Chapter Objectives

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

Ethical and Legal Considerations

- Treat everyone equally
- Be honest
- Give full disclosure
- Don’t take advantage of people
- Keep good documentation
- Follow the law
  - Letter of the law and its intent
- Adhere to a code of ethics
Code of Ethics

• Honesty and integrity
  – Basic obligation to protect consumers
  – Act in accordance with standard practices
  – Treat others as you’d like to be treated

• Professional conduct
  – Always use reasonable care and skill
  – Never take on tasks beyond your ability
  – Never claim expertise you don’t have
  – Never pressure anyone to circumvent professional standards

• Honesty in advertising
  – Clearly state terms and conditions can change if they
    can or are likely to
  – Advertise only terms and conditions that are likely to
    be available (avoid bait and switch)

• Confidentiality
  – Use customer’s personal information only for
    intended business purpose
  – Do not share personal information with anyone unless
    needed to complete transaction
  – Put procedures in place to protect information

• Compliance with the law
  – Know and understand the law
  – Stay current with changes to the law

• Disclosure of financial interests
  – Avoid all situations that might lead to real or apparent conflict
    of interest
  – Do not to use position for personal gain or benefit
  – Disclose:
    • Business relationships with any party to a transaction
    • Personal / family relationships
    • Equity or financial interest in property
    • Any agreement that could restrict duties
Ethical Discussion #1

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

Were Roger’s actions ethical? Why or why not?

Unethical Behavior: Penalties

- Action by the state licensing authority
- Civil lawsuits filed by injured parties
- Disciplinary action by professional associations
- The filing of criminal charges.

Advertising and the FTC

- Advertisement: Commercial message in any medium that promotes, directly or indirectly, a credit transaction
- Federal Trade Commission:
  - Authority to protect consumer interests
  - Prohibits unfair and deceptive practices
- Ads should not:
  - Misrepresent material facts
  - Make false promises
  - Conceal material factors
  - Additional rules have been added by the CFPB under Regulation N Prohibited representations
- Misrepresentation: False or misleading information; unintentional or negligent
- Material if could cause different decision if known
Bait and Switch

- Alluring but insincere offer to sell product or service
- Purpose is to switch consumers from buying advertised product to something else
  - More expensive
  - Less advantageous to consumer
- Still bait and switch if consumer chooses other product/service

Chapter 13: Ethics in the Mortgage Lending Profession

Bona Fide Offer and Switch

- Offer not bona fide:
  - Refusal of advertiser to sell product offered
  - Disparagement of advertised product
  - Failure to make product available
  - Refusal to take orders for product
  - Showing product that is impractical for purpose represented
  - Compensating sales staff for not selling advertised product
- Switch after sale

Chapter 13: Ethics in the Mortgage Lending Profession

Mortgage Advertising

MLO Jane advertises what she calls “5 for 5” mortgage loans: 5% down and 5% fixed rate interest for 30 years. A qualified borrower comes in and starts the loan process, paying for a credit report, and completing a loan application. But Jane does not lock in that interest rate. She knows that rates are going up, so she sits on the application for an extra week, and then tells the borrower that the best she can do is 5 3/4%.

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

Chapter 13: Ethics in the Mortgage Lending Profession
Mortgage Advertising

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

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

Unfair and Deceptive Advertising

• Unfair
  1: The act causes or is likely to cause substantial injury (monetary harm) to consumers
  2: The injury is not reasonably avoided by consumers, and
  3: The injury is not outweighed by countervailing benefits to the consumers or to competition.

• Deceptive
  1: The representation, omission, act, or practice misleads or is likely to mislead the consumer,
  2: The consumers interpretation of the representation, omission, act or, practice is reasonable under the circumstances, and
  3: The misleading representation, omission, act, or practice is material.

