebook. According to their results, an advertisement "can be delivered to vastly different racial and gender audiences" based solely on the advertisement's creative content.
>
> The Federal Reserve: Consumer Compliance Outlook

Many people rely solely on social media platforms to get information about what's going on in the world, so if some FB ads are hidden, they may miss out on important information that could ultimately benefit their life.

The DOJ states that through Facebook's internal ad design parameters, their ad delivery system engaged in both:

- Intentional discrimination
- Conduct that had a disparate impact based on Fair Housing Act-protected characteristics.

Here are the terms of the FB/DOJ Settlement.

- Facebook is required to stop using the "look-alike" advertising tool.
- They are to develop a new system for housing ads to address disparities.
- They are to remove any targeting options for housing advertisers.
- They must pay a civil penalty of $115,054, which, according to the DOJ, is the "maximum penalty available under the Fair Housing Act."

DOJ v. Facebook Settlement Agreement; : Ballard Spahr Compliance Finance Monitor (cited with permission).

Complex Algorithms Used in Lending Decisions

> **Algorithm:** A process or set of rules to be followed in calculations or other problem-solving operations, especially by a computer. -**Oxford Dictionary**

Complex algorithms aid in many mortgage-related decision-making processes. In some cases, the algorithm may even make "the decision."

For example, Automated Underwriting Systems (AUS), like Loan Product Advisor (LP), and Desktop Underwriter (DU) algorithms are part of our everyday work life.

MEC Student Question: What's one of the main algorithms we have in our personal life?

Sample answers:

When you Google a question, their algorithm will bring the most popular sites up first. Using a completely proprietary computation, Google ranks the websites based on the number of keywords or combinations of words and the relevance of the question being asked. Google then provides the top results and ranks them based on the user's profile. This is a great example of a "complex algorithm" because the results can differ for every user.

1. TikTok
2. Pinterest
3. Twitter
4. Instagram
5. EVEN LinkedIn

Using algorithms to help with mortgage credit decisions could be helpful on many levels for mortgage professionals and your clients. The purpose of adding algorithms to credit decisions was to remove the human aspect and inherent bias, but there are still some kinks to be worked out.

Software developers and software programs are built for the mortgage industry based on the specific parameters that have been set up, like credit ratings, lender guidelines, appraisal values, and many other loan dynamics.

However, some regulators are concerned that the input may have some built-in discrimination factors causing a ***disparate impact***. Lenders rely on the software and current algorithms to make the magic happen and tell us if the loan is approved or denied. However, the lender is ultimately responsible for ensuring that fair lending laws are adhered to and that borrowers are treated equally and clearly demonstrate how the lending decision was finally derived.

The more techie we get, the more detached we get from our clients and even the loan itself, which could include, loan denials.

People want information faster and easier, and more simplified with fewer steps, but as we adjust to these desires, we need to be ensure that we're not building discrimination into the system. If a loan is denied, we must know ***exactly*** why they were denied, rather than simply saying they were denied because "AUS" said so. We have to know the exact factors used to make any decision. **Technology is not perfect.**

Most of the speculation and information surrounding the use of complex algorithms and their impact on fair lending is purely theoretical at this point; there are no recent enforcement actions taken related to issues with the use of complex algorithms, but it is being discussed from a rulemaking and legislative perspective.

For example, in 2022, the CFPB released a circular that addresses adverse actions and the use of complex algorithms in an effort to educate the industries that they regulate about ECOA and the use of complex algorithms in decision-making.

There is concern that mortgage companies relying heavily on complex algorithms can make it hard for them to identify those specific reasons for denying credit or taking adverse actions. Even if they struggle to understand the algorithm decision, the mortgage company is denying the borrower. The mortgage company is still required to comply with the adverse action requirements under ECOA. The adverse action notice requirements of ECOA apply equally to all credit decisions, regardless of the technology used to make them. Thus, ECOA and Regulation B do not permit mortgage companies to use complex algorithms if it means that they cannot provide specific and valid reasons for adverse actions. ***We must be able to determine why the application was denied. If the algorithm isn't clear, then it is nearly impossible to defend your decision to decline the loan because you simply don't know why it was denied.***

As we said, this is a common theme and many different entities are making statements and discussing this issue. For example, Patrice Alexander Ficklin, the CFPB Fair Lending Director, recently made the comment that she is:

> "...skeptical of claims that advanced algorithms are the cure-all for bias in credit underwriting and pricing."
>
> **Patrice Alexander Ficklin CFPB Fair Lending Director**

CFPB-Credit Decisions Based on Complex Algorithms; CFPB Circular 2022-03 May 26, 2022

New Rules for Automated Valuation Models (AVMs)

> An automated valuation model (AVM) is a term for a service that combines mathematical or statistical modeling with databases of existing properties and transactions to calculate real estate values. The majority of AVMs compare the values of similar properties at the same point in time...
>
> AVMs usually include the tax assessor's value, all pertinent information on the property in question—such as its sales history—and an analysis of the sales of like-kind properties.
>
> Investopedia

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Congress directed the Consumer Financial Protection Bureau (CFPB) to develop regulations for quality control standards for automated valuation models (AVMs).

Dodd Frank defines an AVM as ***"any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."***

As an alternative to an actual appraisal, some companies are using AVMs more often.

Currently, AVMs must meet quality standards designed to:

1. Ensure a high level of confidence in the estimates produced by automated valuation models.
2. Protect against the manipulation of data.
3. Seek to avoid conflicts of interest.

4. Require random sample testing and reviews.
5. Account for any other such factor that the agencies determine to be appropriate.

Student Poll/Question-AVMs:

How many of you work for companies that are leaning on AVMs more often?

AVMs are utilized more often than you think. Zillow, Redfin, Trulia, and Realtor.com all use their own proprietary AVMs in determining the values they give. These companies use a combination of public record and data that they have collected through their webpages to determine their AVMs. There are also commercial AVM products. Fannie Mae and Freddie Mac, both have AVM tools available for commercial use. They use their own loan data to help determine AVMs.

AVMS are based on existing data; they are only as accurate as the information being used to determine the value. If the information is inaccurate, old, or incorrect, the AVM might not be as reliable as a regular appraisal.

Bringing AVMs into the fair lending conversation can be especially helpful when it comes to appraisal value in minority census tracts. Based on a wide range of data collected from a variety of sources, some appraisals have had bias built into the final report, and the overall valuation and discrimination have been verified. Using this data, the CFPB believes that there is a possibility that the AVM models being built are using discriminatory data, which could also then provide inherent discrimination and an overall lower valuation in minority census tracts.

> Per the CFPB:
>
> "Moreover, like algorithmic systems generally, there are concerns that AVMs may reflect bias in design and function or through the use of biased data and may introduce potential fair lending risk."

According to the CFPB, the increased use of AVMs may require implementation of stricter compliance management systems that would identify and prevent violations of appraisal discrimination. The CFPB is currently working towards additional potential rules for AVMs. They issued an "Outline of Proposals and Alternatives Under Consideration" in 2022.

Before the CFPB can move forward with any new rulemaking, they are required to organize a review panel because there is a reasonable chance these rules could have a significant economic impact on a substantial number of small companies.

Think about it from this perspective: the new rules could easily create the need to pay for new computer programs, hire more people to manage the changes, or maybe there would be a new review/audit event required that would create a financial burden on small companies. They may not have the assets to implement what will potentially be required.

CFPB AVM Rule Making CFPB AVM Report

Property Appraisal and Valuation Equity (PAVE) and New Uniform Appraisal Dataset (UAD)

The Property Appraisal and Valuation Equity (PAVE) is a task force focused on many different components of appraisals. PAVE created a 5 step Action Plan. We talked about this in our 2022 CE course. Do any of you remember?

The PAVE plan was "developed to close the racial wealth gap by addressing mis-valuations for families and communities of color." There were several action items related to appraisal discrimination.

PAVE is working towards:

1. Ensuring that government oversight and industry practice further valuation equity.
2. Combating valuation bias through education and training.
3. Ensuring equity in valuations by making available high-quality data.
4. Creating a comprehensive approach to combating valuation bias through enforcement and other efforts.

Per PAVE:

Researchers have observed a market value gap between majority-Black and majority-White neighborhoods for decades. On average, homes in majority-Black neighborhoods are valued at less than half of those in neighborhoods with few or no Black residents. Statistical analyses show that accounting for neighborhood and property characteristics and amenities—such as the age of the property or its proximity to public transportation—does not explain the entire disparity. Recent research has identified appraisals as one of the drivers of the gap.

New research from Freddie Mac (2021) states that 12.5 % of purchase appraisals in predominantly-Black neighborhoods and 15.4 % in predominantly-Latino neighborhoods result in a value below the contract price, compared to 7.4% of appraisals in predominantly White neighborhoods. This research corroborates prior observations that a neighborhood's average appraised property value tends to decrease as the share of historically marginalized populations increases.

Recently, a study of appraisal commentary (the free-form narrative section of an appraisal report, reflecting the appraiser's reasoning for the property valuation opinion) revealed that appraisers sometimes make racial and ethnic references.

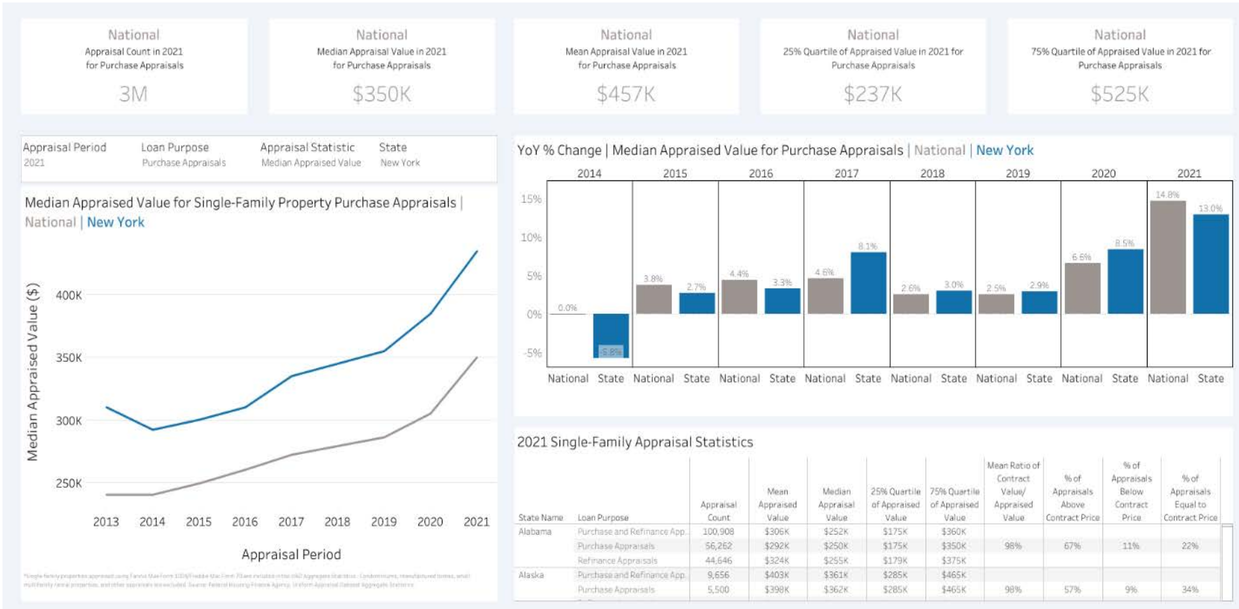
For example, the study found that one appraiser wrote that a majority-White area was "not especially diverse ethnically," and another appraiser noted that residents of a "predominantly Hispanic" neighborhood have "assimilated their cultural heritage" into the neighborhood.

