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FINANCING TODAY'S CHANGING MARKET

HOME STUDY PROGRAM FOR LOAN ORIGINATORS

(Loan Originators)

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CHAPTER I

TODAY'S CHANGING MARKET

Today's borrower has more options than ever before in terms of available financing options. The issue for a borrower is no longer "will I get a loan" but "what loan can I get and how much."

Good credit, Bad credit, No credit, Equity, No equity, and Future Equity are all just conditions for where you go for a loan and what the interest rate will be. Shop enough and someone out there will give you a loan.

Loans that at one time were handled only by high-risk funders today are handled by traditional sources.

The goal of this course is to bring to light these programs, show how loans are underwritten differently, and precautions that lenders take to prevent loan fraud from occurring. Armed with this knowledge, the average real estate agent will have the basic knowledge to help better serve his/her clients.

FORECASTING THE MORTGAGE MARKET

According to The Mortgage Bankers Association, 2003 originations reached $3.6 trillion, another significant increase from the historic $2.42 trillion of mortgage originations in 2002. A refinance boom in 1998 propelled originations to $1.4 trillion, a record held through 2001 when mortgage originations hit $2.1 trillion. It is predicted that 2004 originations will reach only 1.85 trillion, a drop of almost 50%.

Mortgage originations of about $3.6 trillion make 2003 the third best year ever. The growth in sub-prime lending and second-lien loans partially compensates for a moderating level of rate-term refinance activity. S&P notes that the domestic residential mortgage-backed securities (RMBS) maintained an impressive level of performance through the fourth quarter of 2002, nearly doubling the activity of 2001's fourth quarter.

Historically the low interest rates of the late 1990s and early 2000s caused housing to be as affordable as it was in the early 1970s. Baby boomers are buying second homes at a record pace and much of the population continues to shun financial assets in favor of investing in their homes.

Homeowners have also become accustomed to using their home's equity for debt consolidation, home improvement, and cash-out refinances. Homes have become a major source of liquidity for the 68% of the population that own homes.

REFINANCES AND THE ECONOMY

According to Economy.com refinances have injected billions in the economy.

Nationwide refinancing freed up $172.1 billion in 2002, compared to

➢ $3.3 billion	in 2001
➢ $1.4 billion	in 2000
➢ $1.7 billion	in1999
➢ $1.8 billion	in1998

Where does the cash go?

➢ Home improvements	42%
➢ Paying down debt	30%
➢ Buying car or other items	15%
➢ Buying appliance, furniture	13%
➢ Investing	8%
➢ Education	7%
➢ Starting a business	3%

HOUSES AS PIGGY BANKS

As cash strapped homeowners struggle to meet their obligation, home equity borrowing has become the cure-all. Is this judicious use of an asset, or the plundering of one's future?

Investment experts talk about "good debt" and "bad debt". Mortgage debt is considered good debt because the interest is low and is tax deductible.

Financial experts often recommend that that families set up a home-equity line of credit, which can be accessed as the need of a financial emergency arise.

It is estimated that in early 2002, homeowners were financed up to 68% of the homes purchase price, compared to 41% two decades ago. Federal Reserve statistics show that total mortgage debt stood at 44.4 per cent of home values in late 2002, up from 30.1% in late 1982.

Why this rising indebtedness?

- Attitudes to borrowing have changed,
- Families move and refinance more frequently,
- Using home equity as a savings account to draw from,
- Extending loan terms with each refinance,
- Lower interest rates making refinancing attractive,
- The availability of reverse mortgages.

HOME ASSET MANAGEMENT ACCOUNT

What may be the most significant innovation in the American home mortgage field hit the market in late 2002. It is called the "home asset management account."

It grafts a growing equity line of credit onto a standard home mortgage, and essentially makes tax-deductible home equity the centerpiece of a borrower's personal financial affairs. In essence it turns a home into a bank that is always open-if the homeowner chooses to use it.

An individual applies for a home asset management account instead of a traditional mortgage.

The account consists of:

- A FIRST MORTGAGE OF UP TO $750.000 – the rate on the loan is the same as the prevailing rate in the traditional marketplace,

- AN INITIAL HOME EQUITY LINE OF CREDIT equal to all or most of the initial equity or down payment. The credit line comes automatically and need not be applied for separately,

- AN ACCOUNT REVIEW STATEMENT is received quarterly, that tells the borrower how much available equity is at the borrower's disposal as a result of principal loan pay downs and the previous use of equity credit line-

  To activate the credit line, the borrower has multiple options:

  - ✓ A set of checks,
  - ✓ A plastic debit card usable at most ATMs,
  - ✓ A special Web site,
  - ✓ Walking-in to a teller window, if available.

There is no requirement that the credit line ever be activated or drawn down.

- AN ANNUAL STATEMENT that reports the estimated growth in the home's market value. The estimate is based on a proprietary statistical model that analyses resale-pricing patterns in the area,

- The growth in the value of the real estate equity is added automatically onto the available credit line.

If the estimated home resale value jumped $30,000 during the last 12 months, that amount would be added to the credit line for use anytime during the coming year.

Credit line balances on the account carry a variable interest rate competitive with prevailing home equity loan rates elsewhere in the market.

The credit line can be switched to a fixed rate equity loan, whenever the borrower thinks the rates are favorable to lock in.

In most cases, payments on all the combined first and second mortgage debts in the account are expected to be tax deductible.

The asset management account can be paid off either in the individual increments of the first and second or combined or paid off when the property is sold.

Is this the home financing concept of the future? According to Wells Fargo Home Mortgage, the firm that introduced the program, they certainly feel so. Other major lenders are working on similar concepts to be introduced throughout 2004.

BANKS ACCEPT CONSULATE CARDS AS I. D.

With the Hispanic population in the United States rising 58 percent, to 35 million, from 1990 to 2000, financial institutions are targeting the group and foreign residents for banking services and money wiring fees.

Citigroup, Wells Fargo and other major banks have started accepting identification cards from other countries such as voter registration cards and identification cards issued by consulates, as one of three pieces of required identification. This makes it easier for immigrants to make deposits, get loans and wire funds to their countries.

About 9.9 million dollars was sent in 2002 from other countries to Mexico. Western Union now handles 84 per cent of the world's wire transfer business. In two years Harris Bank deposits from Hispanic customers jumped from $15 million to over $200 million.

Mexican consulate cards, known as matricula cards, are issued to individuals regardless of an applicant's legal U.S. status. Banks are under no obligation to determine whether a customer is a legal immigrant. Immigrants want U.S. bank accounts partly to access lower wire transfer fees when sending money to family in their countries and to experience other banking privileges. As wider acceptance of these new methods of identification become prevalent both the real estate and mortgage industry will feel the impact of this new source of customers.

MORTGAGES TO ILLEGAL IMMIGRANTS

About 35 banks have unveiled a coordinated plan to open the financial mainstream to immigrants in Chicago, including a controversial blue print for offering mortgage loans to undocumented residents.

The model loan program provides a road map for banks hoping to follow the lead of a handful of smaller institutions that are offering mortgages to borrowers without Social Security numbers.

2001 was the first year banks started giving limited financial access to undocumented immigrants, including checking accounts or other tools to send money back to Mexico. Seeing a greater need, the Mexican consult general in Chicago worked with the FDIC to create collaboration among leading financial institutions including Bank One (J.P. Morgan-Chase), Citibank, Harris Bank, and Fifth Third Bank to help form a mortgage blue print to deal with the issue of undocumented immigrants.

In addition to the mortgage initiatives, participating banks, known as the New Alliance Task Force, say they will join non-profit groups in creating a financial education institute at the consulate at which all immigrants can take courses on money management. Between 2001 and the end of 2003, local banks opened more than 50,000 accounts without requiring a Social Security number, These accounts averaged about $2,000 per account.

At least two smaller Midwest banks that are part of the alliance, Second Federal Savings and Milwaukee-based Mitchell Bank, have started offering mortgages without requiring a Social Security number.

The banks do require an individual taxpayer identification number issued by the Internal Revenue Service, which can track a holder’s earnings. The borrowers are presumably undocumented immigrants, although banks do not ask that question.

As an alternative to a standard credit report, which is normally triggered by a Social Security number, to gauge an applicant’s credit risk, banks call landlords, employers and utility companies to create a paper trail. Borrowers also have an edge if they maintain a savings or checking account at the bank.

Banks that are willing to go beyond conventional credit checks also can assist legal immigrants who might get paid in cash or share rent with several relatives without appearing on the lease, according to a report by the Fannie Mae Foundation. These loans cannot be sold in the secondary market; therefore, banks keep the loans in their own portfolios and charge higher interest rates to protect themselves.

The Alliance task force will provide a means whereby larger banks can get a sense of the practicality of the loans being offered by the smaller institutions. On these issues, one of the biggest policy battles occurred in 2003, when several lawmakers unsuccessfully urged the U.S. Treasury Department to enact a policy that prohibited financial institutions from accepting the Mexican matricula consular card as a form of identification.

More on the Matricula Car

After Extensive review in late 2003 the Treasury Department has left in place rules that allow financial institutions to accept Mexican identification cards, called matricula consular, which often are used by undocumented immigrants to open bank accounts.

The decision, which extends to all foreign-issued identification, is considered a victory for immigration and Latino groups that have protested efforts to prohibit use of the identification card as anti-immigrant and anti-Hispanic. Financial institutions also had opposed any change in the rule. Critics say the cards are too fraud-prone and pose a security risk. Immigration opponents also have said the card acts as de facto amnesty for illegal immigrants.

The card is issued by Mexico’s consulates to its citizens living abroad and shows the date of birth, a current photograph and the address of the cardholder. Many of the cards have been issued to Mexicans in the United States, including those in the country illegally.

Cardholders have used them to open bank accounts, turn on utilities, check out library books, and get driver’s licenses or other basic services in some communities and states.

Treasury officials decided that under the existing rules, financial institutions bear the risk of failing to have an effective policy on what types of identification to accept. That risk acts as incentive for the institutions to adopt policies that will stem fraud, but still gives them flexibility to accept identification most used in their communities.

“When an institution decides to accept a particular form of identification, they must assess risks associated with that document and take whatever reasonable steps may be required to minimize that risk,” the agency said in a statement.

The department still would hold financial institutions accountable for the effectiveness of their customer identification programs. The agency will notify financial institutions of problems with specific documents. The department’s decision came after Homeland Security Secretary Tom Ridge told the Associated Press that banks and communities that accept the card for identification do so “at their peril” because the cards are not fraud-proof.

Although Mexico is improving the security process for issuing cards, the FBI reported this summer that they remain vulnerable to fraud.

But Steve Bartlett, president of the Financial Services Roundtable, said the Treasury decision is the right one because "there never was a valid argument to deny" acceptance of the cards.

"This is a triple win for the rational thought. This is a win for the matricula, a win for economy and a win for our close ally Mexico," said Bartlett, whose organization represents the 100 largest financial services companies.

Under pressure form Congress and the Justice Department, the Treasury Department decided to review recently implemented rules for financial institutions on identification they can accept from people opening accounts the USA Patriot Act mandated the rules. The Mexican IDs are still under review by a White House – led panel.

DIVERSITY IN MORTGAGES

With three out of every five first-time home buyers expected to be racial and ethnic minorities over the remainder of the decade, major suppliers of mortgage money are rolling out new products at a rapid pace so lenders can meet borrower's needs.

Freddie Mac has eliminated a rule that requires borrowers to be U.S. citizens and is offering an improved version of the old lease-purchase program. Now anyone who is a lawful resident of this country can obtain a home loan.

Meanwhile, Fannie Mae is on the market with an interest only loan that can save a borrower with a $150,000 mortgage as much as $100 per month.

Freddie Mac has begun lending up to 105% of the value of the property, accepts cash-on-hand as a source of funds, and allows borrowers to use money from boarders as part of the income needed to qualify for the mortgage. Freddie Mac is now permitting builders to contribute up to 3% of the purchase price on behalf of the borrower.

IMMIGRANT PATTERNS OF HOMEOWNERSHIP

The majority of immigrants tend to settle in metropolitan areas, such as Chicago, New York, Miami, Houston, Los Angeles and San Francisco.

The Mortgage Bankers Association of America, predicted that 4 million additional home sales will be generated in 20 years by the children of immigrants who are now buying homes

Large home builders, especially those who cater to first-time buyers, have caught on to the potential of the immigrant market and recognize that nationalities tend to cluster in small and large pockets through these major cities.

The current boom is among Spanish-speaking buyers. Peak arrivals of Mexican immigrations followed the amnesty of1989. These individuals have now matured in the workforce. Since it takes 8 to 10 years to become assimilated, they started buying entry-level homes in great numbers starting in 2001.

The message to all builders, real estate practioners, and mortgage lenders are that they better become bilingual, but in what language becomes the question? Beside buyers of Hispanic language, there are also many from Eastern Europe and Asia.

Fernando Armadia, a real estate broker, is a native of Mexico and now specialized in helping Hispanics navigate the complexities of home buying. “Many of them have no clue what they’re getting into. I have to explain the whole process from beginning to end.”

He noted that the homes in Mexico often remain in one family for generations. “Mexicans hardly ever go to a bank for financing a home, though that has started to change in the last 10 years.”

Armadia said he tells prospective buyers what they have to do to qualify for a mortgage. Only about 50 percent speak English.

“While some immigrants may live here for years, the younger generation in seeing the value of owning a home as an investment, “he said.

“Immigration has now only sustained housing but driven it to new height”, said the senior vice president of the National Community Lending center for Fannie Mae, the mortgage giant based in Washington, D.C.

“Immigrants bring with them suspicions and apprehension about government, regulators and big institutions.” “Because of their fears, some may keep money in mattresses. They don’t always use banks. They are vulnerable to unscrupulous lenderswho prey on them”.

“Predatory lending may result in immigrants not getting the best mortgage rates. If they don’t have established credit, they can’t get credit scores. But it’s possible to establish non-traditional credit if they have paid rent and utilities over a period of time,” said the Fannie Mae spoke-man. Additionally, “They must show a history of legally working in the U.S.,” he added.

Despite the increased effect of foreign-born homebuyers, the group lags financially behind U.S.-born buyers, according to “Home ownership in the Immigrant Population,” a study by George J. Brojas, Pforzheimer professor of policy at Harvard University’s John F. Kennedy School of Government.

“In 1998, the typical immigrant worker earned 23 percent less than the typical native worker,” the study said. This translates into lower homeownership rates among immigrant households than among native households.

The vice president at the National Association of Home Builders in Washington, D.C., said that immigrant homebuyers filled in for the fewer buyers in the Baby Boom generation, those born roughly between 1965 and 1979.

Builders have recognized the increasing impact of foreign-born buyers and are catering to them.

Lakewood Homes, one of the largest builders in the Chicago area, prints cost calculation information sheets in 12 languages.

Spanish-language buyers are leading the way in volume. “We’re seeing a soaring buying power of Hispanics,” said Christopher Shaxted, Lakewood’s, executive vice president, who added that the builder plans a Spanish version of its Web site.

“We also advertise in Hispanic publications and have had Hispanic buyers in all our developments. Once a nationality starts to move in, others follow,” he said.

In addition to Hispanic’s, East Indians, Koreans and Eastern Europeans are buying homes in many suburban communities.

“The phenomenon began in the late 1990s and is still growing. Immigrants tend to be hardworking and driven to homeownership. Foreign-born buyers will continue to be a big driver of the housing market in the next decade,” Mankedick said.

CUSTOMS AND TRADITIONS ROLE IN HOMEOWNERSHIP

A priest from the Hindu temple performs a religious ceremony for a new homeowner. Its purpose is to ward off evil spirits and sanctify the ground. Usually, certain mantras are read and water is sprayed around the perimeter of the home.

But cultural differences don’t affect just the house; they also play a role in how it is financed.