Unfair and Deceptive Advertising

• Abusive
  1: An act that materially interferes with the ability on the part of the consumer to understand a term or condition of a consumer Financial product or service, or
  2: Reasonably takes advantage of, a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; the inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.
FTC Advice to Consumers

- Understand all terms and conditions
- Don’t be tempted by ads that don’t disclose all terms
- APR is critical and may be hidden or buried
- Important payment information may be excluded; be prepared to ask
- Consider shopping with several lenders
- Negotiating is acceptable
- Look for buzzwords (should be fair, accurate, complete)

http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt023.shtm

Internet

- Same laws for print and broadcast apply
- Disclosures must be clear and conspicuous
  - Near triggering claim
  - Text or visual clues
  - Obvious links
  - Prominently displayed
  - Limit distractions
  - Sufficient duration
  - Clear language

http://www.ftc.gov/opa/2000/05/dotcom.shtm

Advertising Ethics: Guidance

- Does your advertising make your customers satisfied that they do business with you?
- Are you avoiding impossible promises and guarantees?
- Are your advertised merchandise or programs readily available?
- Do you mean to sell what you advertise?
- Do your ads avoid misleading inferences?
- Do your advertised terms agree with the facts?
- Is your advertising easy to understand without asterisks and fine print?
- Do you believe your own comparatives?
- Would you be attracted by what your ad says?
- Follow all federal and state laws; include NMLS and Equal Housing Lender logo/slogan as appropriate
Laws Against Illegal Discrimination

• Fair and equitable treatment in housing and real estate transactions is a right by law
• In this section:
  – Civil Rights Act of 1866
  – Fair Housing Act The Equal Credit Opportunity Act (ECOA)
  – The Community Reinvestment Act (CRA)
  – The Home Mortgage Disclosure Act (HMDA)

Civil Rights Act of 1866

• Prohibits public and private racial discrimination in any property transaction in the United States
• Applies to all property—real or personal, residential or commercial, improved or unimproved
• Also prohibits any discrimination based on ancestry
• Allows someone who has been unlawfully discriminated against to sue in federal district court
• Remedies may include:
  – Injunctions
  – Compensatory damages
  – Punitive damages

Fair Housing Act

• Title VIII of the Civil Rights Act of 1968
• Prohibits discrimination against protected classes in the sale or lease of residential property
  • Race or color
  • Sex
  • Disability
  • Religion
  • National origin
  • Familial status
• Exemptions
  – Room in owner-occupied 1-4 units
  – Single-family home sold or rented by a private owner without the use of a broker
  – Housing for organizations, private clubs
Fair Housing: Violations

- Refusing to rent/sell property after good faith offer
- Refusing to negotiate sale/rental of residential property
- Taking any action that would otherwise make residential property unavailable or deny it to any person
- Using discriminatory advertising that indicates limitation/preference or intent to do so
- Making any representation that property is not available for inspection/sale/rent when it is
- Coercing, intimidating, threatening, or interfering with anyone for exercising rights granted by the Fair Housing Act
- Discriminating in the terms/conditions of any sale/rental of residential property or providing any services/facilities

Fair Housing: Mortgage Lending

- Refusing to make a mortgage loan
- Refusing to provide information regarding loans
- Imposing different terms or conditions on a loan
- Discriminating in the appraisal of property
- Refusing to purchase a loan or setting different terms or conditions for purchasing a loan
- Blockbusting—trying to induce owners to sell their homes by suggesting that the ethnic or racial composition of the neighborhood is changing, with the implication that property values will decline
- Steering—channeling prospective real estate buyers or tenants to particular neighborhoods based on their race, religion, or ethnic background
- Redlining—refusal to make loans on property located in a particular neighborhood for discriminatory reasons

Fair Housing: Advertising

- Include the "equal housing lender" slogan in any broadcast advertisement
- Display the Equal Housing Opportunity poster in every branch where mortgage loans are made
- Display the Equal Housing Opportunity logo on all printed promotional material
Fair Housing: Enforcement