PAVE was formed to help with such problems and they're diligently working on many others. One of the specific action steps included creating a database of appraisal information about datasets.

To that end, in October of 2022, the FHFA announced that the database is set up and available for practitioner consumers and mortgage professionals to utilize. These two websites are the UAD Aggregate Statistics Data File and the UAD Aggregate Statistics Dashboards.

> The UAD Aggregate Statistics Data File and UAD Aggregate Statistics Dashboards give stakeholders and the public new access to a broad set of data points and trends found in appraisal reports. Additionally, the appraisal statistics may be grouped by neighborhood characteristics and geographic levels (national, state plus the District of Columbia and Puerto Rico, Metropolitan Statistical Areas (MSAs) or Metropolitan Divisions, county, and tract). Of note, the UAD Aggregate Statistics Data File is intended for users capable of using statistical software to extract and analyze data.
>
> In contrast, the UAD Aggregate Statistics Dashboards are for users of all types and are designed to provide user-friendly access through customized maps and charts.
>
> FHFA's Division of Research and Statistics used 47.3 million UAD appraisal records collected from 2013 through the second quarter of 2022 on single-family properties to create a data file of UAD aggregate statistics in a manner that protects borrower privacy. Each UAD appraisal record includes information reported by appraisers on the Uniform Residential Appraisal Report (URAR). The current version of the URAR for single-family homes is Fannie Mae Form 1004 and Freddie Mac Form 70.
>
> FHFA Press Release

There is still some concern that the data collected and presented already has bias and discrimination based on the historical data included in the database. It is yet to be determined how this data will be used and the impacts it may have on the mortgage industry.



The UAD tool allows you to view historical data, specific state and county locations, and compares national with state specific information about appraisals. This data can show a lot of helpful information about what's going on with appraised values across the country. It can be used to look at your individual state and see what appraised values are doing now, and you can also go all the way back to 2013!

For example, the mean appraisal value for purchase appraisals was $457,000 in 2021. In 2013, it was $240,000! That's a substantial difference!

Several entities are using this data to look at many different factors. For example, the FHFA recently used this UAD data set to look at how the COVID-19 Pandemic has impacted the size of houses purchased. Popular press and initial research suggest a growing preference for more space when working at home. With the UAD Aggregate Statistics Advanced Analytics Dashboard, we determined there was no broad movement toward larger homes; in fact, smaller homes accounted for a slightly larger share of newly purchased homes in 2022 compared to 2013. The data was even able to break down where smaller homes changed in their share of appraisals.

> To analyze changes during the pandemic, we compute how much the share of newly purchased homes under 1,200 square feet changed in the second quarter of 2022 compared to the last quarter of 2019. In 75 of the 100 largest Metropolitan Statistical Areas (MSAs), the share of newly purchased homes under 1,200 square feet increased during this time. However, the size of the increase varies substantially among different MSAs.
>
> Table 1 shows where the share [amount or number of] of smaller homes is increasing and decreasing the most. Panel (a) lists the MSAs with the largest

increases in the share of smaller purchase appraisals. These MSAs are in the lower Midwest and Northeast, while the areas with the largest decreases are mainly in coastal cities. Overall, areas with lower population growth over the past decade tended to have larger movement toward smaller houses during the past two years.

Panel (b) shows MSAs with the largest declines in the share of smaller homes. Unsurprisingly, areas with especially densely populated city centers such as New York, Washington, D.C., and the San Francisco Bay Area are among the areas with the most substantial decreases in the share of appraised smaller homes. This result may suggest that the pandemic caused movement toward larger homes in these markets or may reflect that modern homes (newly built and situated) have shifted toward a different style of attached townhome that is slightly bigger and has neighbors living closer together than single-family detached starter homes from prior decades. Either way, this shift is not seen in the majority of MSAs.

Table 1: Where are the Share of Appraisals for Smaller Homes Increasing and Decreasing?

(a) Top 10 MSAs or the Largest Increase in Share of Appraisals for Single-Family Properties under 1,200 sq. ft., 2019Q4-2022Q2

Rank	MSA	Change in Share of Homes <1200 Square Feet
1	Detroit-Dearborn-Livonia, MI*	4.12
2	Warren-Troy-Farmington Hills, MI*	4.02
3	Camden, NJ*	3.74
4	Baltimore-Columbia-Towson, MD	3.72
5	Albany-Schenectady-Troy, NY	3.69
6	Akron, OH	3.69
7	Louisville/Jefferson County, KY-IN	3.66
8	Richmond, VA	3.42
9	Greensboro-High Point, NC	3.40
10	Allentown-Bethlehem-Easton, PA-NJ	3.37

(b) Bottom 10 MSAs or the Largest Increase in Share of Appraisals for Single-Family Properties under 1,200 sq. ft., 2019Q4-2022Q2

Rank	MSA	Change in Share of Homes <1200 Square Feet
100	Urban Honolulu, HI	-5.65
99	Oxnard-Thousand Oaks-Ventura, CA	-1.95
98	San Jose-Sunnyvale-Santa Clara, CA	-1.28
97	New York-Jersey City-White Plains, NY-NJ*	-1.14
96	Salt Lake City, UT	-1.12
95	Worcester, MA-CT	-1.02
94	Cambridge-Newton-Framingham, MA*	-0.99
93	Washington-Arlington-Alexandria, DC-VA-MD-WV*	-0.98
92	Sacramento-Roseville-Folsom, CA	-0.91
91	Oakland-Berkeley-Livermore, CA*	-0.74

It'll be interesting to see how this information can be used to pinpoint discrimination, as well as how it can provide other important insights into the mortgage industry.

🌐 UAD Aggregate Statistics Dashboards; UAD Aggregate Statistics Data File; UAD Aggregate Statistics Blog; FHFA Blog

Redlining Enforcement Actions

The DOJ, OCC, and the CFPB joined forces to enhance their enforcement actions and they have consistently identified "redlining" and "digital redlining" as some of their top priorities.

The DOJ, in particular, has been looking into redlining and digital redlining and making it a priority. In 2021, the Attorney General announced the Justice Department's Combatting Redlining Initiative. This is the most aggressive and coordinated effort to address redlining.

In a recent speech, the Assistant Attorney General made these comments:

> Through this initiative, the Civil Rights Division is working to make fair access to credit a reality in communities of color across the country – and we are doing so in partnership with U.S. Attorneys' Offices.
>
> Since August 2021, CRT has resolved four redlining cases. Collectively, these settlements provide over $38 million in relief for borrowers in Houston, Memphis, Philadelphia, and Newark.

Never before has the department resolved four redlining cases in shortly over one year.

A Bank – Houston, Texas (Aug. 31, 2021) - $4.17 million

A Bank– Memphis, Tennessee (Oct. 27, 2021) - $3.85 million

A Mortgage Company– Philadelphia, Pennsylvania (July 27, 2022) - $18.4 million subsidy fund (first settlement involving non-depository institution

A Bank– Newark, New Jersey (Sept. 28, 2022) - $12 million

Our colleagues in the District of New Jersey have been critical partners in our efforts to combat redlining. In 2015, we partnered with this office to resolve our largest redlining settlement of $25 million. Through that settlement, approximately 2,600 borrowers received mortgage loans in previously redlined communities of color. Over 2,000 of the loans were used to purchase homes, thereby providing an opportunity to generate wealth through home equity.

DOJ Speech

As a result of these combined enforcement efforts, you'll notice there have been some significant financial penalties against both financial and non-depository institutions for discrimination and redlining. Let's look at two of these four cases.

Case Study #1: New Jersey Bank

The first case is against a bank in New Jersey. In this situation, the bank engaged in a pattern of lending discrimination by redlining in the Newark metropolitan area. This resolution is part of the Justice Department's nationwide Combating Redlining Initiative and represents the ***third-largest redlining settlement in department history***.

The complaint filed in federal court today alleges that from at least 2015 to 2021, the Bank failed to provide mortgage lending services to Black and Hispanic neighborhoods in the Newark, New Jersey, metropolitan area, that all its branches were located in majority-white neighborhoods and that its loan officers did not serve the credit needs of Black and Hispanic neighborhoods in and around Newark.

Penalties:

- Invest at least $12 million in a loan subsidy fund for residents of Black and Hispanic neighborhoods in the Newark area.
- $750,000 for advertising, outreach, and consumer education.
- $400,000 for development of community partnerships to provide services that increase access to residential mortgage credit.
- Open two new branches in neighborhoods of color, including at least one in the city of Newark; ensure at least four mortgage loan officers are dedicated to serving all neighborhoods in and around Newark; and employ a full-time Community Development Officer who will oversee the continued development of lending in neighborhoods of color in the Newark area.
- Maintain an expanded Community Reinvestment Act Assessment Area that includes Essex, Somerset and Union counties.

🌐 DOJ Press Release

Case Study #2: Mortgage Company in Philadelphia

The enforcement actions are taking into consideration additional information about the entity that is included in their findings for redlining, including the ethnicity of the staff members, the location of branch offices, the HMDA data, and local census information.

In addition to large fines, these businesses are required to make staff changes, open new branch office locations, and make investments into programs that promote fair lending.

In this case, in a joint effort between the DOJ and the CFPB, they issued a complaint against a mortgage company in Philadelphia. This mortgage company also engaged in redlining in the Philadelphia metropolitan area. This resolution is the first redlining settlement that the Justice Department has reached with a non-bank lender and the second largest redlining settlement in the department's history.

> The complaint filed in federal court today alleges that from at least 2015 to 2019, the mortgage company failed to provide mortgage lending services to neighborhoods of color in the Philadelphia metropolitan area, that its offices were concentrated in majority-White neighborhoods, and that its loan officers did not serve the credit needs of neighborhoods of color. The complaint also alleges that loan officers and other employees sent and received work e-mails containing racial slurs and referring to communities of color as "ghetto."

Penalties:

- The mortgage company will invest over $20 million to increase credit opportunities in neighborhoods of color in the Philadelphia metropolitan area.
  - Invest at least $18.4 million in a loan subsidy fund for residents of neighborhoods of color in the Philadelphia metropolitan area.
  - $750,000 for development of community partnerships to provide services that increase access to residential mortgage credit; $875,000 for advertising and outreach.
  - $375,000 for consumer financial education.
- The mortgage company no longer operates a lending business. It will contract with another lender to provide loan subsidies and services to the "redlined" communities.
- The mortgage company will ensure that the lender employs at least four mortgage loan officers dedicated to serving neighborhoods of color in and around Philadelphia, Camden, and Wilmington; maintains at least four office locations in those neighborhoods; and employs a full-time manager of community lending who will oversee the continued development of lending in neighborhoods of color in the Philadelphia metropolitan area.
- The mortgage company will also pay a civil money penalty of $4 million.

Access to credit helps provide opportunities to build wealth. Mortgage professionals have the obligation of encouraging applicants to complete the loan application and not discouraging them. Discouraging applicants from applying for a loan is discrimination.