Observant American-Muslim families, for instance, require a special housing contract because Islamic religious law prohibits the payment of interest on mortgages and other types of debit, according to Brad German, public relations manager for Freddie Mac, the mortgage giant based in Washington D.C. Contracts through American Finance House-Lariba are available in 15 states, including Illinois. “The American-Muslim population, which ranges from 2.5 million to 6 million households, depending on whose estimate you use, is experiencing strong growth,” said German.

While today’s immigrants come from around the globe, Mexicans top the list of foreign-born homes buyers in numbers.

COMMUNICATION SOLUTIONS

‘Immigrant homebuyers clearly face communication barriers but there is a move now to provide them with bilingual materials,” said the chief economist for the Mortgage Bankers Association of America in Washington, D.C.

Today’ s immigrant population come here in quest of opportunity to create better lives for themselves and their children, are as industrious as the native-born and, have a great desire to realize the dream of homeownership.

In the first three-quarters of the 20th Century, Eastern Europeans dominated immigration and effected homeownership patterns. They still comprise a strong homebuyer segment, but the movement has definitely shifted to the Hispanic, Middle Eastern and Asian immigrants.

Test Your Knowledge Quiz:

T F 1. The issue for a borrower is no longer “will I get the loan” but “what loan I get and how much.”

T F 2. Homes are a major source of liquidity for the 68 percent of the population that own homes.

T F 3. The major cash borrowed on refinances goes for paying off debt.

T F 4. According to investment counselors mortgage debt is considered “bad debt” because it eats up earned equities for the future.

T F 5. Mortgage debt in relation to home value has risen from 30.1% in 1982 to 44.4% in 2002.

T F 6. The average homeowner finances 68% of the homes purchase price compared to only 41% two decades ago

T F 7. Indebtedness has risen in this country because the average homeowner is less responsible.

T F 8. A Home Asset Management Account turns a home’s equity into an always open bank account.

T F 9. Banks do not consider consulate cards, also known as maticula cards, to be a valid form of I.D.

T F 10. Three out of every five first-time homebuyers are expected to be racial and ethnic minorities over the remainder of the decade.

T F 11. Cultural differences have no bearing on homeownership selection or types of financing used.

T F 12. Bilingual material by builders, real estate agencies and mortgage lenders are a critical element in dealing with today's buyers.

True: 1, 2, 5, 6, 8, 10, 12

False:
3 Home-improvement
4 Considered "good debt" because of low interest and tax deductibility
7 Attitudes toward borrowing have changed;
9 Today most lenders accept this as a valid I.D.
11 Ethnic, religious background, and views on interest and loans have a tremendous effect

CHAPTER II: MONEY

Money is the conversion of our mental and physical effort into a convenient method of exchange and standard value.

In past societies money was the exchange of goods and services. In more modern societies it is paper money, coins and checks. Money can be anything that is symbolic of value. With the abandonment of the gold and silver standard, today's money is based on confidence.

It is simply a promise that there is value behind the symbolic representation. Therefore, economic stability is directly tied in to the supply of money available for exchanging and the cost of obtaining that money.

Thus, the manipulation of the supply and cost of money should result in economic balance. This manipulation is entrusted to The Federal Reserve System, The United States Treasury, and The Federal Home Loan Bank.

These three agencies have a tremendous effect on real estate finance.

THE FEDERAL RESERVE SYSTEM

President Woodrow Wilson established the Federal Reserve System in 1913. The original purpose of The System was to establish facilities for selling or discounting commercial paper and to improve the supervision of banking activities.

The original purpose was expanded over time to include the influencing over the cost and availability of money.

The Federal Reserve System is made up of 12 Districts; each served by a Federal Reserve Bank.

The Federal Reserve Banks are not under the control of any governmental agency but each reserve bank is responsible to a board of directors made up of nine members.

The entire Federal Reserve System is coordinated by a seven-member board housed in Washington D.C. The "Board of Governors", as they are called, is appointed by the President and approved by the Senate.

All nationally chartered commercial banks must join the Federal Reserve System; state chartered banks may also join the system.

Membership is based on:

- The purchase of capital stock in the district Federal Reserve Bank,
- Maintaining enough reserves as set from time to time by the Federal Reserve,
- Clearing checks through the system,
- Complying with all other rules and regulations.

Member banks borrow money from the Federal Reserve Bank as needed, as well as, share in the informational system.

THE MAIN FUNCTIONS OF THE FEDERAL RESERVE BANK ARE:

- The issuing of currency in the form of Federal Reserve Notes,
- Supervising and regulating member banks,
- Clearing and collecting member banks' checks,
- Administering selective credit controls,
- Holding the principal checking account for the U.S. Treasury,
- Assisting in the collection and distribution of income taxes,
- Regulating and establishing member banks reserve requirements,
- Determination of discount rate,
- Supervision of the Truth in Lending Act.

THE FED: OUR CENTRAL BANK

Most simply, the Federal Reserve System is the central bank of the United States. Congress created the Federal Reserve through a law passed in 1913, charging it with a responsibility to foster a sound banking system and a healthy economy.

This remains, today, the broad mission of the Fed and its component parts: the 12 Federal Reserve Banks nationwide, each serving a specific region of the country; and the Board of Governors in Washington, D.C., set up to oversee the Fed System.

To accomplish its mission, the Fed serves as:

- A banker's bank,
- As the government's bank,
- As a regulator of financial institutions,
- As the nation's money manager,

… and performs a vast array of functions that affect the economy, the financial system, and ultimately, each of us.

Each of the 12 Fed Banks provides services to financial institutions that are similar to the services that banks and thrifts provide to business and individuals. By serving as a "banker's bank" the Fed helps assure the safety and efficiency of the payments system, the critical pipeline through which all financial transactions in the economy flow.

PROCESSING OF FUNDS

Each day the Fed processes millions of payments in the form of both paper checks and electronic transfers. So when an individual cashes a check or has money electronically transferred, there is a good chance that a Fed Bank will handle the transfer of funds from one financial institution to another.

Each of the Fed Banks offers these and other services, on a fee basis, to the depository institutions in its Federal Reserve District. Institutions can choose to use the Fed's services or those offered by other competitors in the marketplace.

Together, the 12 Fed Banks process more than one-third of the checks written in the U.S., a total that exceeds $12 trillion annually. And the dollar volume transferred through the Federal Reserve's electronic network is far greater, approaching $200 trillion or many times our nation's gross national product.

INSTANT PROCESSING OF CHECKS

Still writing checks to pay your bills? A new procedure used by banks will process payments faster by electronically scanning the check or debit card and creating an instant transfer of funds.

Traditionally an individual would mail their check to a P.O. Box address that was actually a bank hired by the creditor to handle its bill payments.

The processing bank, usually through a Federal Reserve clearinghouse, processes the check and the check is sent to the issuer's bank. The processing of checks in this fashion costs banks about 26 cents per transaction.

The new electronic system of instant processing will reduce the cost to an average of 10 cents per transaction and create an instant transfer of funds from the customer's account to the receiving bank.

The nation's largest banks are embracing the system to more quickly process payments for telephone companies, gas companies and other creditors who bill on a monthly basis.

The new technology will permit a retailer to scan a check at the time of services, instantly debit the customer's bank account, have an automatic transfer of funds from the customer's bank account to the merchant's bank account and return the debited check to the customer on the spot. Likewise a merchant receiving a customer's check in the mail, will scan the check through a processing terminal, the debit and credit will occur between banks, and the customers check will be destroyed.

There is no returning of canceled checks under this system.

Though the number of electronic payments is increasing, according to the Federal Reserve, Americans wrote 49.5 billion checks in 2000 and of all the payments in 2000, 59 percent were checks; by comparison, 77 percent of payments were checks in 1995.

According to law, to employ the new electronic technology, the billing party has to send customers a letter that they are going to do this. Customers can opt out of the electronic scanning if they wish by contacting the billing company.

The purpose of electronic scanning is to cut down on costs and increase revenue for both banks and the Federal Reserve.

THE FED-THE GOVERNMENT'S BANK

Another important Federal Reserve responsibility is servicing the nation's largest banking customer- the U.S. government. As the government's bank or fiscal agent, the Fed processes a variety of financial transactions involving trillions of dollars.

Just as an individual might keep an account at a bank, the U.S. Treasury keeps a checking account with the Federal Reserve through which incoming federal tax deposits and outgoing government payments are handled. As part of this service relationship, the Fed sells and redeems U.S. government securities such as savings bonds and Treasury bills, notes, and bonds.

PRINTING AND DISTRIBUTION OF CURRENCY

The Federal Reserve also issues the nation's coin and paper currency. The U.S. Treasury, through its Bureau of the Mint and Bureau of Engraving and Printing, actually produces the nation's cash supply; the Fed Bank then distribute it to financial institutions.

The currency periodically circulates back to the Fed Bank where it is counted, checked for wear and tear, and examined for counterfeits. If the money is still in good condition, it is eventually sent back into circulation as institutions order new supplies to satisfy the public's need for cash. Bills that are worn-out are taken out of circulation and destroyed by shredding. The average $1 bill circulates for approximately 18 months before being destroyed.

SUPERVISOR AND REGULATOR

As part of its mandate to foster a sound banking system, the Federal Reserve supervises and regulates financial institutions.

As a regulator, the Fed formulates rules that govern the conduct of financial institutions.

As a supervisor, the Federal Reserve examines and monitors institutions to help ensure that they operate in a safe and sound manner and comply with the laws and rules that apply to them. The Fed's supervisory duties are carried out on a regional basis. Each of the Reserve Banks is responsible for monitoring bank holding companies (organizations that own one or more banks) and state member banks (banks that are chartered by the state and are members of the Federal Reserve System) based in its District.

The Federal Reserve also helps to ensure that banks acting in the public's interest by ruling on applications from banks seeking to merge or from bank holding companies seeking to buy a bank or engage in a non-banking activity.

In making these rulings, the Fed takes into consideration how the transaction would affect competition and the local community.

The Federal Reserve implements laws-such as Truth-in-Lending, Equal Credit Opportunity, and Home Mortgage Disclosure, all meant to ensure that consumers are treated fairly in financial dealings.

THE LENDER OF LAST RESORTS

Another way the Fed helps maintain a sound banking system is as the "lender of last resort." A financial institution experiencing an unexpected drain on its deposits, for example, can turn to its Reserve Bank if it is unable to borrow money elsewhere.

This loan from the Fed would not only enable the institution to get through temporary difficulties, but most importantly, would prevent problems at one institution from spreading to others.

The basic interest rate charged for these loans is called the discount rate.

THE FED'S STRUCTURE

The Federal Reserve System

- Is the nation's central bank
- A regional structure with 12 districts
- Subject to general Congressional authority and oversight
- Operates on its own earnings

Board of Governors

- 7 members serving staggered 14-year terms
- All are appointed by the U.S President and confirmed by the Senate
- Chairman appointed by the President of the United States for a 4 year term
- Oversees System operations
- Makes regulatory decisions
- Sets reserve requirements

Federal Reserve Banks

- 12 regional banks with 25 branches
- Each independently incorporated with a 9-member board of directors from the private sector
- Set discount rate, subject to approval by Board of Governors
- Monitor economy and financial institutions in their districts and provide financial services to the U.S. government and depository institutions

Federal Reserve Banks Locations

- Boston
- New York
- Philadelphia
- Cleveland
- Richmond
- Atlanta
- Chicago
- St. Louis
- Minneapolis
- Kansas City
- Dallas
- San Francisco

FEDERAL OPEN MARKET COMMITTEE

- The System's key monetary policymaking body
- Decisions seek to foster economic growth, with price stability, by influencing the flow of money and credit
- Comprised of the 7 members of the Board of Governors, and 5 Reserve Bank presidents whom serve as voting members on a rotating basis
- The president of the Federal Reserve Bank of New York always serves as one of the 5 members

To protect depositors by guaranteeing that their funds will be available when needed, the Federal Reserves requires member banks to maintain on deposit with them a minimum reserve fund. The amount of reserve required is adjusted from time to time and from locality to locality in an effort to control the money available to the public at any given time, and thus control spending. This is the Feds' way of balancing the economy.

THE FED AS A MONEY MANAGER

The most important of the Fed's responsibilities is formulating and carrying out monetary policy. In this role, the Fed acts as the nation's "money manager"-working to balance the flow of money and credit with the need of the economy. Simply stated, too much money in the economy can lead to inflation, while too little can stifle economic growth. As the nation's "money manager," the Fed seeks to strike a balance between these two extremes, or, in other words, to foster economic growth with price stability.

To achieve this goal, the Fed works to control money at its source by affecting the ability of financial institutions to "create" checkbook money through loans or investments. The control lever that the Fed uses in this process is the "reserves" that banks and thrifts must hold.

In general, depository institutions are subject to rules requiring that a certain percentage of their deposits be set aside as reserves and not used for loans or investments. Institutions can meet these requirements by keeping cash in their own vaults and through balances held in a reserve account a Fed bank.

These reserve balances and requirements determine the amount of money an institution can create through lending an investing. Through reserves, then, the Fed indirectly affects the flow of money and credit through the economy by controlling the raw materials that institutions use to create money. The Fed has tools for affecting reserves:

RESERVE REQUIREMENTS

Altering the percentage of deposits that institutions must set aside as reserves can have a powerful impact on the flow of money and credit.

Lowering reserve requirements can lead to more money being injected into the economy by freeing up funds that were previously set aside.

Raising the requirements freezes funds that financial institutions could otherwise pump into the economy. The Fed, however, seldom changes reserve requirements because such changes can have a dramatic effect on institutions and the economy.

The amount of reserve required varies from 1.25% to 22% depending on the type of deposits and the location of the member bank.

Checking account reserves are higher because of the short-term need for money, whereas, savings deposits require less reserve because of the longer-term quality of these funds.

DISCOUNT RATE

An increase in the discount rate can inhibit lending and investment activity of financial institutions by making it more expensive for institutions to obtain funds or reserves. But, if funds are readily available from sources other than the Fed's "discount window", a discount rate change won't directly affect the flow of money and credit. Even so, a change in the discount rate can be an important signal of the Fed's policy direction

OPEN MARKET OPERATIONS

The most flexible, and therefore most important, of the monetary policy tools are open market operations-the purchase and sale of government securities by the Fed. When the Fed wants to increase the flow of money and credit, it buys government securities; when it wants to restrict the flow of money and credit, it sells government securities.

As with the other tools, the Fed's open market operation affects the supply of money through the reserves of depository institutions. If, for example, the Federal Reserve wished to increase the supply of money and credit, it might purchase $1 billion in government securities from a security dealer.

The Federal Reserve would pay for the security dealer's bank keeps at the Fed and the bank would in turn credit the security dealer's account for that amount. While the dealer's bank must keep a certain percentage of these new funds in reserve, it can lend and invest the remainder. As these funds are spent and re-spent the stock of money and credit will eventually increase by much more than the original $1 billion added.

The procedure is reversed to decrease the money supply. If the Fed were to sell $1 billion in government securities to a dealer, that amount would be deducted from the reserve account of the dealer's bank. The bank, in turn, would deduct $1 billion from the account of the dealer. The end result is less money flowing through the economy.

COMMERCIAL DISCOUNT RATE VS PRIME RATE

Banks borrowing money from their district banks receive what is known as a discount rate. This is the rate of interest paid by these banks to their district bank for the use of money. When this money is re-lend to a consumer of a business, the rate is known as the prime rate. That is, the rate charged to its' most creditworthy customer.

In Conjunction with the U.S. Treasury, manipulation by the Federal Reserve directly affects mortgages and the real estate industry.

As one can plainly see the monetary system is pretty well based on promises and perceptions of value versus hard, tangible goods. Understanding this will make it easier to understand the buying and selling of mortgages, regardless of the risk factor involved.

Test Your Knowledge Quiz:

T F 1. The Federal Reserve System, The United States Treasury, and Federal Home Loan Bank play key roles in the manipulation of the supply and cost of money.