- May file complaint with HUD office within 1 year of alleged violation
- Complaints may be
  - Investigated by Office of Fair Housing and Equal Opportunity (FHEO)
  - Referred to state or local agency
  - Heard by HUD
- May file civil lawsuit
  - Court may grant injunction, compensatory damages, punitive damages, attorney fees
- U.S. Attorney General may sue for ongoing pattern

Equal Credit Opportunity Act

- Ensures all consumers given equal chance to obtain credit
- Passed in 1974 and implemented as Regulation B by Consumer Financial Protection Bureau
- Protects individual and business borrowers from
  - Any creditor who regularly extends credit
  - Anyone involved in granting credit
- Requires credit bureaus to maintain separate credit files on married spouses, if requested

ECOA: Protected Classes

Prohibits discrimination in granting credit or discouragement of applicants on basis of:

- Sex
- Age *
- Marital status
- Race
- Color
- Religion
- National origin
- Receipt of public assistance
- Exercised rights under the Consumer Credit Protection Act

* if legal capacity to contract
ECOA: Marital Status

- Ask only if:
  - Joint application
  - Spouse income, alimony, or child support needed to qualify
  - In a community property state

- Use only these terms:
  - “Married”
  - “Unmarried” (which refers to single, divorced, widowed)
  - “Separated”

- May not ask about plans for having/raising children
  - May ask about expenses related to dependents

ECOA: Loan Application

- Compliance with government monitoring
  - Ethnicity
  - Race
  - Sex

ECOA: Income

- Cannot discount or refuse to consider:
  - Public assistance income
  - Income because of sex or marital status
  - Income from part-time employment, pension, annuity, or retirement benefits programs
  - Regular alimony, child support, or separate maintenance payments if the applicant chooses to disclose it

- Cannot discriminate against applicant who exercises good faith rights of nondisclosure
ECOA: Considering Age

- Applicant is too young to sign contracts
- Creditor would favor applicants age 62 and older
- Used to determine the meaning of other factors important to creditworthiness
- Used in a valid credit scoring system that favors applicants depending on their age

ECOA: Compliance/Enforcement

- Creditor must maintain consumer records for 25 months after taking action
- Enforced by CFPB and appropriate regulatory agencies
- Civil action may be filed within 2 years
  - Individual action: Actual damages; punitive damages limited to $10,000
  - Class action: Actual damages; punitive damages limited to lesser of $500,000/1% of creditor’s net worth

Community Reinvestment Act

- Enacted in 1977 to encourage financial institutions to help meet local credit needs
- Includes low- and moderate-income neighborhoods
- Requires periodic evaluation of depository institutions by supervising regulator
  - Considered for institution’s application for deposit facilities, including mergers and acquisitions
- CRA provisions may be extended to mortgage lenders in some states
Home Mortgage Disclosure Act

- HMDA enacted 1975 and enforced by the CFPB as Regulation C
- Applies to financial institutions/non-depository institutions
  - Assets in excess of $10 million
  - Originate more than 100 loans per year
- Does not prohibit any specific activity of lenders nor establish loan quotas
- Collects and publishes data that can be used to determine whether financial institutions are:
  - Serving the housing needs of their communities
  - Showing signs of discriminatory lending practices

HMDA: Covered Properties

- Applies to applications for one- to four-family residential loans, including:
  - Home purchase
  - Home improvement
  - Refinancing
  - Subordinate financing
- Does not apply to loans:
  - Vacant land
  - New construction
  - Sold as part of a pool for servicing

HMDA: Data Reported

- Loan/Application Register (LAR) submitted every March with data on:
  - Loan originations
  - Applications
  - Loan purchases
  - Some requests under a pre-approval program
- Data collected:
  - Loan type, amount, and purpose
  - Rate spread
  - Property type and occupancy
  - Ethnicity, race, and sex of applicant and co-applicants
  - Applicant gross income

- Loan decision, including denial reason(s)
- Population and the percentage of which is minority (census tract)
- Meets HOEPA criteria
- Type of purchaser for sold mortgage loans
HMDA: Additional Data Reported