🌐DOJ Press Release

Limited English Proficiency (LEP)

Fair housing means providing potential borrowers with clear communication regardless of their primary language. Consequences of poor communication can be perceived as bias or discrimination. In the LEP world, Language access means how well we communicate with our borrowers who do not speak English as their primary language. Language access is a top priority, especially when it comes to providing access and equity in homeownership.

Limited English Proficiency or LEP has been an ongoing topic in our continuing education for multiple years. In 2021, the CFPB 's announcement stated:

> Currently, many LEP consumers are not fully integrated into the financial marketplace, despite being a significant portion of the U.S. population (approximately 25.5 million individuals out of 326.7 million). Due to language access issues, LEP consumers face unique challenges in learning about and accessing financial products, services, and education tools;

understanding and completing key financial documents; managing bank accounts; and resolving issues with financial products and institutions. For example, financial disclosures and written documents are generally not available in non-English languages.

The guidance provides information to mortgage companies on how they can provide more access to credit by offering consumers information in other languages other than English. The CFPB Guidance goes into more detail on how to protect the mortgage company from ECOA and UDAAP violations.

Mortgage companies should have an LEP policy in place that is applicable to the communities they serve. Mortgage companies should be:

- Conducting an internal assessment to determine if any current staff are fluent in other languages.
- Conducting an external assessment in the areas in which they are licensed to determine the languages that would be most beneficial to potential applicants.
- After collecting the language data, it is time to start the process of identifying the written materials that will be available, and in which languages.
- Finally, it is important to establish a translation process and develop standards to ensure consistency and accuracy in all translated documents.

The CFPB's guidance also stated that, when developing a company's LEP plan, there are some important factors they should be considering or tools that may be helpful to utilize:

- **Language selection** using the U.S. Census Data to determine the languages that are most likely to be used in their area.
- **Determine what products and/or services** they will be able to provide in the language selected.
- **Determine if the LEP program** will have an in-house program or a third-party translation service.
- **Develop policies and procedures** that will provide quality and accuracy in the interpretation translation practices. This also includes a back-translation procedure to ensure the accuracy of the translation. If the mortgage company has the resources, having a central point of contact who would administer the LEP program could be beneficial.
- **Training staff** on the intricacy of an LEP program and what is expected from them to remain compliant.
- **State specific requirements.** 31 states have some form of LEP policy in place. Every mortgage company needs to determine what is required by the state(s) and then follow their guidelines to be compliant.

As a mortgage professional, you need to service your entire community.

1. What resources are available to you to help your LEP borrowers?

2. Does your company have an LEP policy and a variety of resources already available to you.

3. Does your compliance department have some tools you could use?

If your company does not have an LEP program set up, feel free to use these links yourself and pass them along to your compliance department to get the ball rolling.

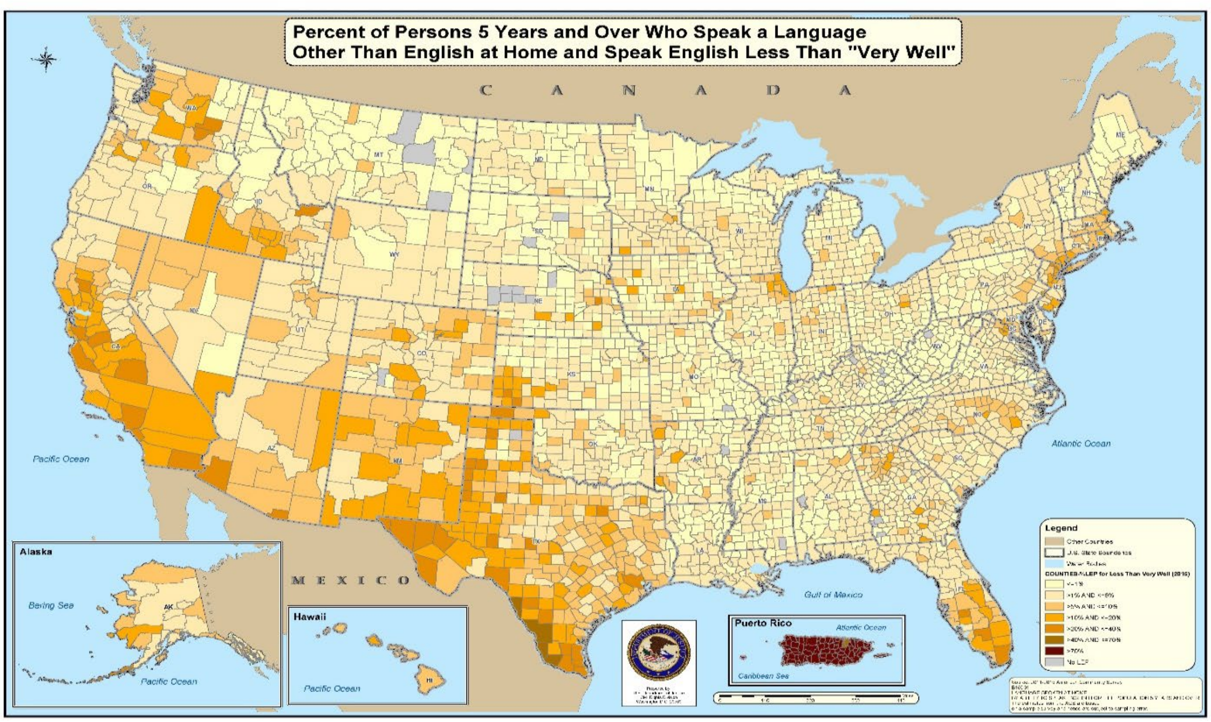
1. LEP.Gov

2. Mortgage Translations Home

3. More CFPB Resources

Let's talk about each of these resources and how you (and your compliance department) can use them to help your LEP borrowers. Part of knowing how to help your LEP borrowers is to determine the language(s) spoken in the areas you serve. LEP.gov can help with that.

The LEP.GOV website https://www.lep.gov/ provides resources and mapping tools to determine the languages.



The Civil Rights Division's Language Map App is an interactive mapping tool that helps users determine the concentration of and languages spoken by LEP individuals in a community. Click on your state or county to identify the number or percentage of LEP persons, download language data, or visually display LEP maps for presentations.

The FHFA's Mortgage Translation website is a resource available to you and the public for translated documents and more.

[redacted]

[redacted]

Lastly, the CFPB has so many additional resources that can help you and your borrower navigate the lending process. The resources include:

- COVID-specific materials to address questions about credit and debt management, student loan repayment, mortgage relief options, scams, banking tips, economic stimulus relief, and other topics. You can also find a video explaining mortgage forbearance options subtitled in Spanish.
- Multilingual Glossaries of over 1,200 financial words and terms in English, Spanish, and Chinese, and will soon be available in Korean and Vietnamese.
- Your Money, Your Goals financial empowerment toolkit, which is currently available in English and Spanish and can enable you to help people in a variety of specific financial areas of their lives, like credit, spending decisions, debt repayment plans, income, and bills.
- Equal Credit Opportunity Act brochures explaining consumers' protections against lending discrimination. The brochure is currently available in English and Spanish, and will soon be available in Chinese, Vietnamese, Tagalog, Korean, French Creole, Arabic, and Russian.

- Financial Wellbeing Scale, available in English and Spanish. This is a 31 page guide to help people understand their financial world and how they are doing. This would be a great link to send to your borrowers to assist them toward financial success
- Newcomer's guides to managing money, available in English and Spanish.

CFPB Announcement; CFPB Statement Regarding the Provision of Financial Products and Services to Consumers with Limited English Proficiency, CFPB More Resources; FHFA: Mortgage Translations Home; LEP.GOV'

Fannie Mae and Freddie Mac Require Language Preference Data to be Collected

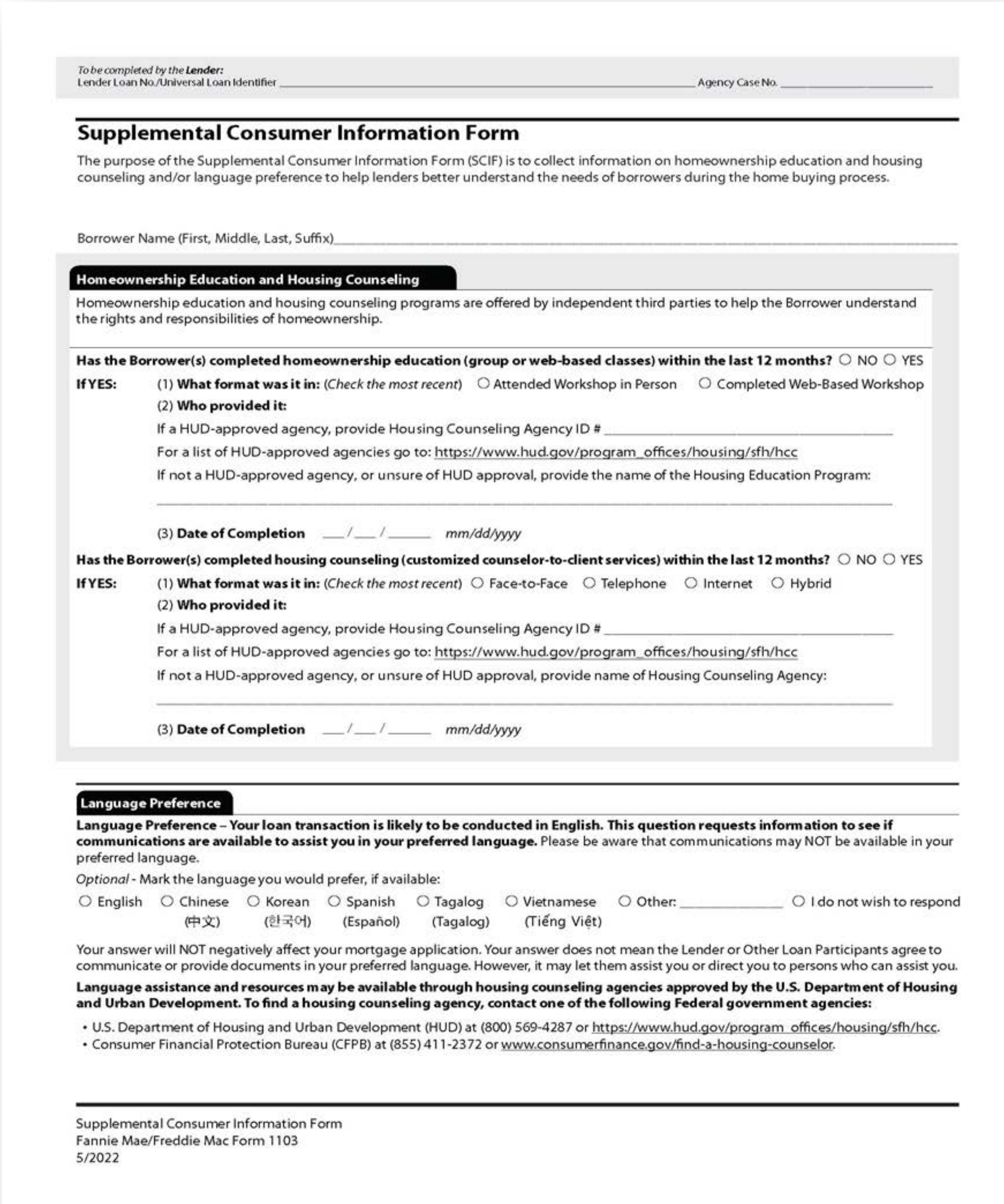
Another tool that may help identify language preferences is the implementation of the **SCIF Form 1103,** as of March 2023. This is an addendum to the 1003.

