

The Loan Officer's Practical Guide to Compliance

Federal Laws, Fraud, Predatory Lending and Ethics

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Chapter 1 – Understanding Federal Laws

Introduction

For many loan officers, the first instruction they receive is indoctrination into the world of federal regulation. While it is critical to be aware of federal regulation from the perspective of borrower protection and compliance, the initial impetus of learning the federal laws should be understanding what the law is, who regulates it, what it tries to do and how it impacts our business.

Objectives

At the end of this chapter you will know

the Federal Agencies that enforce our laws
what RESPA, TILA, ECOA, and HMDA are and how they apply to our business
other laws affecting the Mortgage Industry

This Chapter of this book is designed to give the loan officer a basic competency in understanding the basic requirements of Federal Law. Upon completing this chapter, you will have covered the material that is generally included in tests administered by regulatory authorities.

The Agencies

The Department Of Housing And Urban Development (HUD)

HUD is the federal agency responsible for national policies and programs that address America's housing needs and enforces fair housing laws.



- Supervising the Federal Housing Administration (FHA)
- Directing the Government National Mortgage Association (GNMA)
- Overseeing Fannie Mae and Freddie Mac operations
- Enforcing Fair Housing and RESPA regulations
- Provide Housing Assistance

- Administer Block Grants

HUD sets standards of ethics, management and accountability to ensure that these operations serve mortgagors (borrowers) well.

The Federal Reserve

The Federal Reserve (the “FED”) is the nation’s central bank. The Federal Reserve was established in 1913 when President Woodrow Wilson signed the Federal Reserve Act. Its direct impact on our industry lies in its influence over the availability and cost of money and interest rates. The Federal Reserve is composed of 12 Federal Reserve Districts. A District Federal Reserve Bank serves each District. The Federal Reserve Banks are not under the control of any governmental agency, but each reserve bank is responsible to a board of directors.



The Federal Reserve Board

All nationally chartered commercial banks must join the Federal Reserve. One of the Federal Reserve’s functions is to supervise and regulate member banks. One way The Federal Reserve supervises and regulates member banks is by manipulating its reserve requirements. Each member bank is required to keep reserves equal to a specified percentage of the bank’s total deposits with its Federal District Bank. By raising or lowering the reserve requirements, the Federal Reserve can increase or decrease the amount of money banks have available to lend. As money becomes more scarce interest rates increase.

The Federal Reserve also controls interest rates by raising and lowering the discount rate, which is the rate at which banks may borrow funds from their District Federal Reserve. While this is not the only source of funds banks use for their lending, it is a benchmark of what the Fed would like to see happen to interest rates. It is not unusual to see banks set their prime rate, the rate they charge their most credit worthy borrowers, based on what the Fed discount rate is.

The Federal Reserve also lends money to its member banks without requiring any collateral. These are short-term, often-overnight loans. The rate of interest charged for these loans is called the Federal Reserve Rate. Like the discount rate, the Federal Reserve Rate is another benchmark against which the banks can base the interest rates they charge to their customers.

The Federal Reserve uses its open-market operations to manipulate the supply of money in the economy. These operations consist of the purchase or sale of government securities. Its Open-Market Committee - known as the FOMC - directs the Federal Reserve’s open-market operations. When the FOMC decides to buy or sell securities, it adds or removes money from the economy, accelerating or slowing growth.

The Federal Reserve has a regulatory function. It is responsible for supervising the Truth-in-Lending Act, The Home Mortgage Disclosure Act and the Community Reinvestment Act.

The Federal Trade Commission



For non-federally regulated financial institutions, like mortgage bankers and mortgage brokers, the Federal Trade Commission (FTC) is the regulatory authority responsible for overseeing compliance with Federal Laws. When the FTC was created in 1914, its purpose was to prevent unfair methods of competition in commerce. When Congress passes laws regulating consumer practices, it often gives the FTC the authority to enforce those laws.

In 1938, Congress passed the Wheeler-Lea Amendment, which included a broad prohibition against “unfair and deceptive acts or practices.” The laws that particularly affect the mortgage business are the Telemarketing Sales Rule and the Equal Credit Opportunity Act.

The Division of Financial Practices is responsible enforcing laws related to financial and lending practices, as well as the agency’s consumer privacy program which includes enforcement of the Fair Credit Reporting Act (FCRA) and the Gramm-Leach-Bliley Act (GLBA). Sub-prime lending is a major enforcement area of the FTC targeting deceptive, unfair and abusive practices under the Home Ownership and Equity Protection Act (HOEPA). In addition, the FTC has enforcement authority for The Truth in Lending Act (TILA) and The Fair Debt Collection Practices Act (FDCPA).