- Additional data to be collected when Dodd-Frank provisions implemented:
  - Age
  - Credit score
  - Total points and fees
  - Loan term and pricing
  - Prepayment penalty information
  - Loan-to-value
  - Period of any introductory interest rate
  - Interest-only or negative amortization information
  - Channel of origination

HMDA: Compliance

- Federal Financial Institutions Examination, supervisory agencies compile HMDA data
- FFIEC reports help determine compliance with ECOA
- Notice posted in lending institution lobbies

HOME MORTGAGE DISCLOSURE ACT NOTICE

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

Other Types of Discrimination

- Municipal action / exclusionary zoning
  - Laws that have a disparate impact on minorities or other protected classes
  - Have the effect of denying housing, such as prohibiting low-income housing
- Advertising
  - May not indicate limitation, preference, intent to discriminate
  - Includes words, phrases, images
Illegal Discrimination

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

*Could this potentially be an example of illegal discrimination or is Lou simply practicing good time management?*

Illegal Discrimination

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

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

Illegal Discrimination Review

<table>
<thead>
<tr>
<th>Fair Housing Act</th>
<th>Equal Credit Opportunity Act</th>
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<tbody>
<tr>
<td><em>Which class is protected by which law(s)?</em></td>
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<tr>
<td><em>Neither law? Are there protected classes missing from the list below?</em></td>
<td></td>
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<tr>
<td>Age</td>
<td>Color</td>
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<tr>
<td>Familial status</td>
<td>Marital status</td>
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<td>Military status</td>
<td>National origin</td>
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<td>Receipt of public assistance</td>
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RESPA: Kickback / Referral Fees

• Section 8 of Real Estate Settlement Procedures Act (RESPA) prohibits:
  – Giving or receiving fee, kickback, anything of value for referrals of settlement services on federally-related mortgage loan
  – Fee-splitting and receiving unearned fees
• Thing of value: Any payment, advance, funds, loan, service, other consideration
• Referral: Any action that influences selection of service provider

RESPA: Allowable Fees

• Attorney fees for services actually rendered
• Title company fees to agent for actual policy related services
• Payment for actual origination, processing, or funding services
• *Bona fide* salary or other payment for goods furnished or services actually performed
• Payments related to cooperative real estate agent/brokerage referral arrangements
• Normal promotional and educational activities not conditioned on referral
• Employer’s payment to its own employees for referral activities
• Additional, multiple settlement services that are actual, necessary, and distinct from primary services
RESPA: “Required Use”

- Prohibits requiring consumer to use particular settlement service provider
- Allows legitimate discounts on combination of services at a total price lower than sum of individual services
- Not considered a prohibited “required use” if:
  1. Use of combination is optional
  2. Lower price not made up by higher costs elsewhere

RESPA: Violations of Section 8

- Violators subject to criminal and civil penalties
- Criminal:
  - Fines up to $10,000
  - Imprisonment up to one year
- Civil lawsuit:
  - Liable for amount up to three times charge paid for the service

RESPA Violations

XYZ Mortgage encourages borrowers who receive federally-related mortgage loans from them to employ attorney Bob to perform title searches and related settlement services in connection with their transaction. XYZ and Bob have an understanding that in return for the referral of this business, Bob provides legal services to XYZ’s officers or employees at abnormally low rates or for no charge.

Since the borrower is not required to use the attorney, is anyone in violation of RESPA?
RESPA Violations

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

Is anyone in violation of RESPA?