> The Supplemental Consumer Information Form (SCIF/Form 1103) will be required for new conventional loans sold to Fannie Mae and Freddie Mac with application dates on or after **March 1, 2023**. This requirement will help facilitate the collection of homeownership education, housing counseling, and **language preference information**.

Requesting this information from clients through the initial application process may help clients feel more comfortable to respond freely. As a loan officer, if you know ahead of time which language a client would prefer to communicate in, you could orchestrate a plan to suit their request.

The SCIF form 1103 is being added to the application to help professionals have the information they need about their clients so they can assist them better with homeownership education, housing counseling, and language preferences.

🌐 FHFA Language Access



To be completed by the ***Lender:***
Lender Loan No./Universal Loan Identifier ______________________ Agency Case No. ______________

Supplemental Consumer Information Form

The purpose of the Supplemental Consumer Information Form (SCIF) is to collect information on homeownership education and housing counseling and/or language preference to help lenders better understand the needs of borrowers during the home buying process.

Borrower Name (First, Middle, Last, Suffix) ______________________

Homeownership Education and Housing Counseling

Homeownership education and housing counseling programs are offered by independent third parties to help the Borrower understand the rights and responsibilities of homeownership.

Has the Borrower(s) completed homeownership education (group or web-based classes) within the last 12 months? ○ NO ○ YES

If YES: (1) **What format was it in:** (*Check the most recent*) ○ Attended Workshop in Person ○ Completed Web-Based Workshop

(2) **Who provided it:**

If a HUD-approved agency, provide Housing Counseling Agency ID # ______________________

For a list of HUD-approved agencies go to: https://www.hud.gov/program_offices/housing/sfh/hcc

If not a HUD-approved agency, or unsure of HUD approval, provide the name of the Housing Education Program:

____

(3) **Date of Completion** ___/___/_____ *mm/dd/yyyy*

Has the Borrower(s) completed housing counseling (customized counselor-to-client services) within the last 12 months? ○ NO ○ YES

If YES: (1) **What format was it in:** (*Check the most recent*) ○ Face-to-Face ○ Telephone ○ Internet ○ Hybrid

(2) **Who provided it:**

If a HUD-approved agency, provide Housing Counseling Agency ID # ______________________

For a list of HUD-approved agencies go to: https://www.hud.gov/program_offices/housing/sfh/hcc

If not a HUD-approved agency, or unsure of HUD approval, provide name of Housing Counseling Agency:

____

(3) **Date of Completion** ___/___/_____ *mm/dd/yyyy*

Language Preference

Language Preference – Your loan transaction is likely to be conducted in English. This question requests information to see if communications are available to assist you in your preferred language. Please be aware that communications may NOT be available in your preferred language.

Optional - Mark the language you would prefer, if available:

○ English ○ Chinese (中文) ○ Korean (한국어) ○ Spanish (Español) ○ Tagalog (Tagalog) ○ Vietnamese (Tiếng Việt) ○ Other: __________ ○ I do not wish to respond

Your answer will NOT negatively affect your mortgage application. Your answer does not mean the Lender or Other Loan Participants agree to communicate or provide documents in your preferred language. However, it may let them assist you or direct you to persons who can assist you.

Language assistance and resources may be available through housing counseling agencies approved by the U.S. Department of Housing and Urban Development. To find a housing counseling agency, contact one of the following Federal government agencies:

- U.S. Department of Housing and Urban Development (HUD) at (800) 569-4287 or https://www.hud.gov/program_offices/housing/sfh/hcc.
- Consumer Financial Protection Bureau (CFPB) at (855) 411-2372 or www.consumerfinance.gov/find-a-housing-counselor.

Supplemental Consumer Information Form
Fannie Mae/Freddie Mac Form 1103
5/2022

🌐 Form 1103 Information Required

Affordable Housing Using the Down Payment Assistance Programs (DPAs) as a Fair Lending Tool

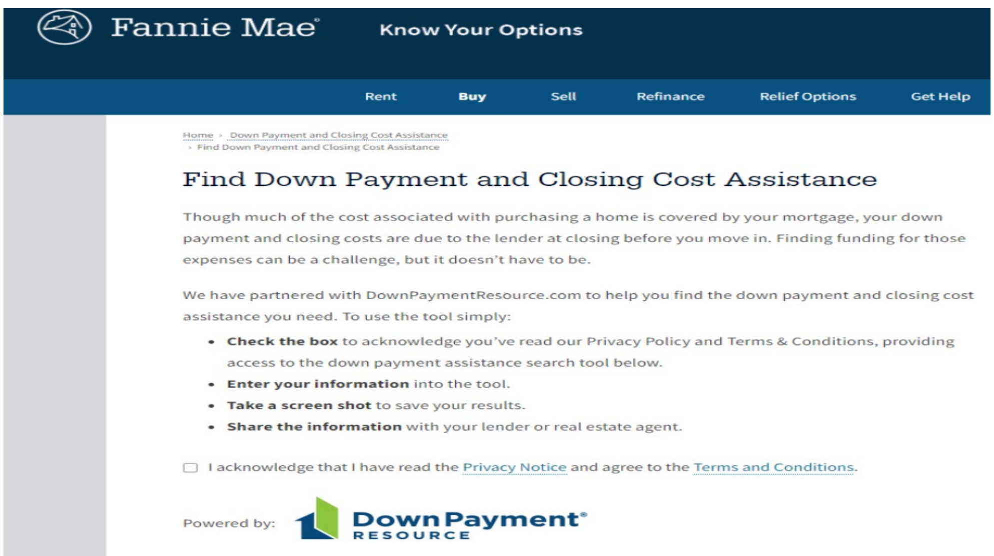
There are a variety of Down Payment Assistance programs (DPAs) available across the United States. Some are state or county run programs, and some are non-profit organizations that provide down payment assistance to borrowers who qualify.

There have been discussions stating that if the mortgage professionals are not providing a borrower who may qualify under the DPA program that opportunity to use it, it could be considered discrimination on behalf of the lender.

If the program is available and the borrower qualifies, but the mortgage professional fails to provide this product, and borrower no longer qualifies for the mortgage, you have not provided the borrower with every opportunity to access credit to purchase a home.

Several of the larger financial institutions have developed internal down payment assistance programs. Borrowers will use the creditor who can provide them with the most options when it comes to bringing in less money for closing costs, which may include the down payment. As mortgage professionals, it behooves you to learn about every loan program available to you. And, even if YOU don't have access to a program, you should learn about it anyway. There may be instances, like with the reverse mortgage, when your clients should at least be presented with different options.

In October 2022, Fannie Mae announced a new tool that borrowers can use to see if they qualify for a Down Payment Assistance program. By entering in their personal information, they can see if the property location and the borrower can qualify for a down payment assistance program.



The Down Payment Assistance Resource provided a video explaining the down payment assistance programs available and the details on how they work and how to qualify the borrower using the DPA programs.

🌐Down Payment Assistance Resource (cited with permission); Fannie Mae Down Payment Resource

Chapter 4 Review

Congratulations, you've completed Chapter 4. In this chapter, we discussed how complex algorithms are used in lending decisions and advertising/marketing materials. We gave an overview of redlining and digital redlining and how they will both continue to be an enforcement directive by the CFPB. We discussed appraisals and how automated valuations models determine the impact on fair housing. Lastly, we discussed the updates to the Limited English Proficiency (LEP) requirements for mortgage professionals.

Quick Reminders from Chapter 4

- Complex algorithms affect many different aspects of fair lending in the mortgage industry, including advertising, decision making, and automated valuation models.
- Redlining and digital redlining remain a priority for fair lending enforcement
- LEP and Language access are evolving fair lending issues that you can be aware of and assist your borrowers with.

Chapter 5

Affordable Housing with Freddie Mac

Learning Objectives for Chapter 5

- ☐ Describe the unique qualities of the millennial borrower
- ☐ Understand the barriers that millennials borrowers are facing
- ☐ Restate things that the GSE's and you can do to help millennial homebuyers
- ☐ Describe the major issues causing the affordable housing shortage
- ☐ Relate the qualifications for the HomePoissible and HomeOne programs

Student will receive a copy of the PowerPoint slides as a deliverable for this chapter.

Chapter 6

Adjustable-Rate Mortgages (ARMs) & Other Recent Program Updates

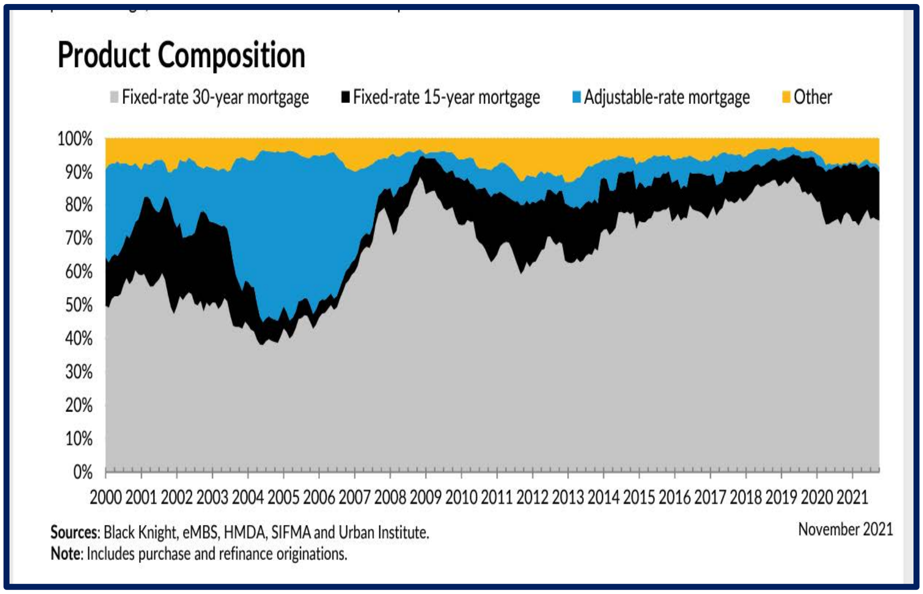
Learning Objectives for Chapter 6

- ☐ Relate the reasons why ARMs might make sense for some borrowers
- ☐ Describe the parts of an ARM
- ☐ Understand the general qualifications for ARMs
- ☐ Identify potential issues with seller contributions and buydowns in this high-interest-rate market
- ☐ Evaluate the new updates from around the industry and what they could mean for your borrowers

Why The ARM?

The adjustable-rate mortgage (ARM) has been an underused product in the past ten years. With record low interest rates in 2020 and 2021, the fixed-rate mortgage was king. Looking at the product composition from 2000-2021, you'll notice how much of the market fixed-rate mortgages have taken up, both 15- and 30-year terms, while the market for ARMs shrank substantially from 2007 to 2021.

The creation of Qualified Mortgage Rule (QM) and Ability to Repay Rule (ATR) and some of the other laws apply to ARMs and have lowered the risk of having an ARM.



Some think ARMs are a more predatory loan, but that's not necessarily the case. ARMs are offered by Fannie Mae and Freddie Mac and must meet the same QM and ATR standards of any other fixed-rate products. They are riskier in a sense; the interest rate can change but borrowers are held to the same qualifying standards (even more stringent requirements in some instances), than borrowers with a fixed-rate mortgage. 2022 was a unique experience for many mortgage professionals. Some MLOs have struggled with where or how to drum up new business or help their borrowers who are still in the market to purchase or refinance. One option may be an ARM.