T F 2. Money is the conversion of our mental and physical effort into a convenient method of exchange and standard value.

T F 3. Money can be anything that is symbolic of value.

T F 4. The Federal Reserve System is made up of 12 Districts and 25 Branches.

T F 5. Federal Reserve Banks are under the control of the U.S Treasury.

T F 6. The Federal Reserve System is coordinated by a seven member "Board of Governors."

T F 7. All nationally chartered commercial banks must join the Federal Reserve System.

T F 8. State chartered banks cannot be members of the Federal Reserve System.

T F 9. The main functions of the Federal Reserve are issuing currency, regulating member banks, clearing checks, administering credit controls, supervising the Truth in Lending Act and making sure that banks make a profit.

T F 10. The Federal Reserve is the nation's Central Bank and is known as a "banker's bank"

T F 11. The Federal Reserve processes over 212 trillion dollars in checks and electronic transfers each year free of charge for member banks.

T F 12. Electronic scanning of checks, debit and credit cards creates an instant transfer of funds and decreases bank's processing costs.

T F 13. The Federal Reserve holds the principal checking account for the U.S. Treasury.

T F 14. The Federal Reserve prints our currency based on the gold reserves maintained by the Federal Government.

T F 15. The Federal Reserve regulates and establishes member banks reserve requirements.

T F 16. Adjusting reserve requirements of member banks is a way of balancing the economy.

T F 17. The minimum amount of reserve required of member banks is 35%.

T F 18. Banks borrowing money from their district bank receive what is known as the discount rate.

TRUE: 1, 2, 3, 4, 6, 7, 10, 12, 13,

FALSE:

5 The Federal Reserve is not under the control of any government agency.
8 State chartered banks can be members of the Federal Reserve.
9 All true except "making sure that banks make money"
11 The processing of checks and electronic transfers is a major source of revenue for the Federal Reserve.
14 The Treasury prints the currency and money is issued on the guarantee (promise) of the Federal Government. There are no gold reserves.
17 Bank reserve requirements vary between 1.25% and 22%

CHAPTER III: SECONDARY MORTGAGE MARKET

With the demise and/or re-organization of the thrift industry the secondary mortgage market became the primary player in the making of home loans in this country.

The major players in the Secondary Mortgage Market are the Federal National Mortgage Association (FNMA), Government National Mortgage Corporation (GNMA), and the Federal Home Loan Mortgage Corporation (FHLMC).

Other players in this market place include the Federal Agricultural Mortgage Corporation (FAMC), Municipal Mortgage Enhancement (MUNIE MAE), and many mortgage investment conduits (REMIC'S) that use mortgage-backed securities (MBS) to collateralize their own securities.

The Secondary Mortgage Market buys real estate loans from loan originators and sells them to investors or pools them. When mortgages are purchased from primary lenders this cycle creates new funds for these lenders and thus their money supply is replenished to make new loans.

Today the ability to dispose of loans to the Secondary Market is of paramount importance to a loan funder or originator. Because of this, most originators underwrite loans to the standards of the Secondary Market.

With the disappearance of portfolio type lending, that was once offered by Savings and Loans, and the popularity of the Secondary Mortgage Market, a consumer with specialty type needs had no place to go until the advent of another emerging market, the market that deals with B, C, and D type loans.

FIRREA

As a result of poor lending decisions, poor management and the negative effects of the tax reform act of 1986 on real estate investing, over half of the nations 4,600 thrift institutions (savings and loans) began disappearing or facing bankruptcy since deregulation of the lending industry began in 1988. At that time savings and loans associations originated 57% of all residential loans.

To deal with the crisis, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act on August 9 1989. The Act introduced new capital-requirement thresholds and thus restructured the regulatory levels of the thrift industry. One of the principal missions of the Act was to close insolvent savings and loan associations and sell or reorganize those on the brink of failure.

The Resolution Trust Corporation (RTC) was created as the agency responsible for running the failed institutions and disposing of the leftover real estate and other assets.

FIRREA proved to be a death sentence for the savings and loan industry and an opportunity for banks to take a stronghold in the business of money.

As smaller savings and loans collapsed, they were merged with larger institutions. By absorbing these smaller institutions, the larger institutions eventually became insolvent and were purchased by banks for pennies on the dollar of their real worth.

SUBPRIME LENDING

STARTING WITH THE A, B, C's OF IT

Once the words to a popular song, the words today refer to a market of mortgage products that deal with non-conforming borrowers who do not meet the standards of the secondary mortgage market.

Once called the " sub-prime market " to cope with today's challenges, many mortgage companies are making a transition to alternative mortgage products, known generally as B/C paper. Once loans that were rejected due to derogatory credit, high debt to income ratios, lack of assets or reserves, or instability of income are now considered viable loan sources for the right price.

Once scattered groups of investors provided funding for these types of loans; thus, the money supply was erratic, unpredictable, short supplied, and expensive. Today a main stream is being created in the format of the secondary market to have available a continuous flow of investors interested in this type of risk and profit.

Consumers apply for these types of loans for a variety of reasons. Most refinance requests are to provide relief through debt consolidation. These loans also help consumers resolve credit problems. They give borrowers a fresh start by using the loans as a means to improve their credit rating over time, to later qualify for an "A" type loan.

In underwriting B/C type loans the credit risk categories are described through a classification grading system using the following designations:

- "A" minus-two 30 day late payments,
- "B" three 30-day or one 60-day late payments,
- "C" four 30 day, or two 60 day, or one 90 day late payment,
- "D" a 120 day late payment.

In addition to the above categories standards are also set for bankruptcy, foreclosure open judgments, and collections.

Appraisal is the key factor in the approval of a B/C loan. And in some instances two appraisals are required. Once the loan meets the assets test then the loan can be underwritten subjectively using various credit standards for different credit trenches.

The demand for this type loan is high in today's market. Contributing to this demand is the state of the economy, as well as, the financial consequences of divorce, illness, or death of a family member.

Today these products are offered at multiple levels of documentation level options, from full to limited to no income verification options.

Fully amortized fixed rate loans, adjustable loans and loan to values as high as 95% are offered to consumers under the proper qualifications.

As the secondary market expands in this area investors will offer an even higher variety of products to consumers needing B/C loan products to meet their needs.

Although just gaining popularity with main line lenders, the B/C market has been a stable investment vehicle for investors for more than 25 years. Historically, private money, or portfolio companies funded these loans.

Today, consumers have more choice than ever before in this market. The interest rate spreads between credit trenches have compressed while loan size and loan to value ratio have expanded.

FANNIE MAE AND THE SUBPRIME MARKET

According to HUD sub-prime lending has grown steadily since 1995, when it totaled $65 billion. In 2001 the market reached $173 billion, equivalent to a 266% increase. By the year 2000 the sub-prime market accounted for over 12% of the loans done in the market place.

Fannie Mae loans to non-traditional borrowers in 2002 exceeded $15 billion compared to $9.2 billion in 2001, and $1 billion in 1999. More than 250 lenders nationwide participate in delivering sub-prime loans to Fannie Mae yearly.

With what started out in 1999 as an 18-month polite project, today Fannie Mae has enhanced the program to great diversity. These enhancements include cash out refinances and 5/1 ARMs programs.

The primary reason for entering the sub-prime field was that mainstream lenders were not often operating in this market place. Fannie Mae is able to lend in this market because of the capabilities of Direct Underwriting.

DU looks at a number of variables and identities compensating factors that allow lenders to approve more borrowers, or to approve borrowers with credit blemishes or non-traditional credit history.

Fannie Mae's delinquencies remain under control due to a robust approach to risk management. These controls include strict attention to servicing support, and training and operational efficiencies. Fair lending reviews are also conducted to assure that proper procedures are followed and that the appropriate laws and regulations are adhered to.

Fannie Mae's feedback from lenders include:

- That the program has been a learning experience for most lenders, enabling them to gain a better understanding of non-traditional borrowers and best practices for origination;

- That Fannie Mae's entry into the market place brings operational efficiencies and makes it easier to do business. The lender's risk is reduced since the lender processes the loans through DU;

- That lenders use the program as a tool for recruiting new originations and to help make inroads with real estate agents, since the lender can now qualify more borrows for home purchases;

- That it improves the lenders efficiency by being able to make quick, on the spot, dependable decisions.

One trend that is for sure is that the largest lenders are retaining servicing and small and medium size lenders tend to sell servicing.

Currently, Fannie Mae represents about 10% of the market.

NICHE LOANS

Another very popular area of loans today is the so- called "niche market". This market normally refers to borrowers with credit scores of 680 or higher who do not meet the standard Fannie/Freddie or jumbo guidelines.

In the past, portfolio lenders only made such loans, often to accommodate the unique needs of their best clients.

Since the mid 1990s, however, the secondary market has undertaken Alt -"A" lending. The result is that a wide variety of standardized fixed and adjustable rate Alt-A products are now available to originators through wholesalers of money.

Generic Alt - A product include such attractive features as:

- 90% LTV investor loans,
- Investor loans with cash out refinances,
- 90% LTV primary residence cash our refinances,
- 95% LTV primary residence to $400,000,
- 90% LTV primary residence to $500,000,
- No Income Verification Loans,
- No Ratio Loans,
- International Borrowers,
- No Income/No Asset Loans.

No Income verification or stated-income loans, which do not require borrowers to document the income stated on the application, account for about one third of all Alt-A lending.

While some ARM programs are available up to 90% LTV, most fixed-rate programs limit primary residences to 80% LTV, second homes to 75% LTV, and investor loans to 70% LTV.

No Ratio Loans ignore income entirely. LTV's are generally limited to 80% for primary residences, 65% for second homes, and 60% for investor loans.

International Borrowers includes the categories of foreign nationals, as well as permanent and non-permanent residents aliens and U.S. citizens who, due to employment abroad, do not have at least two years of established U.S. credit, employment or asset history. Loan to Value is generally limited to 80%.

No Income/No Asset Loans. These loans normally require an LTV of 75%; although, investors can be found that will accept a LTV of as high as 95%.

CREDIT REQUIREMENTS

In general minimum credit requirements include:

- Two years' credit history,
- A minimum of 24 months mortgage or rental history with no late payments,
- No open collections, charge-offs, judgments, liens or other published derogatory records filed within the past 24 months,
- No history of foreclosure, bankruptcy, or notice of default,
- Letters of explanation should address only issues of extraordinary circumstances, such as medical emergency and not be used to justify poor credit.

Most lenders agree that Alt-A products are not underwritten on the basis of ratios but on the basis of a customer's past performance history.

LOANS EXCEEDING PROPERTY VALUE

These formerly eyebrow-raising loans are getting plenty of respect from investors these days. This market, which closed 20 billion in 1998, had a delinquency rate of less than 2%. And has grown to even greater heights, today.

These high LTV loans are in reality not a pure equity loan but a hybrid between a home equity loan and an unsecured loan. Loans exceeding property value have been known to be as high as 175% of value. For the most part the quality of the loan varies depending on who's originating, servicing, and underwriting the loan.

Taking into account that these type of loans pledge future equity, will a home be mortgaged for more than it is worth when a seller wants to move or conditions force him to move and how does he deal with that dilemma?

The answer is called A PORTABLE SECOND MORTGAGE. For a 2% fee the second mortgage can be transferred to the borrower's next house when he moves. Under these circumstances the LTV can be as high as 135%.

Currently, Portable Mortgages are also available as first mortgages.

103% LOAN PROGRAM

Early in 1998 secondary mortgage market giant Freddie Mac announced that it would purchase what it calls the "103 Combo" loan. Designed for people with moderately good credit histories, this program permits the borrower to make a down- payment of 3% from their own cash, and then finance all closing costs and escrows up to another 6% of the home price.

The combination of a 97% LTV, plus a second loan of up to 6% of the home value, produces a 103% combined financing package.

The maximum loan limit on the first is $227,150 with a one-ratio guideline of 40% of the borrowers gross monthly income. The program is targeted to borrowers whose income does not exceed 125% of the median income for the area.

NO MONEY DOWN LOAN PROGRAMS

These types of loans are readily available to creditworthy borrowers. Offered through mortgage brokers these loans represent a combination of a first and second mortgage done simultaneously.

Both Fannie Mae with its' "Flexible 97" and Freddie Mac with its' "Alt 97" are offering programs that permit the borrower to obtain his 3% down payment from either gifts or loans. The loan must be underwritten through both agencies' automated underwriting systems, which use credit scoring as a form of guidance.

WHAT'S YOUR SCORE

Credit scoring is now widely used in determining a borrower's ability to repay. Even though, underwriting has not been eliminated, credit scoring is being used in determining the electronic approval of a buyer by the secondary mortgage market.

Typically in underwriting, concentration is on the borrower's most recent two-year credit history; however, scoring takes into consideration a pattern longer than two years, which can conflict with standard lending practices.

If a borrower has an "abusive credit pattern" such as over use of charge cards, often times this is interpreted as a danger sign that the potential of credit abuse is around the corner. Credit scoring is not a new way to underwrite a loan. Consumer lending in the area of automobile and charge cards has used this method of determining creditworthiness in the past. However, credit scoring is relatively new in mortgage lending.

The three most widely recognized credit-scoring programs are Fair Isaac (FICO) and BEACON (Equifax) and Experion. Both create a higher score for an individual with low risk and a lower score for an individual with high risk.

The factors are pre-determined based on factors such as:

- Number of revolving charge cards,
- Number of installment debts,
- Payment history,
- Derogatory credit,
- Public record information,
- Uses of revolving credit (percentage used vs. available credit,
- Raising or lowering of credit limits,
- Number of inquiries.

When a credit report contains a credit score, it lists the risk features that had an impact on the score.

What credit scoring does not take into consideration is:

- The borrower's length of employment,
- Length of time in a residence,
- Bills paid promptly but not reported to a repository,
- The borrower's property,
- Loan to value,
- Debt to income ratio,

- Savings pattern,
- A catastrophic event in someone's life.

When an individual does not meet the criteria required under a credit scoring process, then, automated underwriting should be converted to the more traditional form of underwriting which takes into account all of the above outlined factors.

Today an estimated 60% to 70% of all single-family mortgages are originated with some type of credit score.

Credit scoring is a comparison of the subject consumers credit report information against a grouping of similarly modeled consumers to arrive at a conclusion on the probability out-come of the subject consumer, if granted a loan. The purpose of the scoring system is to distinguish borrowers with future "good" credit from borrowers with future "bad" credit.

At times, a score comes in for someone with delinquencies on his credit report that is higher than for someone with no delinquencies. How can this be?

In the past, most of an underwriter's attention was focused on the number of late pays, foreclosures, and bankruptcies in determining an applicant's credit risk. But scoring models take a much broader approach by examining the correlation among all the financial information on a credit report.

FICO models look at direct and derived financial statistics within five broad categories with the first two having the most power in predicting defaults:

- Past payment performance including defaults and information from public record on bankruptcies, foreclosure, tax liens, etc;

- Debt utilization includes how much credit is in use in relation to the available credit and past history in this area,

- History of credit establishment - how long have the various trade lines been open,

- Pursuit of new credit,

- Type of credit being used-revolving, installment, etc.

Because a consumer's file of information may vary from one credit repository to another, credit scores may also vary.

Under today's standards FICO scores of at least 580 for FHA/VA and 620 for secondary market conventional loans are considered minimum acceptable scores for automated underwriting. Anything less than this must be considered through normal underwriting standards.

CREDIT REPORT VARIATIONS CAN COST POINTS

Were you charged a slightly higher rate on your mortgage or homeowner's insurance because your credit score wasn't quite up to snuff? It's possible nobody bothered to tell you.

But if you did learn about it, do you know which of your score was used to charge you extra? Just about every American adult has three scores, and they can be difficult enough to cost you tens of thousands of dollars, depending on which score is used to "price" you.

According to a national study covering more than 500,000 consumers. FICO scores, one in three Americans has a variation of 50 points or more from his or her high to low score (FICO stands for Fair, Isaac & Co., the developer of the dominant scoring software used in the mortgage market). One in 20 Americans' FICO score varies by 100 points or more; the average variation is 43 points.