Mortgage Fraud

- **Negligence:** *Unintentional breach of legal duty*
- **Fraud:** *Misrepresentation or concealment of material facts*
  - Actual: Intentional
  - Constructive: Negligent
- **Two categories of mortgage fraud:**
  - For profit – usually done by industry insiders
  - For property – usually done by borrowers
- **Primary methods of mortgage fraud:**
  - Material misrepresentations
  - Material misstatements
  - Omission

Fraud Participants: Borrowers

- Generally commit fraud to obtain ownership of property
- Straw buyer allows name/personal details to be used with no intention of inhabiting property
- Credit enhancement schemes
- Schemes to get out of mortgage loans:
  - Buy and bail
    - Get mortgage for similar, cheaper property
    - Claim rental of original property
    - Walk away from first home and bail on that mortgage
  - Short sale fraud
    - Offer to short sell the property to avoid foreclosure
    - Enlist straw buyer to purchase property at reduced price
  - Arson
Fraud Participants: Lenders/Brokers

- Fraudulent activities:
  - Falsifying loan documents
  - Making loans to straw buyers
  - Illegally flipping properties
- Motivation:
  - Making bad loans and selling to secondary market
  - Collecting fees and yield spread premiums

TILA: Prohibited Appraisal Practices

- implying current / future retention depends on value
- excluding appraiser for not meeting or exceeding minimum threshold
- telling appraiser minimum value needed
- failing to compensate appraiser because value is not at or above a certain amount
- Conditioning compensation on loan consummation
- Extending credit knowing improper coercion occurred unless able to document value is appropriate
- NOT prohibited:
  - Obtaining multiple appraisals if selecting most reliable
  - Withholding fee for breach or substandard performance

Fraud Participants: Appraisers

- Inflated appraisal
  - Intentionally appraised with higher-than-market value
  - Usually in collusion with others
  - Lenders use only appraisers who “hit the number”
  - Impacts future comparables
- Understating value
  - Allow purchase of foreclosed/short sale at reduced price
Fraud Participants: Others

- Attorneys (bogus deeds and other documents)
- Accountants (false tax returns, profit and loss statements, and other documentation)
- Title companies (charge for services never provided, complete incorrect title reports)
- Government workers (falsify deeds and other records)
- Real estate agents (assist in preparing false documentation, find straw buyers, steer borrowers for kickback)
- Rehabbers and FSBO (For Sale By Owner) flippers (use sub-par material, remove materials, provide straw buyers, improperly influence others)
- Investment Property Owners falsify rent rolls or property occupancy/condition

Appraisal Concerns

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

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

• Generally involves collusion among industry participants
• Property is:
  – Purchased at low price
  – Appraised at inflated price without justification
  – Resold for higher price
• More prevalent in mixed value areas
• Any repairs may be only cosmetic
• Rarely use local entities for loan

Illegal Flipping: FHA Response

• Requires 3-months seasoning before resale
• Resales from 91-180 days impose additional requirements
  – Seller is owner of record
  – Second appraisal
• Waived through end of 2011 if:
  – Arm’s length transaction
  – Increase in price does not exceed 20%

Other Mortgage Fraud Schemes

• Air Loan
  – Non-existent loans and no-collateral loans
• Deed Scam
  – Seller’s signature on the deed is forged
• Double Sold Loans
  – Loan sold to fraudulent company for servicing
  – Multiple applications submitted to multiple lenders
• Unrecorded or Silent Second
  – Seller offers concession without informing lender
• Disappearing Second
  – Entice buyers to get a larger loan/pay more for property with “seller-held” mortgage that is destroyed or canceled
• Email/Mail Scams
  – Promises to eliminate mortgage loans or credit card debt for a fee
• Identity Theft
  – Using another’s ID on loan application without knowledge of rightful owner
Identity Theft

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

**What are some “best practices” that would have helped avoid such mortgage fraud from this incident?**

FFIEC Mortgage Fraud Red Flags

- Steering buyers to specific lender
- Stated-income loans requiring little or no documentation
- No money due at closing
- Sale subject to seller acquiring title
- Difference in sale price from the contract
- Sale price changes to fit appraisal
- Related parties involved
- Funds paid to undisclosed third parties
- Cash paid to seller outside of escrow
- Cash paid to borrower

Fraud Enforcement

- Fraud Enforcement and Recovery Act (2009)
  - Makes it a felony to falsify loan documents
  - Holds private mortgage brokers and companies accountable under federal fraud law
- Suspicious Activity Reports (SARs)
  - Filed by federally insured financial institutions
  - Reports from the HUD’s Office of the Inspector General
Fraud Schemes

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

What sort of scheme is being perpetrated?