Looking at the Primary Mortgage Market Survey (PMMS), you can see the difference in interest rates between the 30-year and the 5/1 arm. The difference is over 1%! In addition to lower rates, putting them in an ARM may make sense because of the borrower's situation. Maybe they only plan to be in the house for 2-3 years, for instance.

[Freddie Mac Primary Mortgage Market Survey; Housing Finance At A Glance: Urban Institute]

ARM Basics

Let's review how an ARM works. An ARM is a loan with an interest rate that will change throughout the life of the loan. Over time, the borrower's monthly payments may go up or down. ARMs have two distinct periods: the **initial period** and the **adjustment period**.

1. **Initial period:** Also known as the **fixed-rate period**, the interest rate doesn't change. The **initial period** can range from six months to 10 years. The most common ARM terms have an initial period of 5, 7, or 10 years.
    a. The **note rate** is the interest rate during that initial period.

After the initial period, most ARMs adjust. Simply put, when the loan is set to adjust, the interest rate may change, based on the index it is tied to.

2. **Adjustment period:** All ARMs have adjustment periods that determine when and how often the interest rate can change. The adjusted rate is based on the borrower's individual loan terms and the current market.

Two pieces of information make up the adjustable rate on an ARM: the index and the margin. The index plus the margin is the **fully indexed rate** or the rate that determines the borrower's payment for that adjustment period. Let's break this down further. The margin is a fixed number, usually between 2-3%, but can vary by product. The index is a moving target and is tied to a specific index. The most common indexes used are:

- Secured Overnight Finance Rate (SOFR)
    - The only type of ARM accepted by Fannie Mae and Freddie Mac
    - Replaced LIBOR (see below)
- Constant Maturity Treasury (CMT)
    - It is still popular with depositories and correspondent lenders
- London Interbank Offered Rate (LIBOR)
    - The LIBOR is phasing out and is no longer being originated, but you might see it on a refinance.
- Federal Cost of Funds (COFI), Cost of Saving Index (COSI), and Prime (most common for HELOCs)

Understanding Secured Overnight Financing Rate:

In 2017, The Alternative Reference Rates Committee (AARC) selected the SOFR as its preferred alternative to U.S. dollar LIBOR.

SOFR is a broad measure of the cost of borrowing cash overnight, collateralized by U.S. Treasury Securities in the repurchase agreement (repo) market.

LIBOR is a series of interest rates intended to reflect banks' average cost of short-term, wholesale unsecured borrowing. It is currently used in many financial products worldwide, from derivatives to mortgages, to bonds, to corporate loans. It is currently calculated for five currencies and in seven "tenors" or lengths of time –like three-month or 12-month LIBOR.

Each business day, a panel of banks for LIBOR in each currency (16 banks for USD LIBOR) submits their estimates of the cost to borrow in wholesale unsecured funding markets. For each tenor, the upper and lower quartiles are removed, then the rest is averaged to determine the LIBOR rate for that day.

Changes in how banks fund themselves have caused the volume of transactions underlying LIBOR to decline considerably. Today, the market for unsecured wholesale term borrowing by banks is not sufficiently active, with a relatively small number of transactions underpinning LIBOR. LIBOR is sustained through "expert judgment," which means panel banks submit estimates of their borrowing costs with little actual borrowing activity to validate them.

In 2014, global regulators highlighted the financial stability risks associated with overreliance on LIBOR. In response, national working groups in jurisdictions worldwide–like the ARRC–were convened to support a transition away from LIBOR (and other LIBOR-like rates) by identifying robust alternative interest rate benchmarks anchored in deep, active markets. In 2017, those efforts were accelerated when the Financial Conduct Authority (FCA), the UK government body that regulates LIBOR, stated that it had exerted considerable effort persuading panel banks to continue submitting to LIBOR and that it brokered a voluntary agreement with the remaining panel banks to continue submissions through the end of 2021. In April 2020, following the outbreak of COVID-19, the FCA reaffirmed that timeline announcing that the central assumption that firms cannot rely on LIBOR being published after the end of 2021has not changed and should remain the target date by which all firms should be prepared for LIBOR to be unusable.

AARC: SOFR Starter Kit Part 1; and Part 2

Let's do two quick examples of ARM adjustments:

(1) 30- day SOFR 0.533% + Margin 3.00% = 3.533%. New interest rate will be 3.533%.
(2) 1-year CMT is 1.567% + Margin 3.00% = 4.567%. New interest rate will be 4.567%.

There are different types of ARMs. The names of the ARMs indicate the duration of the initial period and how often in a year the rate can adjust during the adjustment period. For example, the most common type of ARM is the 5/1 ARM. This ARM has a fixed rate for five years and then adjusts once per year for the life of the loan.

The most common types of ARMs on the market currently are:

6. **5/6. 7/6, and 10/6 SOFR ARMs**
   a. **Fixed for 5, 7, and 10 years; then adjust every 6 months**
   b. **These are Fannie/Freddie ARM options**
7. **5/1, 7/1, and 10/1 CMT ARMs**
   a. **Fixed for 5, 7, and 10 years; then adjust yearly**

In addition, most ARMs have a rate cap structure. These caps prevent the interest rate from increasing or decreasing by a certain amount. There are three common types of caps:

- **Initial cap** –Limits how much the borrower's interest rate can adjust at the first adjustment.
- **Periodic cap** – Limits how much the rate can increase from one adjustment period to the next.
- **Lifetime cap** – Limits how much the borrower's rate can increase or decrease over the life of the loan.
- **The floor is the margin unless otherwise indicated.**

The most common type of **cap structures** in today's ARM programs are:

- 2/1/5 for 3/6 and 5/6 SOFR ARMs
- 5/5 for 7/6 and 10/6 SOFR ARMs
- 2/2/6 for 1/1, 3/1, and 5/1 CMT ARMs
- 5/2/5 for 5/1, 5/5, 7/1, and 10/1 CMT ARMs

Let's say the borrower is looking at a 5/1 ARM with a 5/2/5 cap structure. This means, starting in the sixth year, after the borrowers' initial period expires, their rate can increase a maximum of 5 percentage points (the first "5") above the initial interest rate. Every year thereafter, their rate can adjust a maximum of 2 percentage points (the second number, "2"), but their interest rate can never increase more than 5 percentage points (the last number, "5") over the life of the loan.

Freddie Mac: Considering an Adjustable Rate Mortgage?; MGIC Training: Getting Comfortable with ARMs (again) (used with permission).

Fannie Mae and Freddie Mac Guidelines & Pricing

Looking at an eligibility matrix will give us a good idea of how ARMs differ from LTV and Loan Level Price Adjustments (LLPAs) requirements, and from their fixed-rate mortgage counterparts.

Standard Eligibility Requirements - Desktop Underwriter Version 11.0
Excludes: High LTV Refinance, HomeReady, HomeStyle Renovation, and Manufactured Housing

Transaction Type	Number of Units	Maximum LTV, CLTV, HCLTV
Principal Residence		
Purchase Limited Cash-Out Refinance	1 Unit	FRM: 97% (1) ARM: 95%
	2 Units	FRM/ARM: 85%
	3-4 Units	FRM/ARM: 75%
Cash-Out Refinance	1 Unit	FRM/ARM: 80%
	2-4 Units	FRM/ARM: 75%

The biggest difference is the **down payment requirement**. Though it stays the same for two and three-to-four-unit properties on a purchase or limited cash-out refinance, you'll notice the down payment requirement is slightly more on the one-unit purchase or limited cash-out refinance yet is the same as a cash-out refinance. So, for those concerned that qualifying for an ARM requires more money down or more equity in the property, that is not always the case.

In the following two charts, second home and investment properties, the down payment is the same for ARMs and fixed rates.

Second Homes		
Purchase Limited Cash-Out Refinance	1 Unit	FRM/ARM: 90%
Cash-Out Refinance	1 Unit	FRM/ARM: 75%

Investment Property		
Purchase	1 Unit	FRM/ARM: 85%
	2-4 Units	FRM/ARM: 75%
Limited Cash-Out Refinance	1-4 Units	FRM/ARM: 75%
Cash-Out Refinance	1 Unit	FRM/ARM: 75%
	2-4 Units	FRM/ARM: 70%

The same goes for second homes and investment properties; a borrower can choose an ARM on a purchase of a second home and not have to put any more money down or have any more equity than if they were doing a fixed-rate mortgage. With the details noted in the eligibility matrix, it's clear that Fannie thinks ARMs have a similar risk factor to fixed-rate mortgages.

As we talked about earlier, the ARMs available through Fannie Mae and Freddie Mac are 3/6, 5/6, 7/6, and 10/6 SOFR ARMs. The cap structures vary between 2/1/5 and 5/1/5.

Special NOTE: You must qualify your borrower based on the ARM you're putting them in, at the highest rate the borrower could "end up with."

Example: If the borrower has an ARM with a fully indexed rate of 4.75% at the beginning of the loan, and they have a 5/1/5, you must qualify them based on a 9.75% rate.

Here are Fannie's requirements:

Qualifying Interest Rate Requirements	
Transaction Type	**DU and Manual Underwriting**
Fixed-rate mortgages	Note rate
ARMs with initial fixed-rate period of three years or less	The maximum interest rate that could apply during the first five years after the first payment is due.
ARMs with initial fixed-rate period of five years	Greater of • the maximum rate that could apply during the first five years after the first payment date (note rate plus first rate change cap), or • the fully indexed rate
ARMs with an initial fixed-rate period of greater than five years	Greater of the note rate or the fully indexed rate

In terms of Loan Level Price Adjustments (LLPAs), the only time there is an additional price adjustment of 0.250% on an ARM, per Fannie's LLPA Matrix, is if the LTV is over 90.01%.

Fannie allows ARMs on many different products:

- Standard purchase, limited cash-out, and cash-out refinances
- HomeStyle Renovation
- Manufactured housing.
- HomeReady; and
- High LTV refinance

We've talked mostly about Fannie Mae ARMs at this point, so let's look at Freddie Mac. Everything is the same for Freddie Mac; the only difference is that Freddie Mac requires 5% down, unlike Fannie Mae, which would accept 3% down based on their qualifying guidelines. For more on this click here.

PURCHASE AND "NO CASH-OUT" REFINANCE MORTGAGES (Fixed-Rate and ARMs)	
Property Type	**Maximum LTV/TLTV/HTLTV ratio**
1-unit Primary Residence	95%
2-unit Primary Residence	85%
3- and 4-unit Primary Residences	80%
Second home	90%
1-unit Investment Property	85%
2- to 4-unit Investment Property	75%

CASH-OUT REFINANCE MORTGAGES (Fixed-Rate and ARMs)	
Property Type	**Maximum LTV/TLTV/HTLTV ratio**
1-unit Primary Residence	80%
2- to 4-unit Primary Residence	75%
Second home	75%
1-unit Investment Property	75%
2- to 4-unit Investment Property	70%

ARMs are available on many Freddie Mac programs:

- Home Possible® Mortgage options
- Financed Permanent Buydown
- Construction conversion mortgages, renovation mortgages, and mortgages secured by manufactured homes
- Manufactured homes
- ARMs secured by investment properties
- CHOICEHome® eligible ARMs
- CHOICERenovation® mortgages
- GreenCHOICE Mortgages®
- Super Conforming mortgages

Fannie Mae: Eligibility Matrix; Fannie Mae: Standard ARM Plan Matrix: Fannie Mae Selling Guide: B3-6-04: Fannie Mae: LLPA Matrix; Fannie Mae Selling Guide: B2-1.4-02; Freddie Mac: SOFR Indexed ARMs

Mortgage Insurance (MI)

As a mortgage professional, you might be thinking, "But if we do a 95% LTV on an ARM, the mortgage insurance will be higher than on a fixed-rate mortgage, which will negate the savings on the interest, right?" Wrong.