Yet mortgage lenders and insurance companies frequently use hair-trigger score cutoffs to price their products. A person with a FICO score just a few points below 620, for example, might be quoted an interest rate one-half of a percentage point higher on 30-years loan than a person with score slightly above 620.

A loan applicant with a score of 575 would be charged more than 2 percent higher on a 30-years fixed-rate loan than an applicant with a credit score of 675, according to a Fair, Isaac-sponsored survey of more than 2,000 lenders.

Rate differentials like that produce huge differences in cumulative payments over the term of the mortgage. Yet no federal or state law requires lenders or insurers to use any one of the scores.

Though many mortgage lenders and brokers use the middle score of applicants to quote rates, lenders are free to price on the lowest score, effectively yielding them a higher interest rate and a more valuable loan for sale to investors.

The independent study of more than 500,000 customers' credit files and scores, conducted by the National Credit Reporting Association and the Consumer Federation of America, concluded that scoring variations and errors in electronic credit files put one in five Americans at risk of being overcharged on home loans. This is especially the case for consumers with bordering scores, where the score range from high to low is 575 to 630.

Why do scores vary so significantly? The simple answer is that the information contained in each of your three national credit reporting files-maintained independent by Equifax, Experian and Trans Union-differs in content from the other, sometimes dramatically. The American credit reporting system is voluntary.

No mortgage company, department store, bank or credit card issuer is required to report a consumer's account information or payment behavior to any one of the giant repositories.

National lenders and credit account holders tend to report to all three repositories. Regional or local creditors may only report to one or two. Other national lenders intentionally withhold information on some of their best customers so competitors will not target them with marketing offers. The national scoring study turned up sobering findings on missing credit data:

- 78 percent of consumers' files examined by researchers were missing at least one revolving credit account in good standing,
- 33 percent were missing a mortgage account that had never been late,
- 67 percent were missing non-mortgage installment accounts that had never been late.

Omission of positive information depresses credit scores. A credit bureau file that does not contain records of all your on-time payments to creditors will produce a lower FICO score than a bureau file has them all. That, in turn, could at least partially account for wide swing in a consumer's highest to lowest score.

How can an individual be certain they are not overcharged on a mortgage because the score selected by the lender is not their best score? Consumers should order copies of their full repository file once or twice a year. Examine each to make sure the significant credit accounts (called "trade lines") are included on all three.

If they find that the mortgage lender-or more likely, one of the credit card issuers-isn't reporting to one or more of the repositories, contact the lender and demand to know why. Second, be on guard for errors of commission as well as omission in the repository file. The national credit study found incorrect information "rampant" in the consumer files it examined.

Errors can drag down the scores. Consumers should demand that the creditor correct its mistakes immediately. Consumers can contact the Federal Trade Commission if the information doesn't get corrected promptly. Consumers should not settle for artificially depressed scores. They could cost them big money on their next loan.

Test Your Knowledge Quiz:

T F 1. FIRREA restructured the regulatory levels of the thrift industry (Savings and Loans).

T F 2. The Secondary Mortgage Market is the primary source of mortgage money by buying loans from loan originators and selling them to investor or pools of investors.

T F 3. The three major players in the secondary mortgage market are FNMA, GNMA, and FHLMC.

T F 4. Most modern day loan originators do not underwrite loans to the standards of the Secondary Market.

T F 5. The B, C, and D mortgage market deals with loans that conform to traditional loan standards.

T F 6. Sub prime type loans are often used to re-establish credit and later refinanced.

T F 7. Appraisals are not a critical element in qualifying for B, C, and D product loans.

T F 8. B, C, and D products are offered at full, limited, and no verification options.

T F 9. According to HUD the “sub-prime” market increased by 266% to a level of $173 billion by the year 2001.

T F 10. Fannie Mae loans to un-traditional sources exceeded $15 billion in 2002

T F 11. “Niche Market” and “Alternate A “ refers to borrowers with credit scores of 680 or better.

T F 12. Alternate “A” products are available through the secondary mortgage market and various other wholesalers.

T F 13. Stated Income loans account for one third of the Alternate “A” market.

T F 14. No Ratio Loans require verification of income.

T F 15. Bankruptcy, foreclosure or collections are permitted on Alternate “A” products.

T F 16. Past performance is of primary concern to an underwriter on Alternate “A” products.

T F 17. A “portable second mortgage” is transferable to a borrower’s next home.

T F 18. The 103% combo loan does not require a down payment.

T F 19. “No Money Down” conventional loans are a combination of a first and second mortgage at the same time.

T F 20. A borrower's minimum down payment of 3% can be borrowed under certain mortgage programs offered in the secondary mortgage market.

T F 21. The electronic approval of a buyer weighs heavily on credit scoring.

T F 22. Past credit abuse does not effect a borrower's credit score.

T F 23. The most widely recognized credit-scoring programs are Fair Isaac (FICO), BEACON (Equifax) and Experian.

T F 24. Credit scoring takes into account the borrower's new property appraisal.

T F 25. The purpose of credit scoring is to predict the borrower's future performance.

T F 26. Today more that 70% of all single family mortgages use credit scoring as a form of review.

T F 27. Credit scores do not vary from one reporting source to another.

T F 28. The average variation in credit scores is 43 points.

T F 29 Errors, causing variations in credit scores, do not effect a borrower's rates and points.

TRUE: 1, 2. 3. 6, 8, 9, 10,11,12,13, 16, 17, 19,20,21,22, 23,25, 26.

FALSE:

4 Most loans are written to the standards of the secondary market in order to insure their marketability at a future date.
5 B, C, D market deals with non-forming, higher risk, or unique type credit or employment situations.
7 Appraisals and property value are often key factors in this type of loan.
14 No ratio loans do not require the verification of income.
15 Alternate "a" products require above average credit with no history of serious credit problems
18 103-combo loans require an out of pocket down payment of 3%, but can finance up 6% of the closing costs into the loan
24 Looks at 5 different factors: past payment history, debt utilization, length of credit, pursuit of new credit, type of credit.
27 Credit scores have proven to vary as much as 100 points between reporting agencies

[28] 78% of Americans have in-accurate information of some kind in their credit files and in some cases causing higher rates or points.

CHAPTER IV: TRADITIONAL LOAN SOURCES

Loans sold in the secondary mortgage market traditionally come in the format of conventional loans and government guaranteed or insured loans.

CONVENTIONAL FNMA AND FHLMC LOANS

These kinds of loans follow specific guidelines and deviate from these guidelines only when compensating factors are present.

The guidelines cover the area of employment, loan to value and income ratios, and credit requirements.

Loans exceeding a loan to value of 80% must have private mortgage insurance (PMI). Borrower's income ratio cannot exceed 28% of gross monthly income for housing and 36% for total debts.

Buy downs of interest rates are permitted on fixed rate loans.

Seller's contributions to closing costs cannot exceed 6% on LTV's of 90% or less and no more than 3% on LTV's of more than 90%.

Down payment can be 100% gifted on loans with LTV's of 80% or less and on loans in excess of 80% LTV, borrower must have a minimum of 5% of own funds toward the down payment.

Gift funds must be verified and must be from a family member.

A two-year employment history is required.

Credit must be fairly perfect with minor exceptions for medical emergencies and situational changes.

Credit scores play a significant role in loan approval and often set aside ratio requirements.

Understanding that residential real estate takes into account one to four units, maximum conforming loan limits for effective January 1, 2004 are as follows:

FIRST MORTGAGES

1 Unit	$333,700,
2 Unit	$427,150,
3 Unit	$516,300,
4 Unit	$641,650.

Note: One to four-family mortgages in Alaska, Hawaii, and the U.S. Virgin Islands are 50% higher than the limits for the rest of the country.

SECOND MORTGAGES

Loan Limit is $166,850 except for Alaska, Hawaii, and the U.S. Virgin Islands where the limit is $250,275.

FHA LOANS

FHA insured loans have generally more relaxed guidelines then conventional. Qualifying ratios, employment history, down payment requirements and past credit problems are all generally addressed in a more liberal way.

FHA has more than 18 different loan programs the most common of which is the 203B loan program.

FHA UNDERWRITING REQUIREMENTS

The following are the current underwriting guidelines for an FHA - Insured loan:

- Minimum legal age as prescribed by state law,
- No maximum age limit,
- Citizenship not required,
- Must be lawful permanent or non-permanent resident authorized to work,
- Must have a Social Security number,
- Borrower’s income ratio cannot exceed 29% of gross monthly income for housing and 41% for total debts,
- Two-year primary employment history,
- One-year history for any part time employment,
- Good credit history for a minimum of one year,
- Past poor credit permitted with letters of explanation for reasonable cause,
- Past Bankruptcy permitted with 2 years waiting period,
- Allowable closing costs can be financed in the loan to arrive at an acquisition cost,
- Minimum down payment requirement based on acquisition cost rather than purchase price,

- Down payment can be entirely gifted by a relative,
- Down payment can be entirely borrowed when borrowers own assets are used as collateral,
- Maximum LTV's differ depending on loan amount (varies between 2 to 5% down),
- Maximum loan ceilings vary from local to local.

FHA LOAN LIMITS:

FHA loan limits are indexed to 75% of Freddie Mac and Fannie Mae loan limits. The FHA loan limits for one to four units effective January 1, 2004 are:

- The basic standard mortgage limits for FHA insured loans are:

One family	Two-family	Three-family	Four-family
$160,176	$205,032	$247,824	$307,992

- High cost area limits are subject to a ceiling based on a percent of the Freddie Mac Loan limits.
  The ceilings are currently:

One-family	Two-family	Three-family	Four-family
$290,319	$371,621	$449,181	$558,336

- Section 214 of the National Housing Act provides that mortgage limits for Alaska, Guam, Hawaii, and the Virgin Islands may be adjusted up to 150 percent of the new ceilings. This results in ceilings for these areas:

One-family	Two=family	Three-family	Four-family
$435,479	$557,432	$673,772	$837,504

FHA MORTGAGE INSURANCE PREMIUM (MIP)

When FHA insures a loan the Up-Front premium charge is 1.50%, which may be either paid in cash or financed into the loan by the borrower. In addition the borrower must pay an annual premium of .50% on a 30-year term and .25% on 15-year term, payable monthly to be included in the regular payment. The up-front premium portion of the insurance is not required on condos, quad homes, or coach homes.

Annual MIP (paid monthly) will be cancelled when the LTV equals 78% based on the lower of the original sales price or appraisal, provided the mortgagor has paid the annual MIP (paid monthly) for at least five tears on 30 year terms and no minimum amount of years on 15 year term loans (scheduled or actual).

The monthly mortgage insurance premium charged on Condo's and 203(k) programs is paid for the full term of the loan regardless of LTV.

FHA DOWNPAYMENT REQUIREMENTS

The FHA down payment simplification calculation was made permanent when in 2003 President Bush signed the FHA Down payment Simplification ACT, S.2239.

The FHA down payment requirement is computed on the appraised value or acquisition cost. The acquisition cost being the purchase price plus the allowable closing costs. Two calculations are required to estimate the loan amount. The one that provides the lower loan amount must be used; the acquisition cost minus the maximum allowable loan equals the down payment.

STATUTORY INVESTMENT

In computing the maximum loan amount it must be determined that the borrower has at least 3% of their funds (can be a gift) invested in the combination of down payment and closing costs.

INDUCEMENTS TO PURCHASE

Some seller concessions are considered inducements to purchase and in reality a reduction of the purchase price. These concessions, if offered, must be subtracted dollar for dollar from the sale price:

- Decorating allowances,
- Moving expenses,
- Repair allowances,
- Personal property,
- Excess rent credit,
- Seller payment of borrower’s sales commission on a present residence,
- A real estate commission on present home that exceeds typical for the area.

PERMITTED SELLER OR THIRD PARTY CONTRIBUTIONS

FHA permits sellers or other interested third parties such as real estate agents, builders, etc. to contribute up to six percent of the property sales price in the following fashion without it being considered a reduction of the sale price.

- Discount points,
- Permanent and temporary interest rate buy-downs,
- Finance-able closing costs,
- Pre-paids,
- UFMIP-Up front MIP,
- Mortgage payment protection insurance,

- Advance on HOA not exceeding one year premium,
- Taxes that becomes due in the first year.

DOWNPAYMENT ASSISTANCE PROGRAMS

FHA recognizes various down payment assistance programs. These programs are available to qualified individuals and the funds are provided directly to the homebuyer in the form of Gift Funds, which are wired to the Settlement/Closing Agent on the day of the settlement or closing. The gift is up to 5% of the home's purchase price and can be used for the down payment and/or closing costs.

The way the gift is created, is by the buyer entering into an agreement, as part of the purchase contract with the seller, that the seller will gift a percentage of the sale price, up to 5%, to a pre-established non-profit organization, whom in turn gifts a percentage of the money to the buyer, at closing, to be used toward the down payment and/or closing costs.

One of the most recognized such program is the Nehemiah Program.

NEHEMIAH PROGRAM

The Nehemiah program is a Private California Non-Profit Organization that offers down payment assistance programs to qualified homebuyers. The program offers free gift funds to be used towards the down payment and closing costs for eligible FHA loan programs. Under this program, the funds do not have to be paid back. Nehemiah will gift up to 3% of the final sales price of the home towards the down payment.

Potential applicants for this program must first get pre-qualified for this home loan grant. Once approved, the applicant will then be referred to an approved Real Estate agent in the applicant's area in order to find a home that qualifies under the program guidelines. Once the home is found, the offer is accepted by the seller, and the loan is ready to close, then the gift funds are wired to the title/ escrow company and the buyer closes on the transaction.

The gift can be up to 5% of the purchase price and can be used for the down payment and/or closing costs.

Similar to the Nehemiah Program are the:

- American Dream Program,
- Partners in Charity (PIC),
- Consumer Debt Solutions (CDS),
- Housing Action Resource Trust (HART),
- Officer Next Door Program,
- Teacher Next Door Program.

All programs require owner occupancy.

TEACHER NEXT DOOR PROGRAM

This program offers teachers a 50% discount on HUD-owned, single family homes in certain designated areas. The homes become available to HUD after homeowners default on their FHA-insured mortgages. HUD will also reduce the down payment to $100 if a teacher purchases the new home with an FHA-insured mortgage.

To be eligible, teachers must be employed full-time by a public school, private school, or a Federal, State, County, or Municipal educational agency as a State Certified classroom teacher in Grades K through 12. The teacher must agree to make the home their sole residence for three years following the purchase. In addition, teachers must work in the areas in which the homes are located.

OFFICER NEXT DOOR PROGRAM

This program offers law enforcement officers a 50% discount on HUD-owned, single family homes in certain designated areas. The homes become available to HUD after homeowners default on their FHA-insured mortgages. HUD will also reduce the down payment to $100 if a teacher purchases the new home with an FHA-insured mortgage.

To be eligible, law enforcement officers must be employed full-time by a Federal, State, County, or Municipal government and is sworn to uphold the law and make arrests for violations occurring in their agency. The officer must agree to make the home their sole residence for three years following the purchase. Officers are encouraged to purchase a home in the communities they serve.

Since HUD created the officer and teacher programs in 1977 and 2000, respectively, more than 6,000 teachers and officers have benefited from its use.

VA LOANS

VA Guaranteed loans are granted to:

- Individuals with more than 90 days active duty in World War II, Korean Conflict, Vietnam War, Persian Gulf War, War with Iraq,
- More than 180 days continues active duty Post World War II (July 26,1947 through June 26tth, 1950),
- Post Korean Conflict (February 1, 1955 to August 4, 1964), Post Vietnam War (May 8th, 1975 to September 6, 1980),
- Two years of continuous active duty during the peacetime period of September 7, 1980, to the present,
- At least six years of continued active duty as a reservist,

- Un-remarried spouse of a veteran.