Fraud Schemes

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

What sort of scheme is being perpetrated?

Fraud Schemes

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

What sort of scheme is being perpetrated?
Predatory Lending

- Loans that take advantage of ill-informed consumers through:
  - Excessively high fees
  - Misrepresented loan terms
  - Frequent refinancing without benefit
  - Other prohibited acts, such as bundling unrelated products
- Motive is profit
  - Take property or strip its equity
  - Profit from excessive fees
- May involve subprime lenders

Predatory Lending: Excessive Fees

- Excessive fees
  - Generally, greater than 4-5% of loan amount
- Junk fees
  - Multiple fees alleging services that may or may not have been performed
- Excessive prepayment penalties
  - Lock borrowers into abusive loans
  - Discourage payoff of profitable loans
- Confusing documentation
  - Borrower should have time, assistance to review documents thoroughly

Predatory Lending: Equity Skimming

- Loans exceeding ability to repay
  - Misrepresent appropriate loan amount
  - Falsify qualifying documents
- Home improvement scams
  - Collusion between contractor and lender
- Loan flipping
  - Multiple refinancing with little or not net tangible benefit
- Extreme lending
  - Extremely high debt-to-income ratio
Foreclosure Rescue Scams

- Phony counseling or phantom help
  - Offers to “save” home for a fee
  - May have homeowner make payments directly to them
- Rent-to-buy schemes
  - Homeowner surrenders title to remain in home as renter
  - Intends to buy back later
  - Original owner is either unable to purchase or is evicted
- Bait and switch

Predatory Lending: Indicators

- Encouraging lies on application
- Knowingly lending more than borrower can afford
- Charging high interest rates based on race/national origin
- Charging fees for unnecessary or nonexistent products and services
- Pressuring borrowers into high risk loans
- Targeting vulnerable borrowers
- Stripping homeowner equity

Predatory Lending: Red Flags

- MLOs telling borrowers they are the borrower’s only option
- Price of house out of sync with neighborhood
- Borrowers asked to sign documents with blanks
- Borrowers given false information about protection provided by FHA insured loans
- Cost or loan terms different than what was agreed to
- Promises that refinancing can solve credit problems
Predatory Lending

Allen faces possible foreclosure, and contacts a mortgage lender whose ad promises to save his home. At closing, Allen sees that the lender changed the terms of the loan that they had agreed to, but he felt he had no choice but to go ahead with the loan or lose the house.

Is this an example of predatory lending?

Predatory Lending

Bill takes an application for a cash-out loan from a woman on a fixed income so that she can pay her real estate taxes. Bill does not tell her that she can make sure the new loan collects for real estate taxes, hoping in a few years she will need to get a new loan for the same reason.

Is this an example of predatory lending?

Predatory Lending

Kara has some credit issues, trying to bounce back from a recent bankruptcy. Still, she is interested in buying a home. She finds a mortgage broker who can secure a loan for her, but only if she will pay 20% down and consent to an interest rate that is higher than that offered to consumers with perfect credit.

Is this an example of predatory lending?
Predatory Lending

Pamela has applied for a loan with XYZ Mortgage Company. The mortgage loan originator tells her that since she is a single woman, she can only be approved for the loan if she takes out a credit insurance policy to cover the mortgage in the event of her death. The insurance policy requires a significant one-time fee at closing.