Per MGIC, mortgage insurance premiums are the same for fixed-rate loans and ARMs with an initial fixed period of five years or more. MI on fixed-rate mortgages are determined by the LT, and credit score of the borrower. When pricing ARMs with an initial fixed period of **seven years or more,** the only difference is that the mortgage insurance rate is based on the ARM's **note rate.**

MGIC Training: Getting Comfortable with ARMs (again) (used with permission).

Borrower Considerations

Now that you have a better understanding of ARMs and their guidelines, how would you know if an ARM is right for your borrower?

A good place to start is by asking some questions about their short- and long-term goals.

For instance:

1. How long do they plan to own the home?
2. How important is keeping the payment the same?
3. Are they comfortable with the risk of their payment increasing?
4. What's the maximum rate they'd feel comfortable facing?
5. Is it likely that their income will increase? Any chance it decreases?
6. Do they anticipate any major expenses: tuition, new car, medical bills, etc.?
7. Do they like or dislike the idea of an ARM and how it works?
8. What are their feelings about the current fixed-rate interest rates versus an ARM interest rate? (show them both interest rate options)?

Other Updates From Around the Industry

Our industry is ever evolving. Let's look at a few of the updates. Make sure you have access to current mortgage news and that you take time to read about, listen to, and basically keep up with the changes.

FHFA – Validation and Approval of FICO 10T and VantageScore 4.0 Credit Score Models

In October of 2022, there was big news on the New VantageScore 4.0 and FICO 10T credit score models. Let's look at the FHFA's Factsheet on this announcement:

On October 24, 2022, the Federal Housing Finance Agency (FHFA) announced the validation and approval of both the FICO 10T and the VantageScore 4.0 credit score models for use by Fannie Mae and Freddie Mac (the Enterprises). After a multiyear transition period, lenders will be required to deliver loans with both scores when available.

Currently, Fannie and Freddie use Classic FICO, a model that they have required [the mortgage industry to use] for nearly 20 years. In 2014, FHFA, Fannie and Freddie, began an effort to modernize the credit score model requirements, and in 2018, Congress required FHFA to create a process for validating and approving credit score models. The validation and approval of FICO 10T and VantageScore 4.0 is the result of a long effort by FHFA, Fannie and Freddie, to further support accuracy, innovation, and inclusion in credit score models.

As a result of FHFA's announcement, lenders, investors, and other industry stakeholders, as well as borrowers and first-time homebuyers, can expect:

1. ***More Accurate Credit Scores:** Part of the evaluation of new credit score models included extensive testing to ensure that any validated and approved models met the necessary accuracy standards to treat borrowers fairly and to protect the safety and soundness of the mortgage market. Both FICO 10T and VantageScore 4.0 met those standards. •*

2. ***More Inclusive Credit Scores:** While both Enterprises have already taken steps to expand equitable access to credit, such as enhancements to their underwriting systems, both FICO 10T and VantageScore 4.0 include new payment history information such as rent, utilities, and telecom payments when available.*

3. ***Enhanced Safety and Soundness in the Housing Market:*** *Promoting accuracy and newer innovative credit score models in the housing finance system will ultimately lead to better outcomes for borrowers, lenders, and the Enterprises. Additionally, because both FICO 10T and VantageScore 4.0 are more accurate than Classic FICO, the mortgage market will be provided with an improved view of risk from two different credit score models.*

*On October 24, 2022, FHFA also announced that the Enterprises will **require two**, rather than three, credit reports from the national consumer reporting agencies. This change to the Enterprises' credit report requirements is expected to reduce costs and encourage innovation, without introducing additional risk to the Enterprises.*

FHFA and the Enterprises expect that implementation of FICO 10T and VantageScore 4.0 will be a multiyear effort. FHFA and the Enterprises are committed to working with stakeholders to ensure a smooth transition to VantageScore 4.0 and FICO 10T and to the new credit report requirements, with a key priority being to reduce unnecessary cost and complexity.

Until this point, Fannie and Freddie have mostly used what they call the 'Classic FICO.'

The FICO® Score was introduced in 1989. It revolutionized the credit application process by enabling credit issuers to give qualified borrowers quick approvals on loans, credit cards, and in-store financing programs.

As you'd expect, for any decades-old system, the FICO® Score has seen many updates since its introduction. It has also spawned multiple specialized spinoff versions designed for specific industries. Today, there are at least 16 versions, or models, of the FICO® Score, which is used by 90% of top lenders. The most widely used versions are FICO Score 9 and Score 8. These are used by Experian, Equifax, and TransUnion.

What is the major difference between the Classic FICO credit scoring models and the new FICO 10T and Vantage Score 4.0? **Trended Data.** Per Experian:

Definition of Trended Data

By analyzing historical payment information, lenders can determine if a consumer is consistently paying more than the minimum payment, has a demonstrated ability to pay and shows no signs of payment stress. It can conversely identify if a consumer is making only minimum payments and has increasing payment stress.

Knowing how a consumer uses credit, or pays back debt over time, can help lenders offer the right products and terms to increase response rates [your borrower taking you up on the offer or quote], determine up-sell and cross-sell opportunities, prevent attrition, identify profitable customers, avoid consumers with payment stress and limit loss exposure. Using a consumer's historical payment information provides a more accurate assessment of future behavior, which in turn, helps effectively manage changes in risk, predicts in-the-market timing or balance transfer activity, and provides additional insight for other lending strategies.

VantageScore 4.0 uses ***machine learning technology***, meaning that computers learn from financial data, identify patterns, and generate credit scores automatically. Machine learning is giving consumers more credit access than ever before—and giving lenders more opportunities to serve them. It also includes trended credit data. This means that it uses consumer credit behavior ***over a period of time instead of via a sample snapshot***.

FICO 10T uses FICO's version of VantageScore trending data. Per FICO:

Scores that don't use trended data typically use the most recently reported month of data to drive certain components of the score, such as the most recently reported balance and/or credit limit on an account.

By contrast, with FICO Score 10 T the "trended data" considers a longer historical time frame (the previous 24 months or longer) of the balance and/or credit limit to get a more refined view of your credit risk.

The trended data allows the credit scoring model to determine what the "trend" is: are the balances trending up, down, or staying the same?

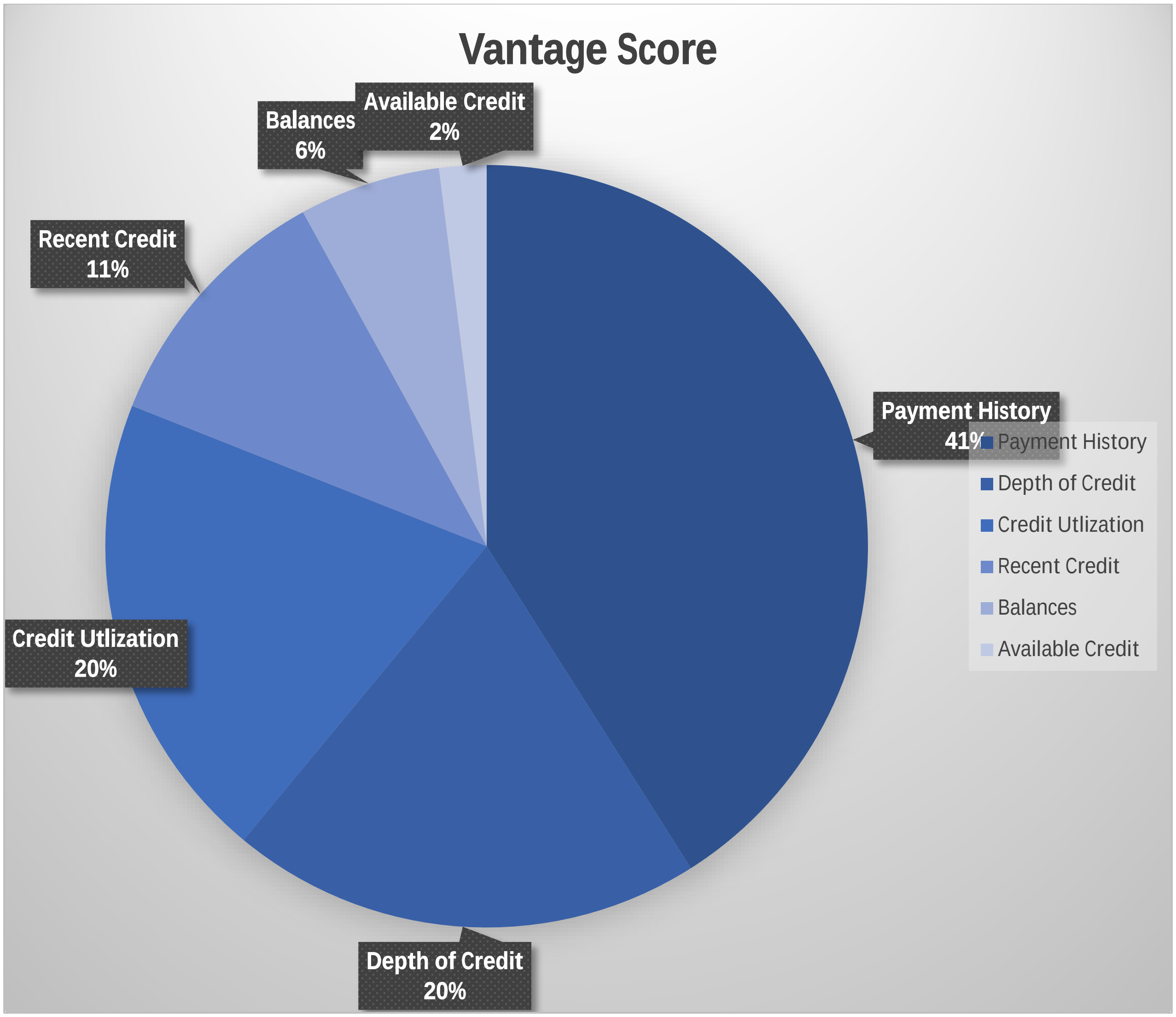
Someone whose balances are trending up may be higher risk than someone whose balances are trending down or staying the same.