The VA provides a loan guarantee of up to 25% of the veteran's home loan up to the current limit of $240,000. This enables a veteran to get a loan of up to $240,000 with no down payment. The VA full entitlement is $60,000 and all or any unused portion may be used to obtain a home loan. The entitlement represents the maximum guarantee the VA will do for that specific veteran.

Examples of this would be:

- Entitlement $60,000 representing 25% of VA GUARANTEE
  Maximum purchase price without a down payment would be $240.00,

- Entitlement $40,000 representing 25% of VA GUARANTEE
  Maximum purchase price without a down payment would be $160.00.

It is possible that a veteran has less than the full current entitlement because he has used a portion of the entitlement for a previous purchase which was not paid off; therefore, that previously used entitlement is deducted from the current maximum entitlement and the balance used toward a new purchase. Keep in mind that the available entitlement represents 25% of the purchase price to be guaranteed by VA.

A veteran can obtain a loan exceeding the $240,000, up to a limit of $333,700 (2004 limit), by putting 25% down on any amount exceeding the $240,000 limit.

In fiscal 2003, the VA backed a record amount of 490,000 loans, totaling nearly $63 billion. Nearly a third of the country's 24 million veterans used their GI loan benefits for a second and third time.

VA FUNDING FEE

- A Funding Fee is required on All **V.A.** loans (EXCEPT those with Disabilities).
- As of January 1ST, 2004. the funding fee is 2.2% for active duty personnel and 2.4% for reservists, but on subsequent use, the charge is 3.3% for all users.
- Funding Fee can be financed into the loan, however loan amount Including Funding Fee cannot exceed maximum loan limit.

VA INCOME RATIO

The ratio for income is up to 41% of the gross monthly income to include the P.I.T.I. and all other monthly re-occurring debts.

Today most loan funding is done through Mortgage Bankers or Mortgage Brokers.

FUNDING SOURCES

Mortgage Bankers provide funding from both their own sources, as well as, from the secondary mortgage market. They are originators, funders, and servicers of loans.

Mortgage Brokers on the other hand are for the most part originators of loans and use Mortgage Bankers as their source of funding loans. They normally have a higher variety of loan choices and in some cases represent the interest of the borrower.

Which source is best, is a question that is often asked?

The answer to that question might be best answered by stating that both have a value depending on the borrower's specific needs.

In summary it might be stated that the Federal Reserve System is the conduit of the "green" paper called money. And that it has the power in conjunction with government sources to control the rise and fall of the value of money in this country.

The Secondary Mortgage Market is the conduit for "white" paper called mortgages. And that in conjunction with Wall Street and other investor sources control the rise and fall of the value of mortgage paper in this country.

Test Your Knowledge Quiz:

T F 1. Conventional loans normally have more relaxed guidelines than FHA loans.

T F 2. Loans exceeding a loan to value of 80% require PMI (Private Mortgage Insurance

T F 3. Seller's contributions on conventional loans cannot exceed 3% of the purchase price.

T F 4. Residential real estate includes 1 to 4 unit dwellings.

T F 5. Conventional loans use credit scoring as the predominant source loan approval

T F 6. Citizenship is a "must" requirement of FHA Insured loans.

T F 7. Past poor credit is not permitted on FHA loans.

T F 8. Down-payments can be entirely gifted on FHA loans.

T F 9. FHA loan limits are indexed to 75% of Freddie Mac & Fannie Mae loan limits.

T F 10. Maximum loan limits are the same throughout the United States on FHA loans.

T F 11. FHA loans required MIP insurance.

T F 12. FHA loans require a borrower to have a minimum investment of 3%, including closing costs.

T F 13. Some seller inducements are considered a reduction of the purchase on FHA loans and must be deducted from the purchase price.

T F 14. FHA does not permit seller or third party contributions in the purchase of a home.

T F 15. FHA recognizes various down payment assistance programs as a legitimate source for a borrower's down payment.

T F 16. VA loans require a minimum of 3% down and have no ceiling.

TRUE: 1, 2. 4, 5, 8,9, 11,13,14

FALSE:

3 6% on LTV's below 90% and 3% on LTVs at 90% or higher
6 Citizenship is not required, must be a lawful permanent or non-permanent resident.
7 Past poor credit permitted with letters of explanation and reasonable cause
10 Maximum loan limits vary between high cost and low cost designated areas
14 FHA permits sellers or other interested third parties such as real estate agents, builders, etc. to contribute up to six per cent of the property sales price under specific guidelines.
16 Loans are available with no money down to qualified Veterans and have a ceiling of $240,000 up to the Veteran's maximum entitlement.

CHAPTER V: PREDATORY LENDING

A SYNOPSIS OF PREDATORY LENDING

A relatively new term, predatory lending, refers to mortgages that are particularly burdensome to borrowers because they are unaware of hidden and abusive costs as well as alternative sources of finance.

According to Federal Reserve Board, this lending practice typically has some or all of the following characteristics:

- Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation,
- Inducing a borrower to refinance a loan in order to charge high points and fees each time the loan is refinanced; and/or,
- Engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrowed.

Predatory lending has become a hot topic in the real estate industry because of low interest rates and more lending activity in the industry. More first time home buyers are purchasing and, perhaps because of their inexperience, are more subject to predatory lending then someone who purchased before. Females, the elderly, and minorities are particular targets of predatory lending.

According to the Mortgage Brokers Association (MBA), conventional home-purchase mortgage lending to low-income borrowers nearly doubled between 1993 and 1999, whereas that to upper-income borrowers rose 56%.

Also over the same period, conventional mortgage lending increased by about 120% to African-American and Hispanic borrowers, compared with an increase of 48% to white borrowers.

The number of sub-prime (less-than-perfect credit borrowers) home equity loans has increased 130%. In addition, buyers sometimes do not use real estate professionals to assist in their purchase and are trying to complete the transaction on their own using the Internet. New lending companies pop up all the time.

Starting in the year 2000, congress began passing legislation that cracked down on unfair lending practices. A number of other federal bills and amendments to existing legislation are now in progress to eliminate predatory lending. In addition, many state governments have recently passed laws to prevent predatory lending.

For example:

- Illinois approved House Bill 2146 that would create a board to set guidelines for mortgage companies.
- Alabama is another state that introduced guidelines centered on high cost fees and counseling for the buyer.
- Washington, D.C. enacted the Protections from Predatory Lending and Mortgage Foreclosure Improvements Act of 2000 to go into effect as of Aug 31, 2001.
- Connecticut recently passed the Abusive Home Loan Lending Practices Act. This Act limits prepaid finance charges on all purchases and refinance transactions and contains specific lines that focuses on “ high cost Loans” by definition.

In spite of state regulation, predatory lending is still practiced. This happens because of the influx of new loan officers from other industries. Training and understanding of the business for these new loan officers are limited to attitude of the company for which they work. Some companies monitor the activity of its loan officers and restrict them from any practice of predatory lending.

Predatory lending continues to exist because the public, buyers, borrowers and real estate professionals themselves do not recognize what it is or even which lenders are involved in this illegal and unethical practice.

Some red flags for borrowers and their agents should be:

- Unusually high up-front loan fees,
- A loan officer guarantees buyer/borrowers that they will get loan,
- An out-of-state lender with no local office,
- No Good Faith Estimate (GFE) provided-the GFE should explain all lending costs and is supposed to be mailed within three days of application,
- A promise of “no closing costs” when what is really meant is that the closing costs will not be paid up-front but rather financed as part of the loan,
- A verbal promise to lock in an interest rate,
- Bait and switch: a low interest rate is quoted at loan application only to discover at closing that the rate quoted was for an adjustable rate mortgage.

In order to help their clients avoid predatory lending, here are some practices that real estate professional can pass along to their buyer-borrowers:

- Buyer/borrowers should go to a recognized lender with a good local reputation,
- Buyer/borrowers should get everything in writing,
- Buyer/borrowers should understand the type of loan that was applied for,
- Buyer/borrowers should receive a Good Faith Estimate form,
- All up-front fees and closing costs requested should be explained,

- Buyer/borrowers should know that there is an option to lock or not to lock. If the loan is locked, have the lock term payment in writing,
- Buyer/borrowers should find out who is going to fund the loan,
- State lending laws should be reviewed and understood by real estate professionals.

Predatory lending has been around as long as currency has existed. However, unethical and illegal lending practices can only flourish where there is ignorance. Real estate educators and their students can significantly influence the practice of predatory lenders if they encourage consumers to seek guidance in obtaining loans and managing their debts.

HUD RULES AIM TO STOP FLIPPING

The Department of Housing and Urban development is taking a major step towards preventing an abusive lending practice known as flipping that has left thousands of unsuspecting home buyers with properties worth far less than what they owe on them.

Effective June 2, 2003 the Federal Housing Administration stopped insuring mortgages on properties that have been sold more than once in 90 days. And if a repeat sale occurs between 91 and 180 days, lenders will be required to obtain an additional and independent appraisal.

The new rules are designed to stop "flipping," a maneuver in which speculators buy a rundown property, often at foreclosure, make a few cosmetic repairs, and sell it – sometimes within days-at artificially inflated prices.

Sometimes the houses are sold to fictitious buyers and then resold again and again at higher and higher prices until they carry a mortgage far greater than their actual worth. Then, when the monthly payments stop, if they have been made at all, lenders take over the properties and file claims with the FHA, which guarantees to make lenders whole if borrowers fail to meet their obligations. Often when flipping schemes are discovered, sellers, lenders and appraisers are found to have been working together in the scam.

The new rule is a major step in efforts to eliminate predatory lending practices by HUD.

FHA-insured mortgages are considered the financing of last resort for first–time, low and moderate-income and immigration borrowers who don't meet the requirements set by conventional lenders. Without the FHA to back their loans, they would be forced to either pay higher rates and fees from "sub prime" lenders or wait until they can solve their credit issues.

There are some exceptions to the new anti-flipping rules. FHA-insured mortgages will still be available on houses taken back by HUD and then resold as well as on properties purchased by an employer or relocation company.

Otherwise, re-sales occurring 90 days or less following acquisition will not be eligible for an FHA-insured loan. Repeat sales executed within three months "imply pre-arranged transactions that often prove to be among the most egregious example of predatory lending practices.

For re-sales between 91 and 180 days, HUD requires lenders to provide additional documentation of value if the new purchase price exceeds the old price by more than 50 percent.

According to HUD, this threshold is high enough not to hurt legitimate rehabilitation efforts, but low enough to "still deter unscrupulous sellers, lenders and appraisers from attempting to flip properties and defraud home buyers."

In localities where HUD determines an inordinately high number or substantial pattern of abuses is taking place, a second appraisal will be required if the sales price has increased by 5 percent or more within the previous 12 months.

In additions, HUD said buyers would only be eligible for FHA-insured mortgages only when they purchase their houses from the owner of record.

COMPLIANCE BY MORTGAGE FIRMS

Mortgage firms are increasingly concerned about meeting the rising amount of anti-predatory regulations as well as the threat of class action lawsuits.

With 19 states and several more municipalities, including the city of Chicago, with laws on the books and more than a dozen additional states with laws in the works, compliance becomes a major priority for mortgage firms.

Compliance is especially important because the wholesale loan buyer can be liable for losses and lawsuits.

Mortgage firms are taking action to avoid being accused of predatory lending. They are examining their procedures and loan programs to make sure that none of the "hot-buttons" of predatory lending are present.

Some of the steps and cautions being taken include:

- If offering single premium life insurance, the insurance is being offered on a monthly premium basis,
- Showing borrowers loan cost with and without insurance,
- Using clearer advertising and marketing materials,
- The use of hypothetical examples is restricted to the use of only clear and concise examples,
- The use of only empirical data (credit scores from outside sources) when risk based underwriting is a determining factor,

- Loan pricing exemptions are restricted to decisions made only by a high-level mortgage firm employee,
- Yield spread premiums are being clearly disclosed,
- Offering loans with both prepayment and no prepayment penalties and allow the customer to choose between the two,
- Clearly explaining the pros and cons of loan programs offering prepayment penalties and non-prepayment penalty loans,
- Carefully deal with no-doc loans,
- Restrict negative amortization loans and clearly explain the consequences when used,
- Careful screening by mortgage funders of mortgage brokers, handling their products, to make sure that they are reputable and ethical in their practices.

Since predatory lending has no accepted definition there is always a "gray" area of concern when dealing with unique loan products.

The National Association of Consumer Advocates has listed practices associated with predatory lending as:

- Single premium credit insurance,
- Deceptive advertising and sales practices
- Loan Flipping,
- Refinancing without a tangible net benefit to the borrower,
- Abusive pricing,
- Excessively high "yield spread premiums",
- Negative amortization,
- Balloon payments,
- Mandatory arbitration in the event of dispute or delinquencies.

Because some of these practices can sometimes benefit the consumer, as well as harm the consumer, it is critical that consumers, mortgage firms, real estate brokers and governmental agencies work together to bring defined resolutions to the issue of predatory lending.

Test Your Knowledge Quiz:

T F 1. Predatory lending, refers to mortgages that are particularly burdensome to borrowers because they are unaware of hidden and abusive costs as well as alternative sources of finance.

T F 2. Inducing a borrower to refinance for no good reason is not considered to be predatory lending.

T F 3. Sub prime home equity lending has increased over 130% over the last 5 years, causing concern over predatory lending practices.

T F 4. Congress, the federal government, and state organizations have no say so in relation to predatory lending practices.

T F 5. Bait and switch is when a low interest rate is quoted at loan application only to discover that at closing that the rate quoted was for an adjustable rate mortgage.

T F 6. In order to help avoid predatory lending, Buyer/borrowers should go to a recognized lender with a good local reputation.

T F 7. Effective June 2, 2003 the Federal Housing Administration no longer insures mortgages on properties that have been sold more than once in 90 days as a precaution to flipping practices.

T F 8. If a sale occurs between 91 and 180 days, HUD does not require lenders to obtain any additional data or precautionary measures.

T F 9. "Flipping is a maneuver in which speculators buy a rundown or foreclosed property, make a few cosmetic repairs and sell it at an artificially inflated price.

T F 10. Flipping scams very seldom involve collusion between sellers, lenders, loan officers, and appraisers.

T F 11. Exceptions to the HUD "flipping" rules are HUD owned properties and relocation or employer purchased homes.

T F 12. FHA-insured mortgages are now only available when the purchase is made from the owner of record.

T F 13. Compliance with predatory laws is important to mortgage brokers and lenders because the wholesale loan buyer can be liable for losses and lawsuits.

T F 14. One of the "hot buttons" of predatory lending is single premium life insurance.

T F 15. Mandatory arbitration in the event of dispute or delinquencies is considered a predatory lending practice.

TRUE: 1, 3, 5, 6, 7, 9, 11, 12, 13, 14, 15

FALSE:

2. Inducing a borrower to refinance a loan in order to charge high points and fees each time the loan is refinanced is unethical and considered predatory lending.

4. Starting in the year 2000, congress began passing legislation that cracked down on unfair lending practices. A number of other federal bills and amendments to existing legislation are now in progress to eliminate predatory lending. In addition, many state governments have recently passed laws to prevent predatory lending.

8. If a repeat sale occurs between 91 and 180 days, lenders are required by HUD to obtain an additional and independent appraisal.

10. Most often flipping is occurring as a result of collusion between the parties involved in the transaction.

CHAPTER VI: FRAUD PROTECTION

QUALITY CONTROL

Quality control is a requirement all lenders must deal with in the processing of loans. A lender must be able to demonstrate that they take proper precautions to prevent fraud. Doing a series of self-audits during the processing and post funding periods does this. Post funding of a loan, either the secondary market owner of the loan or HUD does quality control checks.

At one time, a lender would report suspected incidents of fraud to HUD and then wait on pins and needles to see what action HUD would take against the lender. Actions could include administrative sanctions, indemnification to HUD for any losses resulting from the fraudulent loans, or potentially civil money penalties.