*Is this an example of predatory lending?*

Mortgage Assistance Relief Services

- Ban on collecting fees without written acceptable offer
- Companies must disclose key information
- False and misleading claims prohibited
- Ban on advising consumers to discontinue communication with lender

Ethical Discussion #2

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

*What should you share with Velma about the ARM loan given her situation? Are you obligated to help her apply for the loan she wants?*
Ethical Discussion #2

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

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

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

2. Were the mortgage loan originator's actions:
   - ETHICAL
   - UNETHICAL
   - DEBATABLE

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

Case Study

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Real Success

- Superior knowledge/position should not be used for personal gain at the expense of general public
- Follow the same guidelines and principles for everyone
- Treat others ethically, honestly, and with respect
- Keep good records of meetings, calls, appointments, missed appointments
- Be able to illustrate that everyone is treated fairly and equally
Key Term Review

- Advertising
- Bait and Switch
- Blockbusting
- Civil Rights
- Community Reinvestment Act
- Equal Credit Opportunity Act/
- Fair Housing Act
- Familial Status
- Flipping
- Fraud
- Home Mortgage Disclosure Act
- Kickback
- Material Fact
- Negligence
- Predatory Lending
- Redlining
- Steering
- Straw Buyer

Summary

1. Laws are the minimum duty required by mortgage loan originators
   - MLOs should also strive to fulfill intent
   - Better Business Bureau and state attorney general’s office provide guidance
   - National Association of Mortgage Professionals has a Code of Ethics

Summary

2. Bait and switch advertising is an alluring but insincere offer to sell a product or service which the advertiser in truth does not intend or want to sell in order to switch consumers from buying the advertised merchandise. Every advertisement should be a bona fide offer to sell. Misrepresentation is simply false or misleading information that could include documents, misstatements, or omission. A material fact is one that, if known, might have caused a reasonable consumer to make a different decision. The Federal Trade Commission Act states that advertisements must be truthful and non-deceptive, that advertisers must have evidence to back up their claims, and that advertisements cannot be unfair. An ad is unfair if it causes or is likely to cause substantial consumer injury which a consumer could not reasonably avoid and it is not outweighed by the benefit to consumers. An ad is deceptive if it contains a statement—or omits information—that is likely to mislead consumers acting reasonably under the circumstances and is material to a consumer’s decision to buy or use the product. The same laws that regulate print and broadcast media apply equally to advertising, promotion, and marketing on the internet.
3. Treat everyone equally
   - Civil Rights Act of 1866 (prohibits race discrimination)
   - Federal Fair Housing Act of 1968 (Title VIII): Illegal to discriminate on race, color, religion, sex, national origin, disability, or familial status
   - Redlining: Illegally refusing to make loans in a particular neighborhood for discriminatory reasons; compliance enforced in part by HMDA
   - Exclusionary zoning laws discriminatory, especially if they have a disparate impact on a minority group
   - Advertising must be fair and neutral in its language
   - Equal Credit Opportunity Act: Illegal to discriminate on sex, age (18), marital status, race, color, religion, national origin, receipt of public assistance, exercised rights under the Consumer Credit Protection Act

4. Real Estate Settlement Procedures Act (RESPA) regulates settlement and closing procedures
   - Requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures
   - Section 8 prohibits kickbacks and unearned fees

5. Actual fraud: Intentional misrepresentation or concealment of a material fact, for example:
   - Borrower who lies on applications to gain property
   - Appraiser who provides inflated property value
   - Mortgage broker who ignores derogatory information to get loan approved
   - Also includes:
     • Not reporting all items on closing statement accurately
     • Creating phantom documents for verification
     • Concealing the true nature of down payment
Summary

6. Predatory lending: Loans that take advantage of ill-informed consumers
   - Excessively high fees
   - Misrepresented loan terms
   - Frequent refinancing with no benefit
   - Laws addressing predatory lending include:
     • Home Ownership and Equity Protection Act (HOEPA)
     • Mortgage Disclosure Improvement Act (MDIA)
     • Mortgage Reform and Anti-Predatory Lending Act

Chapter 13 Quiz

1. The Civil Rights Act of 1866 prohibits what type of discrimination in property transactions?
   A. race
   B. religion
   C. sex
   D. all of the above