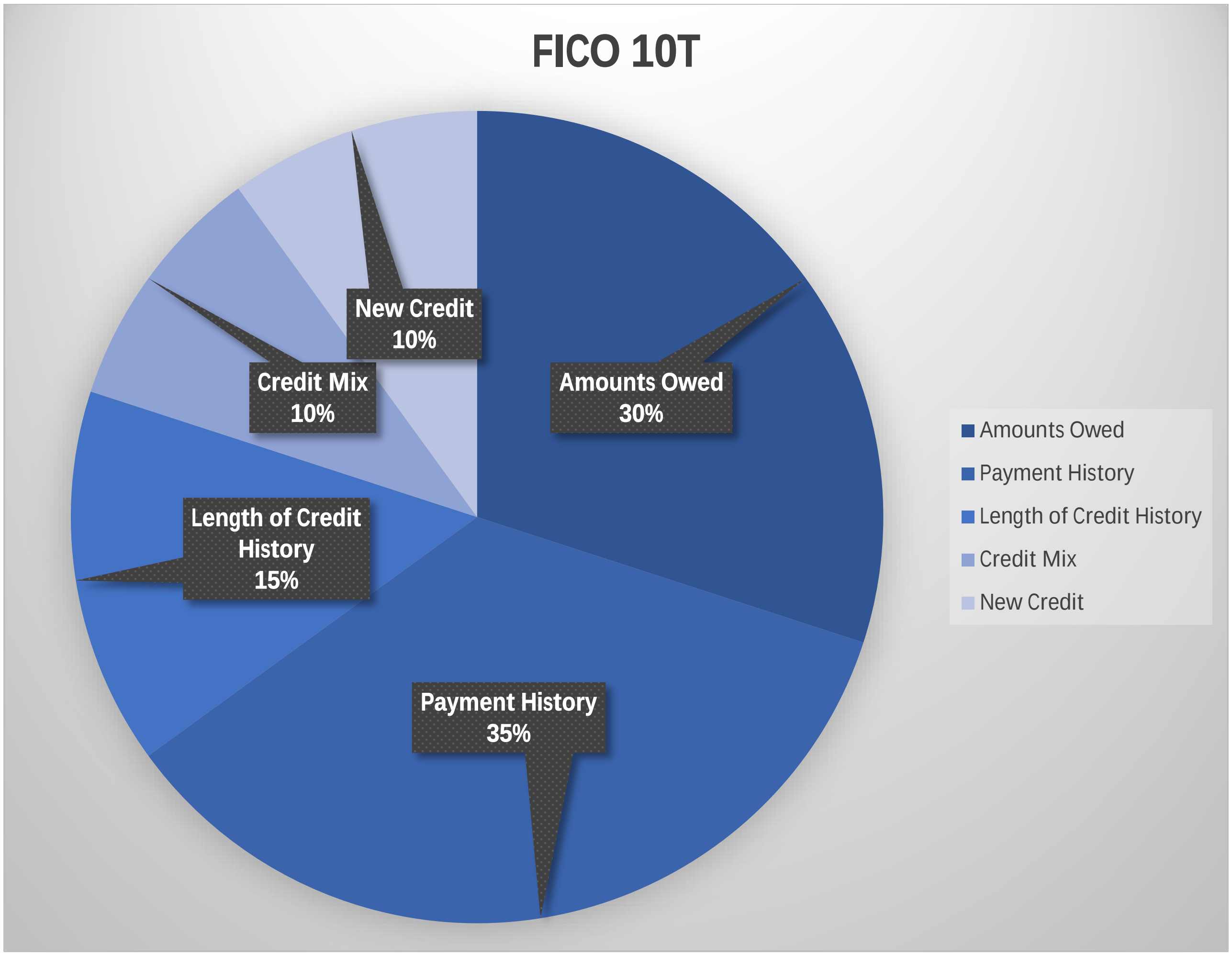
Each of the two credit scoring models use different score ranges and terminology to describe a borrower's credit. Let's compare:

Score Range For Vantage 4.0	Score Range for FICO 10T
781-805 – Superprime	**800 plus – Exceptional**
661-78- - Prime	**740-799 Very Good**
601-660- Near Prime	**670-739 - Good**

300-600 - Subprime	**580-669 – Fair**
	Less than 580 – Poor

Each of the credit scoring models use different determining factors and weigh factors differently. Let's compare:





FHFA Announcement; The Complete Guide to Your VantageScore; myFICO Education; Experian: What is Trended Data?

LLPAs Changing in 2023

To promote sustainable and equitable access to affordable housing, on Oct. 24, 2022, FHFA announced targeted changes to Fannie Mae and Freddie Macs' pricing by ***eliminating upfront fees*** for certain borrowers and affordable mortgage products.

FHFA also announced targeted increases to the upfront fees for some cash-out refinance loans.

Here are the basics of that announcement:

- NO LLPAs (Loan Level Price Adjustments) for First Time Homebuyer, HomeReady, and Manufactured.
- Cash-out refinance LLPAs will increase or decrease for some borrowers, depending on credit score and LTV.

Here is the before:

Cash-Out Refinance (Price Adjustments do not apply on the FNMA Student Loan Cash-Out products)								
	<=60%	60.01-70%	70.01-75%	75.01-80%	80.01-85%	85.01-90%	90.01-95%	95.01-97%
>=740	-0.375	-0.625	-0.625	-0.875	N/A	N/A	N/A	N/A
720-739	-0.375	-1.000	-1.000	-1.125	N/A	N/A	N/A	N/A
700-719	-0.375	-1.000	-1.000	-1.125	N/A	N/A	N/A	N/A
680-699	-0.375	-1.125	-1.125	-1.750	N/A	N/A	N/A	N/A
660-679	-0.625	-1.125	-1.125	-1.875	N/A	N/A	N/A	N/A
640-659	-0.750	-1.750	-1.750	-2.750	N/A	N/A	N/A	N/A
620-639	-0.750	-1.750	-1.750	-3.250	N/A	N/A	N/A	N/A
<620	-1.625	-2.625	-2.625	-3.250	N/A	N/A	N/A	N/A

Here is the after:

Representative Credit Score	LTV Range			
	≤60.00%	60.01-70.00%	70.01-75.00%	75.01-80.00%
≥ 740	0.375%	0.750%	1.375%	1.875%
720 – 739	0.500%	1.125%	1.500%	2.000%
700 – 719	0.500%	1.125%	1.625%	2.000%
680 – 699	0.625%	1.500%	1.625%	2.000%
660 – 679	0.875%	1.750%	1.750%	2.000%
640 – 659	0.875%	1.875%	1.875%	2.125%
620 – 639	0.875%	1.875%	1.875%	2.125%
< 620	0.875%	1.875%	1.875%	2.125%

Fannie Mae, Freddie Mac and FHFA have announced more changes to the LLPA matrixes in first quarter 2023. These new matrixes (see below) are effective August 1, 2023. The implementation of additional changes to their LLPA framework that represent the next step in their effort to increase support for borrowers historically underserved by the housing finance market while ensuring a level playing field for small and large lenders, fostering capital accumulation, and achieving viable returns on capital.

Some other notable changes include new delineation of credit score and LTV ratio buckets and the inclusion of an additional LLPA attribute related to DTI ratio, which may be subject to an applicable waiver.

In addition, they also released a revamped LLPA Matrix that differentiates pricing by loan purpose. By capturing all LLPAs associated with each loan purpose on one page, they believe the new matrix is concise and comprehensive. The redesigned LLPA Matrix includes stand-alone, base price grids for purchase loans, limited cash-out refinance loans, and cash-out refinance loans, along with additional LLPAs by loan attribute. The modernized matrix supports pricing model durability through market cycles and conditions.

Purchase Money Loans – LLPA by Credit Score/LTV Ratio										
Credit Score	LTV Range Applicable for all loans with terms greater than 15 years									
	≤ 30.00%	30.01 – 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	80.01 – 85.00%	85.01 – 90.00%	90.01 – 95.00%	>95.00%	SFC
≥ = 780	0.000%	0.000%	0.000%	0.000%	0.375%	0.375%	0.250%	0.250%	0.125%	N/A
760 – 779	0.000%	0.000%	0.000%	0.250%	0.625%	0.625%	0.500%	0.500%	0.250%	N/A
740 – 759	0.000%	0.000%	0.125%	0.375%	0.875%	1.000%	0.750%	0.625%	0.500%	N/A
720 – 739	0.000%	0.000%	0.250%	0.750%	1.250%	1.250%	1.000%	0.875%	0.750%	N/A
700 – 719	0.000%	0.000%	0.375%	0.875%	1.375%	1.500%	1.250%	1.125%	0.875%	N/A
680 – 699	0.000%	0.000%	0.625%	1.125%	1.750%	1.875%	1.500%	1.375%	1.125%	N/A
660 – 679	0.000%	0.000%	0.750%	1.375%	1.875%	2.125%	1.750%	1.625%	1.250%	N/A
640 - 659	0.000%	0.000%	1.125%	1.500%	2.250%	2.500%	2.000%	1.875%	1.500%	N/A
≤ 639[1]	0.000%	0.125%	1.500%	2.125%	2.750%	2.875%	2.625%	2.250%	1.750%	N/A

Additional LLPAs by Loan Attribute Applicable to Purchase Money Loans										
Loan Feature	LTV Range Applicable for all loans									
	≤ 30.00%	30.01 – 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	80.01 – 85.00%	85.01 – 90.00%	90.01 – 95.00%	>95.00%	SFC
Adjustable-rate mortgage	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.250%	0.250%	N/A
Condo[2]	0.000%	0.000%	0.125%	0.125%	0.750%	0.750%	0.750%	0.750%	0.750%	N/A
Investment property	1.125%	1.125%	1.625%	2.125%	3.375%	4.125%	4.125%	4.125%	4.125%	N/A
Second home	1.125%	1.125%	1.625%	2.125%	3.375%	4.125%	4.125%	4.125%	4.125%	N/A
Manufactured home[3]	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	235
Two- to four-unit property	0.000%	0.000%	0.375%	0.375%	0.625%	0.625%	0.625%	0.625%	0.625%	N/A
High-balance fixed-rate	0.500%	0.500%	0.750%	0.750%	1.000%	1.000%	1.000%	1.000%	1.000%	808
High-balance ARM	1.250%	1.250%	1.500%	1.500%	2.500%	2.500%	2.500%	2.750%	2.750%	808
Subordinate financing[4]	0.625%	0.625%	0.625%	0.875%	1.125%	1.125%	1.125%	1.875%	1.875%	N/A
DTI Ratio > 40%	0.000%	0.000%	0.250%	0.250%	0.375%	0.375%	0.375%	0.375%	0.375%	N/A

Limited Cash-out Refinances – LLPA by Credit Score/LTV Ratio										
Credit Score	LTV Range Applicable for all loans with terms greater than 15 years									
	≤ 30.00%	30.01 – 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	80.01 – 85.00%	85.01 – 90.00%	90.01 – 95.00%	>95.00%	SFC
≥ = 780	0.000%	0.000%	0.000%	0.125%	0.500%	0.625%	0.500%	0.375%	0.375%	007
760 – 779	0.000%	0.000%	0.125%	0.375%	0.875%	1.000%	0.750%	0.625%	0.625%	007
740 – 759	0.000%	0.000%	0.250%	0.750%	1.125%	1.375%	1.125%	1.000%	1.000%	007
720 – 739	0.000%	0.000%	0.500%	1.000%	1.625%	1.750%	1.500%	1.250%	1.250%	007
700 – 719	0.000%	0.000%	0.625%	1.250%	1.875%	2.125%	1.750%	1.625%	1.625%	007
680 – 699	0.000%	0.000%	0.875%	1.625%	2.250%	2.500%	2.125%	1.750%	1.750%	007
660 – 679	0.000%	0.125 %	1.125%	1.875%	2.500%	3.000%	2.375%	2.125%	2.125%	007
640 - 659	0.000%	0.250%	1.375%	2.125%	2.875%	3.375%	2.875%	2.500%	2.500%	007
≤ 639[1]	0.000%	0.375%	1.750%	2.500%	3.500%	3.875%	3.625%	2.500%	2.500%	007