HUD regulations imposed a clear obligation to report fraud, but lenders on the other hand, were hesitant aware of the financial consequences that could follow.

In the fall of 1997 HUD issued a “Quality Assurance Agreement” wherein “reasonable relief measures” could be extended to a lender caught in this dilemma.

Under this agreement the Mortgage Review Board can still:

- Impose administrative sanctions, ranging from a letter of reprimand, placing the lender on probation or suspending or terminating the mortgagee’s HUD approval,
- Impose civil money penalties usually in the area of $5000 per individual violation (To a maximum of $1 million dollars in a twelve-month period),
- For larger violations assess treble damages.

LOSS MITIGATION INCENTIVES

For lenders that comply with the requirements of the agreement HUD offers “loss mitigation incentives” that include:

- Abatement of claim losses,
- Flexible repayment plans for losses,
- Waiver of fees and/or late charges,
- Waiver of civil money penalties.

The incentives that HUD will offer a mortgagee will be based on:

- the losses suffered by HUD,
- past mortgagee performance,
- the mortgagee's financial capability,
- HUD will also measure the mortgagee's claim and default rate against the rates of other mortgagees making loans in the same geographic areas.

The mortgagee must also co-operate with HUD in pursuing criminal prosecution and administrative sanctions against individuals and companies involved in the fraud.

In order to qualify for HUD's loss mitigation incentives mortgagees must:

- Timely report to HUD any program violations involving insured loans, and false statements that affect the insurability of the mortgage,
- Maintain adequate controls for the origination of insured mortgages,
- Maintain controls to prevent and detect fraud and program violations,
- Co-operate with HUD in connection with legal or administrative action that HUD brings against participants who have committed violations or fraud.

Lenders that enter into this agreement have an absolute obligation to report fraud to HUD and failure to do so will result in severe sanctions against lenders who sign the agreement and than fail to keep up their end of the bargain.

To help lenders detect fraud a checklist has been created to help detect "red flags" for possible fraud.

LOAN APPLICATION RED FLAGS

Although the following do not indicate that a potential fraud is present, they do represent an "alert" to the underwriter that additional "diligence" is required in underwriting the loan:

- No face-to-face interview,
- Buyer currently lives in property (buying from landlord),
- Deposit or down payment is a promissory note,
- Borrower is buying an investment property but doesn't own current residence,
- IRA is shown as a liquid asset,
- Borrower and co-borrower work for same employer,
- Same telephone number for home and work
- Personal property exceeds one year's salary,
- Unrealistic or significant commute distance to work,
- Number of family members compared to size of house being purchased is not consistent,
- Date of application and dates of verification forms are not consistent,
- Borrower's age and the number of years employed are not consistent,

- Unreasonable accumulation of assets compared to income,
- Lack of accumulation of assets compared to income,
- Excessive real estate currently owned,
- Initial fee check returned "NSF",
- Buyer down sizing from larger to smaller home,
- Borrower intends to rent or sell current residence with no documentation,
- Stocks and bonds not publicly traded,
- Significant or contradictory changes from handwritten to typed application.

VERIFICATION OF DEPOSIT (VOD) RED FLAGS

- Even dollar amounts,
- Significant change in balance over prior two months,
- Original VOD is not creased,
- Evidence of whiteouts or strikeovers,
- Account was opened on a Sunday or holiday,
- No date stamp by depository,
- Recently opened account,
- Illegible signatures with no further identification,
- Excessive balance in checking accounts vs. savings account,
- Young borrowers with substantial cash in bank,
- Is entire verification typed with same typewriter or same handwriting,
- Is VOD addressed to a P.O. Box or mail drop,
- Source of funds consists of unverified note, equity exchange,
- Borrower has no bank account,
- High-income borrower with little or no cash,
- Borrower's funds are security for a loan.

VERIFICATION OF EMPLOYMENT (VOE) RED FLAGS

- Is the entire verification typed with the same typewriter or same handwriting and ink,
- Is the employer's address the same as the property being purchased,
- Was the VOE prepared/signed by the originator on the same date as completed and signed by the employer,
- Even dollar amounts,
- VOE addressed to a particular person's attention other than personnel manager,
- Evidence of whiteout or strikeovers,
- Numbers that appear to be squeezed,
- Employer's signature dated less than one day after originator's signature,
- Illegible signatures with no further identification,
- Inappropriate verification source, (secretary, relative, etc.),
- Overtime or bonus exceeds 50% of base pay,
- Income not appropriate for location or type of employment,
- Borrower self-employed and verifying own earnings,

- Excessive praise in remarks section,
- Date of hire was holiday,
- Overlaps in current and prior employment dates,
- Drastic change from previous position or profession to current employment status,

CREDIT REPORT RED FLAGS

- All accounts paid in full recently possible new consolidation,
- Employment information history varies from loan application,
- No credit-possible use of alias name,
- Variance in employment or residence data from other sources,
- Recent inquiries from other mortgage lenders,
- Invalid social security number,
- Limited credit history for income and age,

GIFTS RED FLAGS

- Unable to verify source of funds by donor,
- Discrepancies between signatures on gift letter and donor check,
- Variation of phone numbers given by donor and number listed in phone directory.

TAX RETURN RED FLAGS

- Is borrower's income consistent with job description,
- If borrower has stock assets, is dividend income shown on return,
- If borrower shows large savings, is interest income shown on return,
- Does return show quarterly tax deposits made,
- Is the tax form prepared by borrower or a tax preparer,
- Use the IRS Tele-tax service to verify any tax refund,
- Examine cancelled checks for estimated quarterly tax payments.

EXAMINING THE 1040 FORM

- Tax computation does not agree with tax table,
- Evidence of erasures, cross-outs, squeezed-in entries,
- Type or handwriting not consistent throughout the return,
- Paid preparer signs taxpayer's copy,

- Borrower files Schedule G (used for income averaging thus reflecting fluctuating income).

W2 WAGE FORMS RED FLAGS

- Invalid employer identification number,
- FICA wages/taxes and local taxes exceed ceilings or set percentages,,
- Even dollar year-end figure,
- Different type or print within the form,
- Be suspect of copies of W-2 submitted other than "employee's copies",
- Employer's address different than on VOE.

PAY STUBS RED FLAGS

- Even dollar amount on paycheck,
- Company name not imprinted on check,
- Handwritten pay stub.

APPRAISAL RED FLAGS

- Is appraiser from out of the area,
- Missing information,
- Ordered considerably earlier than sales contract,
- Comparables used are more than nine months old,
- Comparables are more than one mile from subject property,
- Line adjustments are more than 10%,
- Overall adjustments are in excess of 25%,
- Land value constitutes a large percentage of value,
- Erasures, cross-outs, squeezed in characters,
- Sales contract as dated after appraisal,
- Appraisal ordered by a party to the transaction (seller, buyer, real estate agent),
- Photographs do not match description,
- For rent sign on property.

SALES CONTRACT RED FLAGS

- Seller is the real estate agent,
- Power of Attorney is used to sign contract,
- Sale is subject to seller acquiring title,
- Buyer is required to use a specific lender or broker,

- Odd amounts used as earnest money,
- Seller secondary financing is an element of the contract.

RESOLVING DISCREPENCIES & FRAUD

If fraud is discovered during the loan-processing period and merely involves the stretching of the truth by a zealous borrower, suggesting a different loan program to better suit the customer's needs may solve the problem easy enough.

When fraud is discovered post funding and after being sold in the secondary market, a lender has no choice but to report the fraud and each must deal with the consequences.

Test Your Knowledge

T F 1. Quality control is not required of lenders who have less than 2% foreclosure rate.

T F 2. When fraud is discovered in a quality control check, a lender is required to report the fraud to HUD and suffer the consequences for their lack of diligence.

T F 3. Lenders reporting fraud to HUD could suffer financial consequences imposed by HUD.

T F 4. Under a "Quality Assurance Agreement" with HUD a lender can only be fined a maximum of $1 million dollars in any 12-month period.

T F 5. In a fraud case, a lender is not obligated to cooperate with HUD in pursuing criminal prosecution of an accused.

T F 6. A Loan application "red flag" is an unreasonable accumulation of assets compared to income.

T F 7. A significant change in balance over the previous two months is reason to further investigate a verification of funds.

T F 8. Numbers that appeared to be squeezed on a verification of employment are reason for further investigation by an underwriter.

T F 9. Quantities of recent credit inquiries are of no concern to an underwriter.

T F 10. When FICA wages exceed ceilings on W-2 forms, further investigation should be undertaken.

T F 11. A credit report showing recent inquiries by other mortgage lenders is of no concern for further investigation.

T F 12. Tax return observations should include if borrower's income is consistent with job description.

T F 13. Handwritten pay stubs are acceptable and do not require further investigation.

T F 14. A sales contract" underwriting alert" is required if the seller is also the real estate agent.

TRUE: 2, 3, 4, 6, 7, 8, 10, 12, 14

FALSE:

1. Quality control is required of all lenders
5. A lender is required to cooperate with HUD in all investigations
9. Recent credit inquiries indicate potential new credit and must be explained
11. FHA has more relaxed guidelines regarding credit and employment
13. Hand written pay stubs are cause to further investigate the authenticity of the information.

CHAPTER VII: QC-A MONEY SAVER

PREVENTING FRAUD

Fraud's impact on the mortgage industry has grown considerably and money-lending schemes can result in serious losses and be extremely costly to the industry.

Take a loan where a property has been altered until its collateral value is only 65% of the balance from the actual loan. Faced with a possible buyback of that loan from an upstream purchaser and a further loss from foreclosure and resulting REO, the funded company can be involved in a scheme concerning several loans.

Losses can be brutal. Investigating and verification prior to or right after the loan closing can often pinpoint issues before they reach a distressing outcome.

A lender's quality control department can make a significant difference in the bottom line and in the future. Implementing quality control has its' pros and cons. Quality control can be extremely beneficial to a company but also can be very costly.

Issues and solutions dealing with quality control can be viewed in two different ways. Some companies view quality control as a cost center, while other companies view quality control as a profit center.

Some companies view quality control as a cost center, because it takes the right personnel, innovative tools to get the job done, neither of which are inexpensive.

Other companies view quality control as a profit center because preventing a bad loan out weighs having to suffer a costly foreclosure, a possible buyback or an REO. There are those lenders who track and reward their personnel based on the quality of the product produced. This is a great motivational tactic for employees, and in turn produces a better quality product for the company.

All businesses must evaluate their manufacturing process and determine the quantity and severity of the problems and how those problems can be addressed to improve the process.

Mortgage lending is no different. In terms of mortgage loans, quality control is often seen only as paperwork review, determining issues without the analysis of the frequency and severity of the issues discovered during the quality control process.
The person performing the quality control often doesn't have the right tools outside of the file to detect any problems. In dealing with quality issues, one must take time to

investigate, to analyze and to classify the findings based on the severity of the data found.

An effective quality control program will allow you to examine the information provided, get to the focal point of the issues at hand and to determine the source. Some areas of concentration in dealing with findings are:

- ✓ The source of the issues within the process,
- ✓ Define the severity of the issues detected,
- ✓ Buyback, foreclosure, REO analysis. Of the issues found, is the level of severity extreme enough to cause a repurchase of the loan or a loss on an REO,
- ✓ Can the issues that are found be corrected,
- ✓ Have you developed and implemented a sound quality control plan with an assessment of its effectiveness? Is management supportive of the plan,
- ✓ Are you paying attention to follow-up? Are the sources of the issues found, and the data analyzed, so that repeating of those problems does not occur again.

Quality control expenses are often viewed as a cost of running a business. Even though being reported to management, the results of the process may get lost or pushed back in the day-to-day effort to move forward and to produce and purchase more loans.

The end result for the company can be costly when quality control is sacrificed for volume or any other reason. An excellent benefit to quality control is that it allows an evaluation of your file control system to see if notes and documents are being handled expeditiously. Failures in document control can lead to lost documents or errors in files that may disrupt delivery of those loans to meet investor commitment deadlines.

AREAS OF ABUSE

Areas of production abuse seem to remain persistent, so verifying some facts up front can save money in the long run. The common areas of abuse or fraud are:

- ➢ Fraudulent gift letters,
- ➢ Income verifications falsified or distorted,
- ➢ Falsified verifications of deposit,
- ➢ Fraudulent bank statements,
- ➢ Appraisals with false comparables or improper adjustments made to justify a highly inflated value,
- ➢ Flips- property that is acquired and resold in a very short time frame, usually to a related party, but not always,
- ➢ Sending verifications to P.O. Boxes or unsubstantiated addresses,

- Use of residential addresses for certain verifications,
- Straw buyers obtaining loans to facilitate a transfer of the property either away from a builder or to someone who otherwise would not qualify for the loan,
- Fraudulent use of Social Security numbers.

Technologically advanced tools allow an enhanced opportunity to discover fraud and misrepresentation.

Some tools are expensive multifaceted databases accessed only through an account and are generally employed only by outsource companies that can distribute the cost over thousands of loans. Others are free Internet databases and CD phone disks that are obtainable at many computer retail outlets.

Prior to funding have personnel verify given information to make certain it is accurate. Making telephone calls that may save one's company tens of thousands of dollars just by verifying information can accomplish this. Investigation and verification done during the application process, or just before closing, can result in discovering a problem before the loan is funded. Once the money is gone, so is much of your leverage to correct the problem.

TO IN-HOUSE OR OUTSOURCE

Before implementing a quality control plan, you should evaluate if it is best to use in-house personnel or an outsource provider. Each of these solutions has different implications. The in-house personnel will be more of a fixed expense, while the outsourcer's cost would be a variable expense based on the number of files audited each month. Suggestions for building a sound quality control plan include the following steps:

- Phone calls regarding any questionable documents,
- Use of reference tools to check addresses or phone numbers that may be uncertain,
- Checking the documents and signatures against others already on file,
- Checking for round numbers on employment or bank data,
- Checking the FICA tax calculations on payroll information,
- Checking the social security numbers being used to determine who may be using them and when the number was issued,
- IRS forms 4506 and 8821 allow verification of income reported to the IRS.
- Good common sense. Ask yourself, "Is the document being viewed logical, based on the other loan facts before me?"
- If available, certain database checks could also be run to look at property values, location, or existence and ownership of employers, etc.
- Written responses from parties responsible for serious defects or issues found,
- Evaluation of minor issues to determine if a response or training is needed to address the issues,

- The ability and resources to do follow-up on issues identified as possibly fraudulent.

Minor quality control issues generally result from a lack of training, poor communication or poor work habits. A look at the trending of certain error types can point out areas where additional training or support may be needed.

Follow-up on minor issues is not necessary unless those issues are forming a trend or arising on a repeated basis. Forcing responses for every single issue found from a quality control department can be costly, create animosity and lead to a less effective department.

A more effective approach may be to identify the frequency of minor issues and their severity, then address only a couple of higher frequency issues each month. By concentrating your efforts in this way, you can resolve problems rather then create them.

TWO CATEGORIES

Fraud can be divided into two categories: major and minor.

Minor fraud generally involves one or two people. Though it is a significant issue and may be costly, it can usually be isolated to a single loan in which some piece or pieces of the income or credit were falsely disclosed and falsely verified.

The consequence of this type of loan could lead to a repurchase. However, this would be an isolated case, not a series of loans. This type of fraud is more often than not "fraud for property" where a party genuinely wants to own a property but cannot meet the expense of the loan.

"Major" quality control issues are different. They must be addressed immediately. The fraudulent issues come from many sources:

- Fabrication of employment with phony companies,
- Legitimate companies at false addresses,
- Gift letters,
- Falsification of bank statements,
- Falsification or alteration of checks or money orders,
- Poorly or fraudulently completed appraisals,
- Title flipping to build a highly inflated value in the property.

Assistance in committing some of these acts may unfortunately come from within the lender's own shop. Incentives to produce loans often create incentives to help borrower's qualify, even if it entails being deceitful.