The United States Treasury

The Treasury acts as the nation’s fiscal



manager. One of the Treasury’s main operations is the management of the federal debt. How effectively the Treasury balances the government’s income against its debt has a direct effect on the supply of money and the cost of credit (interest rates).

When the Treasury does not have sufficient cash to keep the many federal agencies in operation, it borrows money. The Treasury borrows money by issuing securities.

- Treasury Bonds – Long term debt, more than ten years
- Treasury Notes – Intermediate length debt, two to ten years
- Treasury Bills – Short term debt

The Treasury's management of the government's debt has a direct impact on the availability of funds and the cost of credit (interest rate) for real estate finance.

Treasury - Federal Deposit Insurance Corporation (FDIC)



The FDIC directly examines and supervises about 5,300 banks and savings banks, which is more than half of the institutions in the banking system. Banks can be chartered by the states or by the federal government. Banks chartered by states also have the choice of whether to join the Federal Reserve System. The FDIC is the primary federal regulator of state chartered banks that do not join the Federal Reserve System. In addition, the FDIC is the back-up supervisor for the remaining insured banks and thrift institutions.

Treasury - Office Of The Comptroller Of The Currency (OCC)



Comptroller of the Currency
Administrator of National Banks

The Office of the Comptroller of the Currency (OCC) is an agency within the Department of the Treasury that charters, regulates, and supervises national banks. National banks fund the agency through assessments based on assets. A national bank is a financial institution chartered by the OCC. National banks can usually be identified by the words national, national association, or by the letters N.A. National banks represent about 28 percent of all insured commercial banks in the United States, holding 57 percent of the total assets of the banking system.

Treasury - The Federal Home Loan Bank System (FHLB)

The Federal Home Loan Bank System (FHLB) was organized in 1932, and was designed to regulate and control the nation's savings associations, now known as thrifts. The Office of Thrift Supervision (OTS) charters and regulates the member associations of the FHLB. The OTS takes precedence over state laws and allows operation in all 50 states rather than having to be licensed in each individual state.



Treasury - Office Of Thrift Supervision (OTS)

 **Office of Thrift Supervision**

The Office of Thrift Supervision (OTS) is the primary regulator of all federally-chartered and state-chartered thrift institutions, including savings banks and loan associations. The OTS was established as a bureau of the U.S. Department of the Treasury on August 9, 1989 and has four regional offices located in Jersey City, Atlanta, Dallas, and San Francisco. The OTS is funded by assessments and fees levied on the institutions it regulates.

National Credit Union Administration (NCUA)

The National Credit Union Administration (NCUA) charters and supervises federal credit unions. NCUA operates the National Credit Union Share Insurance Fund (NCUSIF) insuring the savings of 80 million account holders in all federal credit unions and many state-chartered credit unions.



Financial Institutions Reform, Recovery, and Enforcement Act Of 1989 (FIRREA)

FIRREA is an act signed into law in August 1989 that restructured the thrift regulatory and insurance system. The Federal Home Loan Bank Board (FHLBB) was abolished and its various functions reassigned to existing and new government agencies. The Federal Housing Finance Board (FHFB) was formed to replace the Federal Home Loan Bank system. It oversees the credit functions of the twelve regional Federal Home Loan banks. The Office of Thrift Supervision (OTC) was formed to charter federal thrifts, serve as the primary federal examiner and regulator of federal and state chartered savings associations (formerly insured by the FSLIC) and administer laws governing savings and loan holding

companies. The Federal Deposit Insurance Corporation (FDIC) provides insurance of accounts for institutions whose deposits were formerly covered by the Federal Savings & Loan Insurance Corporation (FSLIC). The FSLIC was abolished. The Resolution Trust Corporation (RTC) was formed to resolve thrift failures over the next three years and dispose of their assets and liabilities.

Real Estate Settlement Procedures Act (“RESPA”) Also known as Regulation “X”

Governs Real Estate Transaction Practices

Regulation Title	Practical Application	Disclosure	Highlights/Features of the Law
Real Estate Settlement Procedures Act RESPA - Regulation X Department of Housing and Urban Development – HUD (also supervises FHA, GNMA, Housing Programs)	Application	<ul style="list-style-type: none"> Good Faith Estimate of Closing Costs Special Information Booklet - HUD Guide to Closing Costs 	Residential Only, < 25 Acres, Lot Loans, Commercial Exempt Deliver to customer within 72 Hours Customer uses special information booklet to shop for services
	Business Practices	Section 8 - Anti-Kickback Provision	No "thing of value" in exchange for referrals. Payment for referral when no service is rendered is considered Kickback. Gifts must be given to all. Penalty – up to \$10,000 per
	Business Practices	Controlled/Affiliated Business Arrangement Disclosure	Interested parties must disclose nature of business relationship at time of sale
	Closing	HUD-1 Settlement Statement	24 hours prior to closing borrower may inspect HUD-1
	Application/ Servicing	Transfer of Servicing/Servicing Practices	Signed disclosure within 3 days. Borrower has right to 1.) Annual analysis, 2.) 15 day notice of loan sale from selling and buying lender 3.) Max "cushion" 3 months (2+1) 4.) 60 day Late Charge and Late Payment waiver