Additional LLPAs by Loan Attribute Applicable to Limited Cash-out Refinances										
Loan Feature	LTV Range Applicable for all loans									
	≤ 30.00%	30.01 – 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	80.01 – 85.00%	85.01 – 90.00%	90.01 – 95.00%	>95.00%	SFC
Adjustable-rate mortgage	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.250%	0.250%	N/A
Condo[2]	0.000%	0.000%	0.125%	0.125%	0.750%	0.750%	0.750%	0.750%	0.750%	N/A
Investment property	1.125%	1.125%	1.625%	2.125%	3.375%	4.125%	4.125%	4.125%	4.125%	N/A
Second home	1.125%	1.125%	1.625%	2.125%	3.375%	4.125%	4.125%	4.125%	4.125%	N/A
Manufactured home[3]	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	235
Two- to four-unit property	0.000%	0.000%	0.375%	0.375%	0.625%	0.625%	0.625%	0.625%	0.625%	N/A
High balance fixed-rate	0.500%	0.500%	0.750%	0.750%	1.000%	1.000%	1.000%	1.000%	1.000%	808
High-balance ARM	1.250%	1.250%	1.500%	1.500%	2.500%	2.500%	2.500%	2.750%	2.750%	808
Subordinate financing[4]	0.625%	0.625%	0.625%	0.875%	1.125%	1.125%	1.125%	1.875%	1.875%	N/A
DTI Ratio > 40%	0.000%	0.000%	0.250%	0.250%	0.375%	0.375%	0.375%	0.375%	0.375%	N/A

Cash-out Refinance Loans[5] – LLPA by Credit Score/LTV Ratio						
Credit Score	LTV Range Applicable for all loans					
	≤ 30.00%	30.01 – 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	SFC
≥ = 780	0.375%	0.375%	0.625%	0.875%	1.375%	003
760 – 779	0.375%	0.375%	0.875%	1.250%	1.875%	003
740 – 759	0.375%	0.375%	1.000%	1.625%	2.375%	003
720 – 739	0.375%	0.500%	1.375%	2.000%	2.750%	003
700 – 719	0.375%	0.500%	1.625%	2.625%	3.250%	003
680 – 699	0.375%	0.625%	2.000%	2.875%	3.750%	003
660 – 679	0.375%	0.875%	2.750%	4.000%	4.750%	003
640 - 659	0.375%	1.375%	3.125%	4.625%	5.125%	003
≤ 639[1]	0.375%	1.375%	3.375%	4.875%	5.125%	003

Additional LLPAs by Loan Attribute Applicable to Cash-out Refinances						
Loan Feature	LTV Range Applicable for all loans					
	≤30.00%	30.01-60.00%	60.01-70.00%	70.01-75.00%	75.01-80.00%	SFC
Condo[2]	0.000%	0.000%	0.125%	0.125%	0.750%	N/A
Investment property	1.125%	1.125%	1.625%	2.125%	3.375%	N/A
Second home	1.125%	1.125%	1.625%	2.125%	3.375%	N/A
Manufactured home[3]	0.500%	0.500%	0.500%	0.500%	0.500%	235
Two- to four-unit property	0.000%	0.000%	0.375%	0.375%	0.625%	N/A
High-balance fixed-rate	1.250%	1.250%	1.500%	1.500%	1.750%	808
High-balance ARM	2.000%	2.000%	2.250%	2.250%	3.250%	808
Subordinate financing[4]	0.625%	0.625%	0.625%	0.875%	1.125%	N/A
DTI Ratio > 40%	0.000%	0.000%	0.250%	0.250%	0.375%	N/A

Fannie Mae LLPA Matrix; Fannie Mae Announcement; Fannie Mae New Matrix

More Fannie Mae Updates

Specifically, from Fannie Mae, a few other things have come out of first quarter that we want to make you aware of:

1. **Cash-out Refi Seasoning:** cash out loans must now have 12 months seasoning from note date of existing loan being paid off, and the new mortgage note date. This is a big change from the previous 6 months seasoning requirement.
2. **Valuation modernization** involves leveraging technologies, data, and analytics to enhance the management of collateral risk, making the process more efficient for lenders, borrowers, appraisers, and secondary-market investors. Valuation modernization helps lenders, appraisers, and risk investors manage collateral risk more effectively, while also benefiting consumers via greater appraisal accuracy, lower costs, and increased speed of loan decisioning

More on the Valuation Modernization: Fannie states that "We are on a journey of continuous improvement to make the home valuation process more efficient and accurate. As such, we are transitioning to a range of options to establish a property's market value, with the option matching the risk of the collateral and the loan transaction. The spectrum balances traditional appraisals with appraisal alternatives."

In the same Selling Guide announcement introduced some new tools including:

- **Value acceptance** is being used in conjunction with the term "appraisal waiver" to better reflect the actual process of using data and technology to accept the lender-provided value. They are moving away from implying that an appraisal is a default requirement. (Note that they are using “value acceptance (appraisal waiver)” for a period of time and will eventually move to “value acceptance” after the market absorbs this change.)

- **Value acceptance + property data** which is a new option that utilizes property data collection by a third party who conducts interior and exterior data collection on the subject property. To ensure consumer protections, the lender must verify and be able to demonstrate that data collectors are vetted through an annual background check, professionally trained, and they possess the essential knowledge to competently perform the property data collection.
- **Hybrid appraisals** are based on interior and exterior property data collection by a vetted and trained third-party that is provided to an appraiser to inform the appraisal.
    - They are permitted for certain one-unit transactions where value acceptance + property data was initially started, but changes in loan characteristics results in the transaction not being eligible for that option.

They also announced a new policy that allows alternative methods to the Appraisal Update and/or Completion Report (Form 1004D). These include a borrower/builder attestation letter to verify completion of construction, and a borrower attestation letter to confirm completion of repairs for existing construction in lieu of Form 1004D. The policy further describes required exhibits and controls. These completion alternatives are necessary for lenders to confirm completion of repairs or alterations with the value acceptance + property data option because Form 1004D cannot be used when there is no appraisal. This change also allows appraisers to use virtual inspection technology to supplement the 1004D process with certain constraints.

Fannie Mae Selling Guide Announcement (1/2023); Fannie Mae Selling Guide Announcement (3/2023)

FHA Updates

We wanted to bring you a couple new FHA updates specifically: new mortgage insurance (MIP) premiums and an update on policies related to individuals having multiple roles in a transaction and being compensated for both.

First off, MIP is dropped from 80 bps to 50 bps coming April 2023.

Annual Mortgage Insurance Premium (MIP)			
Applies to all Mortgages except: • Streamline Refinance and Simple Refinance Mortgages used to refinance a previous FHA endorsed Mortgage on or before May 31, 2009 • Hawaiian Home Lands (Section 247)			
Hawaiian Home Lands (Section 247) do not require Annual MIP.			
Mortgage Term of More Than 15 Years			
Base Loan Amount	**LTV**	**MIP (bps)**	**Duration**
Less than or equal to $726,200	≤ 90.00%	50	11 years
	> 90.00% but ≤ 95.00%	50	Mortgage term
	> 95.00%	55	Mortgage term
Greater than $726,200	≤ 90.00%	70	11 years
	> 90.00% but ≤ 95.00%	70	Mortgage term
	> 95.00%	75	Mortgage term
Mortgage Term of Less than or Equal to 15 Years			
Base Loan Amount	**LTV**	**MIP (bps)**	**Duration**
Less than or equal to $726,200	≤ 90.00%	15	11 years
	> 90.00%	40	Mortgage term
Greater than $726,200	≤ 78.00%	15	11 years
	> 78.00% but ≤ 90.00%	40	11 years
	> 90.00%	65	Mortgage term

Also, in Late 2022 – FHA issued a mortgagee letter clarifying who can have multiple roles and be paid in a transaction – this has always been a little unclear but with this mortgagee letter – they clarified that Individuals that have a ***direct impact*** on the mortgage approval decision are prohibited from having multiple roles or sources of compensation. (ex: underwriter, processors) while Participants that ***do not have a direct impact*** on the mortgage approval decision may have multiple roles or sources of compensation. (ex: Real Estate agents) This means that more real estate agents might look to become loan officers now that it's acceptable to do so on both conventional and FHA loans – or you could look to expand your business into real estate and still originate. So, be aware.

FHA Mortgagee Letter 2022-22; FHA Mortgagee Letter – 2023-05

2023 Conventional Loan Limits

As always, the Federal Housing Finance Agency (FHFA) has updated the conventional loan limits for 2023. They are as follows:

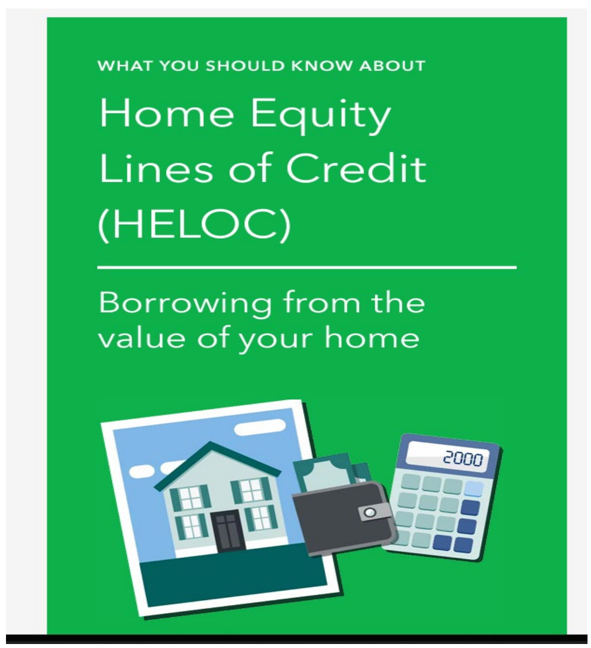
1. Loan Limit for one-unit properties will be $726,200, an increase of $79,000 from $647,200 in 2022
   a. Two unit: $929,850
   b. Three unit: $1,123,900
   c. Four Unit: 1,396,800
2. Special statutory provisions establish different loan limits for Alaska, Hawaii, Guam, and the U.S. Virgin Islands. In these areas, the baseline loan limit will be $1,089,300 for one-unit properties.

FHFA Press Release

New HELOC Booklet

In December of 2022, the Consumer Financial Protection Bureau (CFPB) released a new HELOC Booklet entitled "What You Need to Know About Home Equity Lines of Credit (HELOC). This Booklet is required to be provided to borrowers within three days of application on all HELOC transactions.

For more information: click here



Chapter 6 Review

Now that you've completed Chapter 6, let’s discuss what we covered. In this chapter, we covered the basics of adjustable rate mortgages, including guidelines from Fannie Mae and Freddie Mac, we also discussed some updates like the FICO 10T and VantageScore 4.0.

- An ARM can be a great option for certain borrowers during high-interest rate times, and there are quite a few pros to offering it to borrowers.
- Be sure to ask all the right questions to ascertain whether an ARM is a good fit for your borrowers.
- Always keep up to date on new products and programs or changes entering the market. Some changes may have excellent benefits for your borrowers!
- Be aware of the changes coming with the new FICO 10T and Vantage 4.0 Credit Scoring Models.