Fraud schemes are at an even advanced level. A fraud scheme can originate with employees or third-party originators who are selling loans to numerous wholesale purchasers. Some of these schemes are hard to detect because they are sophisticated and involve multiple players in the process. A scheme usually involves several parties. It may involve the borrower, seller, real estate agent, appraiser, originator or processor.

Participants go to multiple loan transactions with an ultimate goal of “fraud for profit.” This is the most difficult fraud to uncover. It can be extremely costly due to the complexity and loan involvement of various wholesale purchasers.

Once detected, the lender should investigate immediately to determine the number of loans it has which might have common people and properties (gift letters, verification of employment and verification of deposit.) It may be necessary to develop an exceptional project to review a larger percentage of loans where the identified parties are involved to determine the magnitude of the scheme.

WELL PERPETRATED SCHEMES

Some fraud schemes are so well perpetrated they are difficult to spot on a single transaction or even multiple transactions over longer periods of time.

Usually they have common fundamentals, but without seeing all of the loans simultaneously, the elements meld into our everyday processing pot. Once discovered, a review of several loans involving the same parties usually will bring to light the real scheme. Improvements in technology have made fraud increasingly more difficult, and fraud schemes have definitely declined in statistics in recent years.

When encountering a fraud scheme, it may be worthwhile for your company to contact the investor to obtain assistance.

But such a contact is a decision left up to the lender’s management. Further additional contact may be advisable with other lenders who are known to have done business with the same parties. Inter-company contact may determine if additional fraud has been discovered and help to determine an approach for pursuit of restitution from or prosecution of the offending party.

Certain areas of the country seem to be perpetual hotbeds for fraudulent schemes:

- ✓ The West Coast,
- ✓ The Southeast,
- ✓ The Northeast (certain areas),
- ✓ Midwest.

In these areas, schemes often go unnoticed for longer periods due to high volume of transactions.

A larger database of perpetrators is needed to allow lenders to become aware of potential problems before they occur. No area is immune to fraud, and many of the known players move from one area to another.

Quality control auditors need to develop a suspicious nature and communicate with various individuals within and outside their companies. The quality control department should also be able to provide management with the necessary reports to access the need for policy changes, additional training or discipline.

The quality control professional can provide the information needed to request a repurchase of a loan by a provider when it does not meet the criteria under which the loan was purchased. They may also sound an alert about serious defects in loans coming from a particular source, thereby allowing time to correct those defects.

FOLLOW GUIDELINES

High loan-to- value lending brings more people seeking homeownership. Lenders and purchasers of loans must adhere to guidelines and be increasingly aware of potential areas of abuse by unqualified borrowers seeking a home they simply cannot afford and must maintain vigilance toward criminals seeking profit by defrauding lenders of large sums.

In either case, lenders stand to lose. Seeking a quality product is everyone's goal, and investigating suspicious documents in the application process can prevent such a loss. Beyond that, good post-closing quality control and detailed reporting can help management identify problem areas and deal with them accordingly.

In pushing to move applications to meet the demand for loans, time and pressure cave-in to shortcuts. These cause a failure to closely review certain documents, such as gift letters, bank statements, appraisals or income verifications, to determine their validity.

In addition, some within the lending community are profiting from schemes that defraud lenders or wholesale loan purchasers. Lenders must be cautious in their efforts to identify abuse and investigate suspicious documents.

Some fraudulent documents are so poorly altered or prepared that they can quickly become suspect. A few of the most commonly altered documents problems are as follows:

- ✓ Misaligned addresses,
- ✓ Changes in type fonts,
- ✓ Obvious signature mismatches,
- ✓ Missing logos.

A simple phone call can determine the validity of the documents in question.

Quality control must be placed in the hands of competent personnel, either internally or with an outsource vendor. The quality control department must have access to the right tools for obtaining information, storing the findings and circulating the information.

A sound Quality control plan must include meeting all of the requirements of the agency or GSE who will be the insurer or purchaser. Their individual requirements are set out in the various investor/agency handbooks or guides. Also, automated underwriting doesn't eliminate a need for quality control, since it includes representations of data accuracy and data integrity.

CONSIDERATIONS IN BUILDING A QUALITY CONTROL PLAN

Sampling. Single out a 10% sample of loans, or a valid statistical sample if you have a very large volume, and verify for compliance with required guidelines.
Confirm the accuracy of information obtained in the loan to determine its integrity.

Review the input and responses on automated underwriting loans for accuracy.
Identify problems encountered in processing, underwriting and closing the loan.
Determine the severity of problem issues encountered and the need for a response.
Report the problem issues and their appropriate severity in summary to management and have backup detail available.

Develop a management plan of action to correct the problems and implement the plan. Does you quality control plan allow you to obtain and verify the accuracy of the process? Does it allow you to check information to help solve the mystery of “Who may have done it?” If not, you should consider updating your plan and the way you approach quality control.

If you don't have the staff or expertise for quality control, it may be a good time to look at the advantages of outsourcing the work.

Outsourcing can often relieve a large amount of the effort in quality control work and allow your staff time for reviewing issues and implementing changes. Most outsourcing companies have built systems and staffs exclusively for providing quality control services and reports. They can work with you to handle customized data to and from your shop, timely file reviews, customized reporting that serves the response staff, and management summaries that allow upper-level management to easily review the results of the process.

PRE-FUNDING QUALITY CONTROL

This is still a relatively new area. The advantage of pre-funding quality control is you maintain full leverage (i.e. “your money”). Some steps in the pre-funding process would include:

Re-verifying the existence and address of the employer, even if you cannot always verify the amount of income paid to the employee.

Checking to see if the borrower is still employed at the employer given on the application. (You may be able to get an oral verification of actual income, but don’t count on it.)

Being certain social security number(s) the borrower(s) are using are valid and not being used by others.

A computerized records check to view the ownership history, how recently the title to the property may have been transferred and at what reported price.

An in-file credit report to check any new debts since the original credit check.

A bit of diligence here can more than pay for itself if a bad loan is stopped prior to closing and funding. Talk with the investors (Fannie Mae or Freddie Mac) if you are implementing a pre-funding quality control plan. Show them your written plan, and you might be pleasantly surprised to find you may be able to get some relief on the post-funding quality control if you implement a reasonable front-end plan.

Making sure the pre-funding quality control plan has elements that are realistic in relationship to the short time fuse involved in re-verification of application data, usually no longer than 24 to 48 hours.

It is imperative to discover significant problems before they are embarrassingly brought to your attention from outside the company. Quality control can help you identify trends where errors are continually made, identify who is making them and allow you to target training to correct those errors. Keeping in mind that quality control only samples the loans you are making, once issues are identified, it may be necessary to do a targeted sample on the personnel or branch where any serious issues originated.

A common statement that sums up quality control nicely, “One big loss on a bad loan pays for a whole lot of quality control.” Don’t share that feeling. It can mean a profit if you pay attention to quality and cost you heavily if you don’t.

Q & C COMPLIANCE & THE CONSUMER PRIVACY ACT

Mortgage companies can meet the Gramm-Leach-Bliley Act through effective quality control practices.

The Gramm-Leach-Bliley Act requires financial institutions to disclose their privacy policies and practices with respect to information sharing with third parties on financial products for personal, family and household purposes.

The act's provisions apply to non-public personal information about consumers who apply for a financial product, regardless of whether the credit is extended, and customers who have a continuing relationship with the institution.

Under the final rule, the initial notice and opt out requirements do not apply to processing and servicing transactions necessary to effect, administer or enforce a transaction requested or authorized by the consumer or in connection with certain servicing, processing, securitization and secondary market functions.

The Federal Trade Commission is expected to release substantially similar guidelines to the Consumer Privacy Act to all non-depository mortgage lenders. Under the present rule, a customer relationship is established by the entity responsible in the loan origination (including brokers) and continues through transfers to loan services.

Post-funding quality control reviews of residential mortgages loans are covered under the exemption for sharing of personal information between financial institutions and nonaffiliated third parties. Mortgage institutions must enter into a contractual agreement with the third party that:

Requires the third party to maintain the confidentiality of the information to at least the same extent that the institution must maintain confidentiality under the rule, and Prohibits the third party from disclosing or using the information other than to carry out the purposes for which the third party is contracted in the ordinary course of business.

Overseeing third-party service providers is addressed in the Interagency Guidelines Establishing Standards for Safeguarding Customer Information as required by Gramm-Leach-Bliley Act. Under III.D of the guidelines, financial institutions must exercise appropriate due diligence in selection service providers, require their providers by contract to implement measures designed to meet the objectives of the guideline and monitor their services to confirm compliance to the act.

Best practices

The privacy act has led to increased consumer awareness and misunderstandings regarding the lender's use to re-use of personal information. Suggested are the following best practices:

- Re-assess internal workflow steps to ensure respectful treatment of borrower information throughout all processing, underwriting and post-closing functions,

- ➢ Consider technology enhancements and end-to-end automated underwriting tools that help reduce exposure of borrower information to unauthorized parties,

- ➢ Consider today's level of expertise necessary for effective and compliant quality control whether completed within the institution or out sourced.

Fannie Mae and Freddie Mac have reduced certain quality control steps for loans approved through Desktop Underwriter and Loan Prospector. In as much as the agencies' amendments are unrelated to the Consumer Privacy Act, compliance to Fannie Mae and Freddie Mac re-verification steps verbatim can be a critical measure toward safeguarding borrower information.

Agency guidelines

This is a summary of the most recent guidelines:

Fannie Mae requires a post-funding quality control review of 10% of a lender's total mortgage production and recommends review to be completed on monthly basis.

Quality control sampling selections mush reflect the institution's full scope of business and include a representative sample of loans underwritten by Desktop Underwriter that receives an Approve, Refer, or Refer with Caution recommendation.

A new credit report is not required for Desktop Underwriter loans. However, if significant errors, discrepancies or erroneous data is found, a new credit report is required. In-file reports are required for all non-DU loans, and residential mortgage credit reports (RMCR) are required for a 10% of the QC sampling.

Re-verification of income and asset documentation for DU loans requires the same procedure as non-DU loans. If telephone verification was a DU condition, QC must complete a telephone re-verification.

Field review property appraisals are required for 10% of the QC sampling. Field reviews include subject property photographs, street scene and completion of FNMA 2000. For DU loans, reviews will be conducted on the applicable FNMA Appraisal or Collateral Assessment such as Fannie Mae 1055, 1065 or 1075.

Quality control procedures must determine that the loan meets Fannie Mae eligibility and underwriting standards as follows:

Approved loans: QC must confirm that all verification messages/approval conditions have been satisfied and are adequately documented.

Referred loans: QC must determine the rationale applied in the decision to approve a referred loan and review the entire underwriting file, including additional documentation provided to support the underwriting decision.

Ineligible loans (approve or Refer): QC must verify that the ineligible conditions referenced in the underwriting findings report are permitted in the master agreement or negotiated variances. Verification is not required if the loan receives an eligible recommendation.

Freddie Mac Requirements

Freddie Mac requires that post funding quality control audits are performed within 90 days on 10% of the lender's total annual home mortgage production, total secondary market production or total Freddie Mac production, including Freddie Gold. A 10% sampling is required of the lender's entire portfolio of three to four-unit mortgages. Quality control must include a full representation of Loan Prospector loans and must be clearly identified as LP on management reports.

A new credit report is not required for Loan Prospector mortgages. QC must verify that the Loan Prospector-provided credit reports are for the correct borrower. Loan Prospector Accept mortgages and A-minus mortgages do not require QC to determine credit-underwriting compliance. Credit must be re-underwritten to Freddie Mac's requirements for LP and non–LP loans.

Caution advised

An in-file report is required for non-LP loans. An RMCR or a three-bureau merge is required for 10% of the entire sampling. If the mortgage requires an Indicator score, QC must confirm the correct method was used on the Transmittal Summary Form 1077.

Re-verification of income and asset documentation for LP loans requires the same quality control procedures on as non-LP loans. If telephone verification was completed, a telephone re-verification is required.

Field review property appraisals are required for one out of 10 loans in the sampling with a desk review for the remaining nine, or field reviews on three out of 10 loans and no desk reviews for the remaining seven.

Original collateral assessment documentation for Loan Prospector mortgages may include Freddie Mac Form 70, 72, 465, 2070, Fannie Mae 2075 or Fannie/Freddie Form 2055.

As our industry moves forward with increased consumer disclosure, mortgage lenders must take a new look at marketing and promotional materials to build trust and maintain customer loyalty.

Employee education programs should incorporate training on the Consumer Privacy Act so consumer questions may be addressed in a manner that upholds the institution's mission toward quality customer service.

Focus Points

- Fraud and money-lending schemes can result in serious losses and be extremely costly to the insurance industry.
- Quality control can be beneficial to a company as well as very costly.
- Quality control expenses are viewed as a cost of running a business.
- The use of technology has aided in discovering fraud and misrepresentation.
- Use of in house personnel or an outsource provider must be evaluated before implementing a quality control plan.
- The in-house personnel will be more of a fixed expense in the quality control process.
- The costs of outsourcing would be a variable expense based on the number of files audited each month.
- Outsourcing companies have built systems and staffs exclusively for providing quality control services.
- Major and Minor are the two categories in which fraud is divided.
- Fraud schemes can originate with employees or third-party originators selling loans to numerous wholesale purchasers.
- The Gramm-Leach-Bliley Act requires financial institutions to disclose their privacy policies and practices with respect to information sharing with third parties on financial products for personal, family and household purposes.
- Through effective quality control practices mortgage companies can meet the Gramm-Leach-Bliley Act requirements.
- The Gramm-Leach-Bliley Act provisions apply to non-public personal information about consumers who apply for a financial product.
- Under the Consumer Privacy Act a customer relationship is established by the entity responsible in the loan origination (including brokers) and continues through transfers to loan services.

- Post-funding quality control reviews of residential mortgages are covered under the exemption for sharing of personal information between financial institutions and nonaffiliated third parties.

- The overseeing of third-party service providers is addressed in the Interagency Guidelines Establishing Standards for Safeguarding Customer Information as required by Gramm-Leach-Bliley Act.

- The privacy act has led to increased consumer awareness and misunderstandings regarding the lender's use to re-use of personal information.

- Using Desktop Underwriter and Loan Prospector, Fannie Mae and Freddie Mac have reduced certain quality control steps for approved loans.

- Fannie Mae requires a post-funding quality control review of 10% of a lender's total mortgage production and recommends review to be completed on monthly basis.

- Quality control procedures must determine that the loan meets Fannie Mae eligibility and underwriting standards.

- Freddie Mac requires that post funding quality control audits are performed within 90 days on 10% of the lender's total annual home mortgage production.

- Non-LP loans require an in-file report.

- An RMCR or a three-bureau merge is required for 10% of the entire sampling.

- QC must confirm the correct method was used on the Transmittal Summary Form 1077 if the mortgage requires an Indicator score.

- Re-verification of income and asset documentation for LP loans requires the same quality control procedures on as non-LP loans.

CHAPTER VIII: RESPA IN SUMMARY

The Real Estate Settlement Procedures Act (RESPA) is a consumer protection statute, first passed in 1974.

One of its purposes is to help consumers become better shoppers for settlement services. Another purpose is to eliminate kickbacks and referral fees that increase unnecessarily the costs of certain settlement services.

RESPA requires that borrowers receive disclosures at various times. The disclosures spell out:

- The costs associated with the settlement,
- Outline lender servicing and escrow account practices,
- Describe business relationships between settlement service providers,
- RESPA also prohibits certain practices that increase the cost of settlement services.

Section 8 of RESPA prohibits

A person from giving or accepting any thing of value for referrals of settlement service business related to a federally related mortgage loan

Prohibits a person from giving or accepting any part of a charge for services that are not performed.

Section 9

Section 9 of RESPA prohibits home sellers from requiring homebuyers to purchase title insurance from a particular company.