Purpose of the Law

The purpose of the law is to protect consumers from excessive settlement costs and unearned fees. RESPA

- Establishes prohibited practices to protect consumers from unearned fees (Kickbacks and Controlled Business Arrangements)
- Allows consumers to obtain information on the costs of closing so that they can shop for settlement services. (Good Faith Estimate and Closing Cost Booklet)
- Gives consumers a complete and accurate accounting of all funds collected and disbursed in conjunction with the transaction. (HUD-1 Settlement Statement)
- To protect customers from financial loss when their loan or the servicing of their loan is sold. (Servicing Practices Act)

Exempt Transactions

- Loans for 25 acres or more
- Loans for business, commercial, or agricultural purposes
- Temporary financing, such as bridge loans
- Loans secured by vacant land
- Loan assumptions which are permissible without lender approval
- Loans sold in the secondary market

- Loan conversions, when a new note is not required and the provisions are consistent with those of the original mortgage

Transactions which ARE subject to RESPA are loans secured by a first or subordinate lien on residential property which are made with funds insured by the federal government, from a lender regulated by the federal government, intended for sale to Fannie Mae or Freddie Mac, or any creditor regulated under the Truth in Lending Act.

RESPA is regulated by HUD

The Department of Housing and Urban Development (“HUD”) is the department responsible for issuing implementing regulations (Regulation X) for RESPA and for enforcement of the law. HUD is a large department that also regulates or administers the Government National Mortgage Association (GNMA), Federal Housing Administration (FHA) and many other agencies relating to housing and cities.

Kickbacks and Referral Fees and Fee Splitting

Section 8(a) of RESPA prohibits anyone from giving or receiving a fee, kickback, or “anything of value” pursuant to an “agreement or understanding” for the referral of settlement business. The purpose of the prohibition is to protect consumers from the payment of fees when no additional work is actually performed. Kickbacks tend to increase the cost of the transaction, since the borrower will have to be charged more in order to cover the cost of the referral fee. Penalties for violations of the anti-kickback provision include fines of up to \$10,000 and up to one year in prison.

A “Thing of Value”

- Money
- Discounts
- Commissions
- Salaries
- Stock
- Opportunities to participate in a money-making program
- Special or unusual banking terms
- Tickets to theater or sporting events
- Services of all types at special rates
- Trips and payments of another’s expenses

The “Agreement or Understanding” does not have to be a formal agreement, but can be a verbal agreement or even an agreement established through a practice, pattern, or course of conduct.

Fee Splitting

Fee splitting is when a service provider inflates charges and splits the excess funds with another service provider in exchange for the referral of business. This is tantamount to a kickback and is a prohibited practice. Service providers may attempt to circumvent this prohibition by establishing joint ventures or entering into business arrangements that allow referrals between organizations and conceal the fee splitting arrangement.

Affiliated and Controlled Business Arrangements

In some cases, there can be fee splitting or referral fees paid under what is known as an “affiliated business arrangement”. An affiliated business arrangement is where a person who refers settlement services has an “affiliate relationship” or “an ownership interest of more than one percent in a provider of settlement services.”

The payment of fees is acceptable as long as the relationship is disclosed to the borrower and the referrer actually performs a service – or somehow adds value. The referral service provider may NOT be a REQUIRED provider of services, such as an appraiser or credit bureau that the lender must select. In addition, an affiliate relationship structured simply to legitimize a kickback or referral fee is referred to as a “sham”. They must be a “Bona Fide Provider of Services” to receive a referral fee legally.

Disclosures - At Application

The Good Faith Estimate of Closing Costs and Special Information Booklet.

The Good Faith Estimate (“GFE”) is required to be given at the time of application, or mailed within three business days after completion of loan application. Business days do not include federal holidays, Sundays, or Saturdays.

The GFE is a reasonable estimate of all charges which are due at the time of settlement.

The idea of the Good Faith Estimate of closing costs is to give the borrower advance notice of the costs of the transaction. A properly explained GFE will help borrowers understand their cash requirements better and will result in a borrower who shops less. The reality is that a relatively small portion of the costs reflected on the GFE are paid to the lender whereas the borrower’s perception is that they are ALL paid to the lender. The Settlement Costs Booklet, sometimes referred to as the “Special Information Booklet”, will help the borrower understand how to shop for settlement services.