Chapter 13 Quiz

2. The federal Fair Housing Act prohibits discrimination based on race, color, religion, sex, and
   A. age, national origin, disability/handicap, or familial status.
   B. disability, national origin, or sexual orientation.
   C. marital status, national origin, disability/handicap, or familial status.
   D. national origin, disability/handicap, or familial status.
Chapter 13 Quiz

3. Which law requires lenders to document how they are serving the lending needs within the communities in which they do business?
   A. Equal Credit Opportunity Act
   B. Fair Credit Reporting Act
   C. Fair Housing Act
   D. Home Mortgage Disclosure Act

Chapter 13 Quiz

4. Which act specifically prohibits redlining?
   A. Civil Rights Act of 1866
   B. Equal Credit Opportunity Act
   C. Fair Housing Act
   D. Home Mortgage Disclosure Act

Chapter 13 Quiz

5. As mortgage broker Sam puts together an ad to attract some new customers, what law should he be most concerned about?
   A. FACT Act
   B. GLBA
   C. RESPA
   D. TILA
Chapter 13 Quiz

6. Mortgage loan originator Dave knows that his customer is losing his job at the end of the month because the plant where he works is closing, but in his eagerness to close the deal, he decided to ignore that fact. This might be considered an example of
   A. actual fraud.
   B. constructive fraud.
   C. good business.
   D. negligent misrepresentation.

Chapter 13 Quiz

7. Mortgage fraud can be committed by
   A. appraisers only.
   B. borrowers only.
   C. lenders and brokers only.
   D. any party to a mortgage loan.

Chapter 13 Quiz

8. Which law prohibits kickbacks?
   A. Fair Credit Reporting Act
   B. Gramm-Leach-Bliley Act
   C. Regulation Z
   D. RESPA
Chapter 13 Quiz

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

10. Which situation is LEAST likely to be an example of predatory lending?
   A. ABC Mortgage Co. offers a subprime loan to Mark, who is coming out of bankruptcy.
   B. Dave shows up at closing and finds that the lender has changed the terms of the loan.
   C. Ellie was 12 days late paying her mortgage, and the lender raised the interest rate 1/4%.
   D. Frank paid off his mortgage loan early with lottery winnings and the lender charged a $12,000 prepayment penalty.

11. Which situation does NOT involve a straw buyer?
   A. Ann revises her pay stubs so she can qualify for a loan to buy her dream house.
   B. Bob uses his twin brother’s Social Security number and credit information to apply for a loan.
   C. Dave agrees to secure a loan under his name even though only his sister with bad credit will live in the house.
   D. Tina tells Rob, who is facing foreclosure, that if he deeds the property to her, she will refinance on good terms and let him stay in the house.
Chapter 13 Quiz

12. MLO Cindy’s customer purposely does not tell her that he just co-signed his nephew’s auto loan. The credit report shows neither that loan nor a credit inquiry, and so that debt is not considered when the lender pre-approves him for a larger mortgage than he really should have. Do you think Cindy did anything wrong?
   A. No, she can’t be held responsible if a client withholds information that does not show on his credit report.
   B. Yes, she colluded with the customer to withhold material information.
   C. Yes, she committed actual fraud by approving a purposely false application.
   D. Yes, she committed constructive fraud by not confirming the customer’s debts.

Chapter 13 Quiz

13. Which of the following is NOT an indicator of predatory lending?
   A. charging excessive prepayment penalties
   B. falsifying loan documents
   C. increasing interest charges on late loan payments
   D. requiring mortgage insurance

Chapter 13 Quiz

14. If an ad mentions the interest rate on a specific loan product, that interest rate must be
   A. available for at least 10 business days.
   B. given to every applicant.
   C. locked in without a lock-in fee.
   D. made available to a reasonable number of qualified applicants.
Chapter 13 Quiz

15. Which statement about a bait and switch advertising strategy is FALSE?
   A. The advertiser does not intend to sell the offered product.
   B. The consumer is lured in by attractive terms or promises.
   C. The goal is to get interested consumers in the door.
   D. There is no bait and switch if the consumer accepts the new terms.