Generally, RESPA covers loans secured with a mortgage placed on a one-to-four family residential property.

These include most purchase loans, assumptions, refinances, property improvement loans, and equity lines of credit.

HUD's Office of Consumer and Regulatory Affairs, Interstate Land Sales/RESPA Division is responsible for enforcing RESPA.

DISCLOSURES:

Disclosures At The Time Of Loan Application

When borrowers apply for a mortgage loan, mortgage brokers and/or lenders must give the borrowers:

- ✓ A Special Information Booklet, which contains consumer information regarding various real estate settlement services. (Required for purchase transactions only).
- ✓ A Good Faith Estimate (GFE) of settlement costs, which lists the charges the buyer is likely to pay at settlement. This is only an estimate and the actual charges may differ.
- ✓ If a lender requires the borrower to use of a particular settlement provider, then the lender must disclose this requirement on the GFE.
- ✓ A Mortgage Servicing Disclosure Statement, which discloses to the borrower whether the lender intends to service the loan or transfer it to another lender.
- ✓ Information about complaint resolution.

If the borrowers don't get these documents at the time of application the lender must mail them within three business days of receiving the loan application. If the lender turns down the loan within three days, however, then RESPA does not require the lender to provide these documents.

The RESPA statute does not provide an explicit penalty for the failure to provide the Special Information Booklet, Good Faith Estimate or Mortgage Servicing Statement. Bank regulators, however, may impose penalties on lenders who fail to comply with federal law.

Disclosures Before Settlement (Closing) Occurs

A Controlled Business Arrangement (CBA) Disclosure is required whenever a settlement service provider involved in a RESPA covered transaction refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest.

The referring party must give the CBA disclosure to the consumer at or prior to the time of referral.

The disclosure must describe the business arrangement that exists between the two providers and give the borrower estimate of the second provider's charges. Except in cases where a lender refers a borrower to an attorney, credit reporting agency or real estate appraiser to represent the lender's interest in the transaction, the referring party may not require the consumer to use the particular provider being referred.

The HUD-1 Settlement Statement is a standard form that clearly shows all charges imposed on borrowers and sellers in connection with the settlement.

RESPA allows the borrower to request to see the HUD-1 Statement one day before the actual settlement. The settlement agent must then provide the borrowers with a completed HUD-1 Settlement Statement based on information known to the agent at that time.

Disclosures at Settlement

The HUD-1 Settlement statement shows the actual settlement costs of the loan transaction. Separate forms may be prepared for the borrower and the seller. it is not the practice that the borrower and seller attend settlement, the HUD-1 should be mailed or delivered as soon as practicable after settlement.

The Initial Escrow Statement itemizes the estimated taxes, insurance premiums and other charges anticipated to be paid from the escrow account during the first twelve months of the loan.

It lists the escrow payment amount and any required cushion. Although the statement is usually given at settlement, the lender has 45 days from settlement to deliver it.

Disclosures After Settlement

Loan servicers must deliver to borrowers an Annual Escrow Statement once a year. The annual escrow account statement summarizes all escrow account payments during the servicer's twelve-month computation year. It also notifies the borrower of any shortages or surpluses in the account and advises the borrower about the course of action being taken.

A Servicing Transfer Statement is required if the loan servicer sells or assigns the servicing rights to a borrower's loan to another loan servicer.

Generally, the loan servicer must notify the borrower 15 days before the effective date of the loan transfer. As long the borrower makes a timely payment to the old servicer within 60 days of the loan transfer, the borrower cannot be penalized.

The notice must include the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments.

Respa's Consumer Protections And Prohibited Practices

Section 8: Kickbacks, Fee-Splitting, Unearned Fees

Section 8 of RESPA prohibits anyone from giving or accepting a fee, kickback or any thing of value in exchange for referrals of settlement service business involving a federally related mortgage loan. In addition, RESPA prohibits fee splitting and receiving unearned fees for services not actually performed.

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

Section 9: Seller Required Title Insurance

Section 9 of RESPA prohibits a seller from requiring the homebuyer to use a particular title insurance company, either directly or indirectly, as a condition of sale. Buyers may sue a seller who violates this provision for an amount equal to three times all charges made for the title insurance.

Section 10: Limits on Escrow Accounts

Section 10 of RESPA sets limits on the amounts that a lender may require a borrower to put into an escrow account for purposes of paying taxes, hazard insurance and other charges related to the property.

RESPA does not require lenders to impose an escrow account on borrowers; however, certain government loan programs or lenders may require escrow accounts as a condition of the loan.

At settlement, Section 10 of RESPA prohibits a lender from requiring a borrower to deposit more than the aggregate amount needed to cover escrow account payments for the period since the last charge was paid, up until the due date of the first mortgage installment.

During the course of the loan, RESPA prohibits a lender from charging excessive amounts for the escrow account. Each month the lender may require a borrower to pay into the escrow account no more than 1/12 of the total of all disbursements payable during the year, plus an amount necessary to pay for any shortage in the account. In addition, the lender may require a cushion, not to exceed an amount equal to 1/6 of the total disbursements for the year.

The lender must perform an escrow account analysis once during the year and notify borrowers of any shortage. Any excess of $50 or more must be returned to the borrower.

Respa Enforcement

Civil law suits

Individuals have one (1) year to bring a private law suit to enforce violations of Section 8 or 9. A person may bring an action for violations of Section 8 or 9 in any federal district court in the district in which the property is located or where the violation is alleged to have occurred. HUD, a State Attorney General or State insurance commissioner may bring an injunctive action to enforce violations of Section 8 or 9 of RESPA within three (3) years.

Loan Servicing Complaints

Section 6 provides borrowers with important consumer protections relating to the servicing of their loans.

Under Section 6 of RESPA, borrowers who have a problem with the servicing of their loan (including escrow account questions), should contact their loan servicer in writing, outlining the nature of their complaint.

The servicer must acknowledge the complaint in writing within 20 business days of receipt of the complaint. Within 60 business days the servicer must resolve the complaint by correcting the account or giving a statement of the reasons for its position. Until the complaint is resolved, borrowers should continue to make the servicer's required payment.

A borrower may bring a private law suit, or a group of borrowers may bring a class action suit, against a servicer who fails to comply with Section 6's provisions. Borrowers may obtain actual damages, as well as additional damages if there is a pattern of noncompliance.

Other Enforcement Actions

Under Section 10, HUD has authority to impose a civil penalty on loan servicers who do not submit initial or annual escrow account statements to borrowers. Borrowers should contact HUD's Office of Consumer and Regulatory Affairs to report servicers who fail to provide the required escrow account statements.

Filing a RESPA Complaint

Persons who believe a settlement service provider has violated RESPA in an area in which the Department has enforcement authority (primarily sections 8 and 9), may wish to file a complaint. The complaint should outline the violation and identify the violators by name, address and phone number.

Complainants should also provide their own name and phone number for follow up questions from HUD. Requests for confidentiality will be honored. Complaints should be sent to:

> Director, Interstate Land Sales/RESPA Division
> Office of Consumer and Regulatory Affairs
> U.S. Department of Housing and Urban Development
> Room 9146
> 451 7th Street, SW,
> Washington, DC 20410

Proposed Model for Mortgage Broker Contract

Notice to Prospective Borrower(s):

Read this contract carefully so that you make an informed choice.

This contract is between:

> [Name(s) of borrower(s)] the "Borrower(s)" or "you" and [Name of mortgage broker company] located at [Address of mortgage broker company], who has authorized [Representative of mortgage broker company] to enter into this contract on its behalf. In this contract, the mortgage broker company and the mortgage broker are called "I" and the entity that will provide your mortgage loan funds is called "lender."

Who Do I Represent?

I REPRESENT YOU: Yes No

I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives. I will shop for your loan from among [number] lender(s). For my services, I will charge you a fee, but I will not receive any fee for your mortgage loan from a lender.

I REPRESENT YOU, BUT I MAY RECEIVE A FEE FROM A LENDER Yes No

I am your agent and I will get you the most favorable mortgage loan that meets your stated objectives. I will shop for your loan from among [number] lender(s). For my services, I may charge you a fee and I may also receive an additional fee for your mortgage loan from a lender.

I DO NOT REPRESENT YOU Yes No

I am not your agent. I arrange loans from lender(s). For my services, lenders and borrowers pay me. I make mortgage loans available from

[ ] one lender: [Name of lender] [or] [ ] [number] lenders.

What Will I Be Paid?

For arranging your loan of up to $ at an interest rate of _____[% rate or reference/attach ARM program] I will receive no greater than points and other compensation of $ _______ so that my total compensation will be no greater than: __________ [total compensation in $ amount and/or % of loan].

My TOTAL COMPENSATION will be made up of--

Fees YOU PAY me of: _____________________ [$ amount and/or % of loan]

Plus

Fees a LENDER PAYS me of: ______________ [$ amount and/or % of loan]

If you would rather pay a lower interest rate, you may pay higher upfront fees; if you pay less up front, you may pay a higher interest rate. Before you sign this contract, I can display alternatives for you.

The amounts disclosed here apply only if you qualify for this loan.

We agree to the terms of this contract. By signing below, the mortgage broker further certifies that the information in this contract is accurate and complies with all provisions of section 8 of the Real Estate Settlement Procedures Act and 24 CFR part 3500.

Borrower(s) Signature and Date

____

Borrower(s) Signature and Date

____

Mortgage Broker Signature and Date

____

Mortgage Broker License No. (Where applicable)

____

Notice to Borrower(s)

You are entitled to a copy of this contract. Signing this contract does not obligate you to obtain a mortgage loan through this mortgage broker, nor is it mortgage loan approval.

[Back of Form]
BORROWERS - KNOW YOUR RIGHTS!

ATTENTION BORROWER:

This may be the largest and most important loan you get during your lifetime. You should be aware of certain rights before you enter into any loan agreement.

1. You have the RIGHT to shop for the best loan for you and compare the charges of different mortgage brokers and lenders.

2. You have the RIGHT to be informed about the total cost of your loan including the interest rate, points and other fees.

3. You have the RIGHT to ask for a Good Faith Estimate of all loan and settlement charges before you agree to the loan and pay any fees.

4. You have the RIGHT to know what fees are not refundable if you decide to cancel the loan agreement.

5. You have the RIGHT to ask your mortgage broker to explain exactly what the mortgage broker will do for you.

6. You have the RIGHT to know how much the mortgage broker is getting paid by you and the lender for your loan.

7. You have the RIGHT to ask questions about charges and loan terms that you do not understand.

8. You have the RIGHT to a credit decision that is not based on your race, color, religion, national origin, sex, marital status, age, or whether any income is from public assistance.
9. You have the RIGHT to know the reason if your loan was turned down.

10. You have the RIGHT to ask for the HUD settlement costs booklet "Buying Your Home."

"Buying Your Home" and other helpful information is available at HUD's WEB site: http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm For other questions call (800) 569-4287.

[INSTRUCTIONS TO PREPARER: This contract shall be used by a mortgage broker who wishes to claim the qualified safe harbor provided in 24 CFR 3500.14(g)(2). At the top of the contract, insert the name of the prospective borrower(s), the name and address of the mortgage broker's company, and the name of the mortgage broker representative.

Mark the applicable box from among "I REPRESENT YOU," "I REPRESENT YOU, BUT I MAY RECEIVE A FEE FROM A LENDER," or "I DO NOT REPRESENT YOU." If either of the first two boxes are marked, in the appropriate box, state the number of lenders that will be shopped for the loan. If "I DO NOT REPRESENT YOU" is selected, mark the applicable line corresponding to either: (1) "one lender" (insert the name of the lender), or (2) "_[number]_____ lenders" (insert the number of lenders).

Under "Compensation," fill in: (1) the loan amount (which may be stated in terms of an "up to" amount) and the interest rate for the loan (in the case of ARMs, attach or reference descriptive material for the particular ARM program); (2) the points and other compensation to be received by the broker for the loan; (3) the total compensation to be paid to the mortgage broker for the loan including all points and other compensation which may be paid by the borrower and/or the lender; (4) the applicable dollar amount or percentage of mortgage loan principal amount that represents the prospective borrower(s) direct fee (including points, application and any other origination fees)(if none, put "NONE"); and (5) the maximum indirect fees that may be received from the lender in connection with providing the borrower(s) a mortgage loan (if none, put "NONE").

The prospective borrower(s) and the mortgage broker are to sign and date the contract. The preparer is to fill in the mortgage broker license number where indicated or fill in "State does not license mortgage brokers" if applicable. One copy is to be provided to the prospective borrower(s); another is to be retained in the borrower's mortgage loan file. This contract is to be in clear and conspicuous type. The heading "APPENDIX F TO PART 3500" and these INSTRUCTIONS
TO PREPARER should not appear on the contract.]

Focus Points

- RESPA is a consumer protection statute passed in 1974.

- Under RESPA lenders are required to provide borrowers disclosures regarding their loan.

- Section 8 of RESPA prohibits a person from giving or accepting any thing of value for referrals of settlement service business related to a federally related mortgage loan.
- Section 9 of RESPA prohibits home sellers from requiring homebuyers to purchase title insurance from a particular company.

- RESPA covers loans secured with a mortgage placed on a one-to-four family residential property.

- HUD's Office of Consumer and Regulatory Affairs, Interstate Land Sales/RESPA Division enforces RESPA.

- Brokers and/or lenders must give borrowers A Special Information Booklet, (GFE) of settlement costs and a Mortgage Servicing Disclosure Statement at the time of application.

- If buyers don't get the required documents at the time of the application they must receive them within three business days of receiving the loan application.

- If the loan is refused within three days the lender need not provide the required documents.

- Bank regulators may impose penalties on lenders who fail to comply with RESPA laws.

- A CBA Disclosure is required whenever a settlement service provider involved refers a consumer to a provider with whom the referring party has an ownership or other beneficial interest.

- The CBA must describe business arrangements existing between the two providers and give the borrower estimate of the second provider's charges.

- The HUD-1 Settlement Statement shows all charges imposed on borrowers and sellers in connection with the settlement.

- The HUD-1 Statement may be viewed by the borrower one day before the actual settlement.

- The Initial Escrow Statement itemizes the estimated taxes, insurance premiums and other charges to be paid from the escrow account.

- Annual Escrow Statement must be supplied to the borrower once a year.

- A Servicing Transfer Statement is required if the loan servicer sells or assigns the servicing rights to a borrower's loan to another loan servicer.

- Section 8 of RESPA prohibits the giving or accepting of fees, kickbacks or things of value in exchange for referrals of settlement service involving a federally related mortgage loan.

- RESPA prohibits fee splitting and receiving unearned fees for services not actually performed.

- Section 9 of RESPA prohibits a seller from requiring the homebuyer to use a particular title insurance company.

- Section 10 of RESPA sets limits on the amounts that a lender may require a borrower to put into an escrow account.

- RESPA does not require lenders to impose an escrow account on borrowers.

- Section 10 of RESPA prohibits a lender from requiring a borrower to deposit more than the aggregate amount needed to cover escrow account payments.

- Each month the lender may require a borrower to pay into the escrow account no more than 1/12 of the total of all disbursements payable during the year.

- Under Section 10, HUD has authority to impose a civil penalty on loan servicers who do not submit initial or annual escrow account statements to borrowers.

- Lenders must perform an escrow account analysis once during the year.

- Individuals have one year to bring a private law suit to enforce violations of Section 8 or 9 of the RESPA Law.

- HUD, a State Attorney General or State insurance commissioner may bring an injunctive action to enforce violations of Section 8 or 9 of RESPA within three years.

- Under Section 6 of RESPA, borrowers who have a problem with the servicing of their loan can contact their loan servicer in writing, outlining the nature of their complaint.

- The servicer must make written acknowledgement of complaints within 20 business days of receipt of the complaint.

- Within 60 business days the servicer must resolve the complaint by correcting the account or giving a statement of the reasons for its position.

END OF COURSE